



18 November 2005

Committee of European Securities Regulators
11-13 avenue de Friedland
75800 Paris
FRANCE

CESR's Draft Advice on Clarification of Definitions concerning Eligible Assets for investment of UCITS. 2nd Consultation Paper

Dear Sir

We have the following comments on the second consultation paper.

Clarification of Article 1(8) (Definition of transferable securities)

Box 1

We have the following points and provide amending wording which we hope will assist you in your final advice.

- a) The Commission's mandate asks whether admission to trading on a regulated exchange is sufficient for a structured financial instrument to be considered a transferable security. The answer would seem to be 'No' and we believe the level 2 advice should clearly reflect this. (see paragraph 1 below)
- b) We appreciate the words 'negotiable on the capital market' come from MIFID. It may be that we are misunderstanding the term 'capital market' but the retention of the words brings into doubt purchasing any transferable security that is negotiated between parties off exchange. (see paragraph 2 (b) below). We suggest its deletion or additional wording to ensure there is no doubt that such transferable securities are permitted.
- c) We welcome the fact that it is now recognised that listing on a market provides the presumption of liquidity. We would suggest that paragraph 1, bullet 2 is not necessary in the level 2 advice but should form level 3 guidance since they are relevant to Article 37, not the definition of transferable security. Such guidance on Article 37, should, in addition, refer to the fact that a scheme may borrow on a temporary basis to meet redemptions etc¹.
- d) We believe the 3rd and 4th bullets of paragraph 1 provides guidance on the characteristics of a transferable security being traded on an exchange and so should be level 3 guidance on Article 19 (1) (a) to (c) rather than on the definition of a transferable security itself

Level 2 advice.

1. The fact that a structured financial instrument is traded on a regulated market as foreseen by Article 19(1)(a) to (d) is not sufficient for it to be considered a transferable security.
2. To be eligible for investment within Article 19(1)(a) to (d) or Article 19(1)(2) the instrument must fall within the definition of 'transferable security' in Article 1(8) of the Directive. In particular:
 - a) the security must not expose the UCITS to loss beyond the amount paid for it or where it is a

¹ See, for example, paragraph 139 of the informal commentary by Mr Vandamme on the UCITS provisions

partly paid security, to be paid for it; and

b) the security must be freely negotiable.

3. In addition the acquisition of the transferable security must be consistent with the stated investment objectives of the UCITS. These objectives will, of course, have to be consistent with the UCITS Directive.
4. The risk of the transferable security must be adequately captured in the risk management process of the UCITS.
5. Where the transferable security embeds a derivative element, such a derivative element must be taken into account, as required by Article 21(3).

Level 3 guidelines on Articles 19(1)(a) to (d) and Article 37

6. Where transferable securities are admitted to (or will be admitted to) trading on a regulated market the UCITS must take into account the following factors:
 - [As per paragraph 1, bullet 2 of Box 1];
 - [As per paragraph 1, bullet 3 of Box 1]; and
 - [As per paragraph 1, bullet 4 of Box 1]
7. [As per paragraph 5 of Box 1]
8. [As per paragraph 6 of Box 1]
9. The ability to borrow money on a temporary basis provided by the derogation contained in Article 36(2) may be taken into account when assessing the liquidity of the UCITS as a whole.
10. [As per paragraph 7 of box 1].

Box 2

We have the following point which we hope will assist you in your final advice.

- a) Paragraph 1, bullets, 2, 3 and 4 should be moved into level 3 guidelines as per our comments above. A similar construction should be made to the drafting.
- b) The wording 'available to the market' in paragraph 4 seems rather strange where the transferable security is not traded on a market. We believe the suggested wording put to CESR at the open hearing 'available to the UCITS' should be used.
- c) Paragraph 1, bullet 5 should have the words 'on the capital market' deleted for the equivalent reason given as stated above.

Box 3

Does the new wording of the level 2 guidelines in paragraph 4 mean that closed end funds of the trust type are not permitted? In other words, is reference to 'contractual form' meant to include trusts? The explanation provided seems to support this and therefore the guidance needs to be clear.

Other Collective investment scheme (Box 12)

We suggest insertion of the words 'by competent authorities' in paragraph 1 first line after 'to' to ensure the level 3 advice is consistent with Article 19(1)(e) first indent where the Directive refers to the determination of equivalence to be made 'by the UCITS' competent authorities'. We repeat our suggestion that CESR could usefully produce a list (as level 3 guidelines) that it maintains on its website of such equivalent supervisory regimes. We also point out again that allowing a UCITS to carry out this determination may be an illegal sub delegation of the regulators powers (at least in the UK).

Financial Derivative Instruments (Box 14)

We would share the view that was made at the open hearing that putting the detailed reference to an IOSCO document in Level 2 advice is too detailed. We would suggest the wording of the last indent of paragraph 1 of Box 14 be amended to refer to 'generally accepted market criteria' regarding index management. The remained of the box, including paragraph 2 and 3, could then be made into level 3 guidance.

We would also suggest that reference could be made to a property index in paragraph 3.

The second bullet point of paragraph 1 should refer to investment ratios only. Reference to 'diversification rules' may mean reference to 'transferable securities and money market instruments'.

Cost benefit considerations

We note the questions relating to cost-benefit. In future consultations, we presume CESR will carry out such analysis before policy has been decided.

Yours faithfully

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