

**CESR’S ADVICE ON CLARIFICATION OF DEFINITIONS CONCERNING
ELIGIBLE ASSETS FOR INVESTMENT OF UCITS
2nd CONSULTATION PAPER**

A RESPONSE BY FIDELITY INTERNATIONAL

Introduction

We are grateful for the further opportunity to comment on CESR’s draft advice. We particularly welcome the clear evidence that industry comments and concerns have been considered with the resulting improvements to the text. In our response to the 1st Consultation Paper we felt that on the whole the advice was too detailed and has therefore created a lack of clarity. That concern has been addressed in part.

We note the greater use of Level 3 alongside level 2 material, but as a general comment would make the point that the distinction is not always self-evident.

Transition

In the first consultation we asked CESR to address this issue as a matter of urgency. It is therefore somewhat disappointing to see paragraph 13 refer to work underway but no concrete proposals to consider. With CESR’s Advice reaching what we assume is a relatively final form, those funds which have assets whose eligibility may be questionable will find it difficult to obtain registration in Host Member States while retaining existing passporting and other permissions until such time as the Advice comes into effect. This has the effect of permitting such firms to offer strategies that are available to no new fund, as presumably a new application for a strategy or use of assets to be outlawed under the CESR advice will not be countenanced by fund regulators. The result is a blight for one part of the industry and competitive disadvantage for another.

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Q1 *Do you agree with the approach as suggested in Box 1?
Broadly yes, but we have a concern regarding the fourth bullet of paragraph 1 of the LEVEL 2 advice. Given that the concept of “comprehensive” is essentially subjective there is a danger that such a criterion will be difficult to formulate consistently and to monitor. We are concerned that the eligibility criteria should be as objective as possible to ensure a consistent treatment not only within funds but across competing funds. We would suggest that where a security or its issuer is complying with the listing criteria of a regulated market that there is a presumption that it meets this criterion.*

The fifth bullet point of the same paragraph uses the phrase “capital markets” which is not defined. We feel that the phrase is perhaps redundant and that the concept of freely negotiable here, allied to the liquidity considerations set out in the LEVEL 3 advice are sufficient.

Q2 *Do you agree with the approach as suggested in Box 2?
Again we agree broadly with CESR's proposals. However, given that the type of transferable security considered in this section may be offered via a private placement we wonder whether the concept of “the market” in the penultimate bullet point of paragraph 1 of the LEVEL 2 Advice needs to be refined so as to refer to those who are interested and eligible to purchase or otherwise transact in the security.*

We make the same point regarding the last bullet point re the phrase “capital markets” as under Q1.

Q3 *Do you agree with the approach as suggested in Box 3?
Yes.*

Q4 *Do you agree with the approach as suggested in Box 4?
We are slightly baffled by the use of the word “cumulative” in the first line of the LEVEL 3 Advice. Does it mean that all the factors have to be satisfied, or that a preponderance of them must be satisfied?*

As regards the one year maturity limit for instruments for which the amortization method may be used we have two comments. Firstly, CESR has no mandate to set out acceptable or unacceptable NAV calculation methodologies when it is asked to provide advice on instrument eligibility. Secondly, many money market instruments have in fact a maturity of up to 397 days (using the US standard) to allow for settlement and other possible delays at the end of their lives. If CESR is to persist with its ultra vires approach it should at the least adopt the US standard to avoid putting EU funds at a competitive disadvantage.

Q5 *Do you agree with the approach as suggested in Box 5?
Yes*

Q6 *Do you agree with the approach as suggested in Box 6?
Yes*

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- Q7 *Do you agree with the approach as suggested in Box 7?*
We think the new CESR approach is acceptable
- Q8 *Do you agree with the approach as suggested in Box 8?*
No comment
- Q9 *Do you agree with the approach as suggested in Box 9?*
Yes
- Q10 *Do you agree with the approach as suggested in Box 10?*
CESR's clarification is helpful.
- Q11 *Do you agree with the approach as suggested in Box 11?*
We question whether the last two sentences of paragraph 4 of the LEVEL 2 Advice are necessary as they seem somewhat discursive in character.
- Q12 *Do you agree with the approach as suggested in Box 12?.*
Yes.
- Q13 *Do you agree with the approach as suggested in Box 13?*
Yes.
- Q14 *Do you agree with the approach as suggested in Box 14?*
While we do not have strong views as to whether hedge fund indices should be considered as financial indices, we are concerned at the regulatory lacuna that CESR's approach creates. The fact is that CESR's advice will take effect only a few months before CESR promises to complete its further deliberations..
- Q15 *Do you agree with the approach as suggested in Box 15?*
Yes
- Q16 *Do you agree with the approach as suggested in Box 16?*
We still tend to the view that there is an unhealthy mix of instrument eligibility and manager competence in this advice, albeit that the latter is now relegated to LEVEL 3. Having said that, the end result is not impracticable.
- Q17 *Do you agree with the approach as suggested in Box 17?*
It is both surprising and disappointing that CESR has felt unable to comment on the issue of the quality of replication. It notes the issues of competition and consumer choice but seems to ignore the investor protection concerns regarding the legitimate lack of diversification such funds may enjoy.
- Q18 *Do you agree with the approach as suggested in Box 18?*
Without the discipline necessary for defining replication in Box 17 the advice in Box 18 seems of little import.