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CESR – The Committee of European Securities Regulators

11-13 avenue de Friedland
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Comments on 2nd Consultation Paper „Eligible Assets”

To whom it may concern,

The Austrian Association of Investment Fund Management Companies¹ (VÖIG) welcomes the opportunity to comment on *CESR’s Draft Advice on Clarification of Definitions concerning Eligible Assets for Investments of UCITS* (2nd Consultation Paper).

In the following, VÖIG wants to make some general remarks before commenting on some selected details:

General Remarks

VÖIG is of the opinion that the so far included proposals are useful and therefore welcomes the comprehensive initiatives of CESR that seem to be to the advantage of the whole industry.

¹ VÖIG represents the interests of the Austrian investment fund management industry. Its 23 members currently have € 133 bn assets under management. For further information, please have a look at www.voeig.at.

However, in order to effectively implement the proposed initiatives with all positive intentions behind them, VÖIG believes that it is necessary to make some comments in order to give some suggestions regarding the useful implementation of these initiatives.

As already stressed, VÖIG considers the 2nd CESR Consultation Paper on “Eligible Assets” as a positive initiative. Nevertheless, it has to be clearly pointed out that the most significant lack of the 2nd draft are the numerous undefined and vague legal terms which additionally refer to the already undefined legal terms of the UCITS Directive. Some representative examples are the terms *significant influence* or *financial index*. The therefrom resulting scope of interpretation causes the danger that the existing arbitrage could be increased by further diverging interpretations.

In this context, VÖIG has doubts regarding the practical handling of the current draft, in particular how depositaries should be able to control the undefined criteria concerning the management company; it is in many cases also not clear who is the addressee of a norm.

Additionally it is striking that some CESR statements in particular concerning *SFIs*, *closed end funds* or *derivative instruments* are made under the reserve that the principles, rules and requirements set up by the UCITS Directive are not allowed to be circumvented. In our view, this cross-reference is not very useful and we consider it even problematic because the clarification of these principles and rules should actually be subject to this CESR consultation.

Furthermore, the statements in the boxes without the *explanatory statements* are often not comprehensible, out of context as well as incorrect and misleading. Therefore it is highly important that the explanatory statements are an integral part of any further draft or final version in order to guarantee the understanding as well as to give a useful basis for interpreting the statements in the boxes.

Moreover, we noticed that to certain statements of the boxes (without identification) no consensus within CESR has been reached. A very good example for this are the „*appropriate investor protection safeguards*“ for *closed end funds* in Box 3.

Therefore, it is absolutely necessary to clarify key definitions as well as the many undefined terms, such as „*closed end funds*“.

Taking all this into consideration, VÖIG wants to make some comments on selected details which in our view should contribute to make the handling of the CESR proposed initiatives, easier:

Annotations to selected details

- **Re Box 1**

It is questionable if index certificates on hedge funds are permitted as *transferable securities* according to point 1 or not. In our view, one could affirm this question by stating that it does not depend on the underlying at all due to lack of an explicit prohibition, but it is also possible to negate the question by arguing that hedge funds are not permitted as underlying for derivative instruments as well as index components.

If the need for liquidity of the fund will be considered as liquidity requirement, it has to be clarified if Art. 37 of the UCITS Directive allows the restriction of the withdrawal of shares twice a month or not, in order to avoid a distortion of competition. In this context, we refer to Box 4 „*prospectus guidelines on limiting withdrawals*“. Furthermore, VÖIG refers to the Luxembourg solution that indeed allows the restriction of

the withdrawal of shares twice a month, whereas Austrian funds have to be able to cope with a withdrawal of shares on a daily basis.

Moreover, VÖIG wants to point out that regarding the claim that transferable instruments have to be freely negotiable certain disponibility constraints such as limited public offers, limitations to Non-US-Investors have to be considered as not being detrimental.

Furthermore, the last sentence of the fifth point being „*The presumption does not apply if the UCITS knows or ought reasonably to know that any particular security is not liquid*“ should be deleted without substitution due to its indefiniteness.

- **Re Box 3**

If separate rules for closed end funds will be developed, it would be highly necessary – as already pointed out above – to define what is commonly understood by closed end funds, otherwise it would not be clear if an investment can be qualified as a regular share investment or as closed end fund in need of examination. VÖIG considers fulfilling the listing standards of sec. 45 lit. a) as sufficient in order to show evidence in the sense of appropriate investor protection safeguards. Additionally it is difficult to appraise a further differentiation since the scope of the definition of *closed end funds* is not clarified so far. As long as no clear and stringent definition of *closed end funds* exists, any additional requirements compared to regular stock companies would lead to unqualified differentiations causing disproportional examination expenditures for UCITS funds.

Moreover it has to be clarified what constitutes a circumvention of investment limits according to CESR as well as what additional inquiry duties are imposed on the UCITS regarding the asset structure of the *closed end fund*. Referring to the statements in sec. 48, stating that *closed end funds* can also include real estate funds as well as private equity funds, it can be derived that CESR does not require *closed end funds* to have a UCITS-compliant asset structure. Therefore it remains unclear what special circumstances according to CESR have to be considered additionally resepactively what investment rules should be followed, so that a UCITS is not confronted with the allegation that it circumvents investment limits by acquiring closed end funds.

- **Re Box 7**

The interpretation that only G 10 countries exhibit comparable investor protection rules can only then be accepted if this restrictive interpretation will not be applied analogously in the case of sight deposits of Non-EU credit institutions according to Art. 19 lit. f..

- **Re Point 83**

In this context it would be desirable to clarify under what other rules of the Directive ABS could be acquired according to CESR. In our view, ABS are acquirable as SFI if they fulfil the criteria of transferable securities. A confirmation of this legal opinion by CESR would be desirable as well as the clarification whether the exposure of an ABS has to be apportioned to the SPV or the assignor (e.g. the bank ceding the claims).

- **Re Box 10**

In the light of the significant risk potential and its importance in practical management, VÖIG is of the opinion that this topic is – compared to other topics of the CESR paper, such as *MMIs* – not adequately represented. If the statements of the advice should assure a uniform application of the law, adequate to the risk content, it is insufficient to make a link to blanket clauses. Therefore it would be highly important to deal with this topic in a more comprehensive manner. We just want to stress one example in this context being that in case of securities lending the problem exists that a UCITS acting as borrower could circumvent the prohibition of going short.

- **Re Box 11**

Whilst the indefinite criterion „*significant*“ brings certain administrative alleviation because of the broad scope of interpretation, which is kind of limited due to the given single asset treatment since it is also necessary when having single assessments with clear significant asymmetric risk (such as convertible bonds) to measure embedded derivative risks even if these assets only constitute a marginal part of the assets of the fund.

Analogously to the handling of the liquidity requirements for transferable securities (Box 1), it would be useful for an exception to consider the effects on the fund itself in the sense of an overall view. Even if the asymmetric risk of an asset is significant, it should nevertheless be possible to neglect the compilation of embedded derivative risks, if the quota of these assets is marginal in relation to the total assets of the fund. One argument that such a rule is in accordance to the systematics of the CESR advice, is the example set up by CESR in sec. 102, where the effects of an assessment with an exposure of just 2% of the total assets is negligible. Additionally it has to be mentioned that the “cost efficiency” considerations stressed in the Green Paper stand against the realization of an – in the consequence – disproportional administrative expenditure.

- **Re Box 14**

A country index, recognized as being representative should be excluded from the demand of fulfilling the diversification provisions of Art. 22a. Only in this case the country-specific particularities can be allowed for. Generally it is hard to understand why in case of a representative index, that is to say a market given fixed diversification provisions of a managed portfolio should be applied additionally. The objective justification of these fixed limits for managed portfolios cannot be transferred one-to-one to representative indices because in this case – unlike the case of managed portfolios and customized indices – it is not non-discretionary decisions that are in the foreground but market conditions. The idea that recognized indices should be subject to formal issuer limits does not seem to be timely, in particular in the light of the recent Commission Green Paper: Referring to the comments of the Green Paper, the Commission seems to consider dispensing from formal issuer limits even in the case of actively managed funds that actually form the typical scope of application. Here we want to refer in particular to questions 13 and 19 of the Green Paper.

From this point of view it is desirable to delete the sentence „*Comply with the diversification rules (including ratios) set by Art. 22a of the Directive*“ in point one without substitution.

According to the statements of the CESR advice, it seems to be that a commodity index is an acceptable financial index. This gives rise to questions that have not been dealt with in the CESR advice so far:

What criteria have to be fulfilled by a commodity index, in order to be recognized as financial index? Does such an index have to cover the commodity market as a whole or is it sufficient if the index refers to sub-segments? How many different products are necessary to represent a market (e.g. is oil enough for a market or not (futures on crude oil or fuel oil), the next sub-segment step would be energy – certain futures on gas would be added, or is that still insufficient and therefore other commodities would have to be added (wheat, sugar, coffee, cotton etc.)?

In addition to the question of the structure of a recognized commodity index it is unclear what quota a commodity index has to have in relation to the overall fund. According to the general rule, a financial index could – provided the adherence of issuer limits and the global exposures for derivative instruments – form the sole investment of a fund.

Moreover, according to the statements of sec 118, CESR states as justification why these products are permitted, the risk diversification that can be reached with these products. However, this would just be an argument to support the ancillary character of the investment with the maximal amount still being unclear.

The request that a recognized financial index has to be completely replicable, meaning that every single index component is effectively acquirable is in particular in the case of broad indices practically impossible to control. Therefore, this request should be weakened by adding the terms “*as far as possible*” or “*in essence*”.

Best regards,

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