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**FORMAL MANDATE TO CESR FOR ADVICE ON POSSIBLE MODIFICATIONS TO
THE UCITS DIRECTIVE IN THE FORM OF CLARIFICATION OF DEFINITIONS
CONCERNING ELIGIBLE ASSETS FOR INVESTMENT OF UCITS**

CALL FOR EVIDENCE

Background:

The European Commission intends to make use of the delegated powers conferred by Art. 53a of the UCITS Directive to the Commission to clarify some of the definitions pertaining to eligible assets which are contained in the UCITS Directive. In its preparation of possible draft comitology instruments, the Commission requests technical advice of CESR.

In particular, the mandate covers issues on the following provisions:

- Art. 1(8) (*definition of transferable securities*)
- Art. 1(9) (*definition of money market instruments*)
- Art. 19(1) e (*other collective investment undertakings*)
- Art. 19(1) g (*financial derivative instruments*)
- Art. 22(a)(1) (*index replicating UCITS*)

The request for advice is attached.

The mandate sets the deadline for CESR's technical advice on end of October 2005.

Preparation of CESR's advice on this mandate will be undertaken by the CESR Expert Group on Investment Management, which is chaired by Mr Lamberto Cardia, Chairman of the Italian securities regulator, the Commissione nazionale per le società e la Borsa (CONSOB). A permanent member of the CESR Secretariat, Mr Jarkko Syyrilä assists the Chairman and acts as rapporteur of the Expert Group.

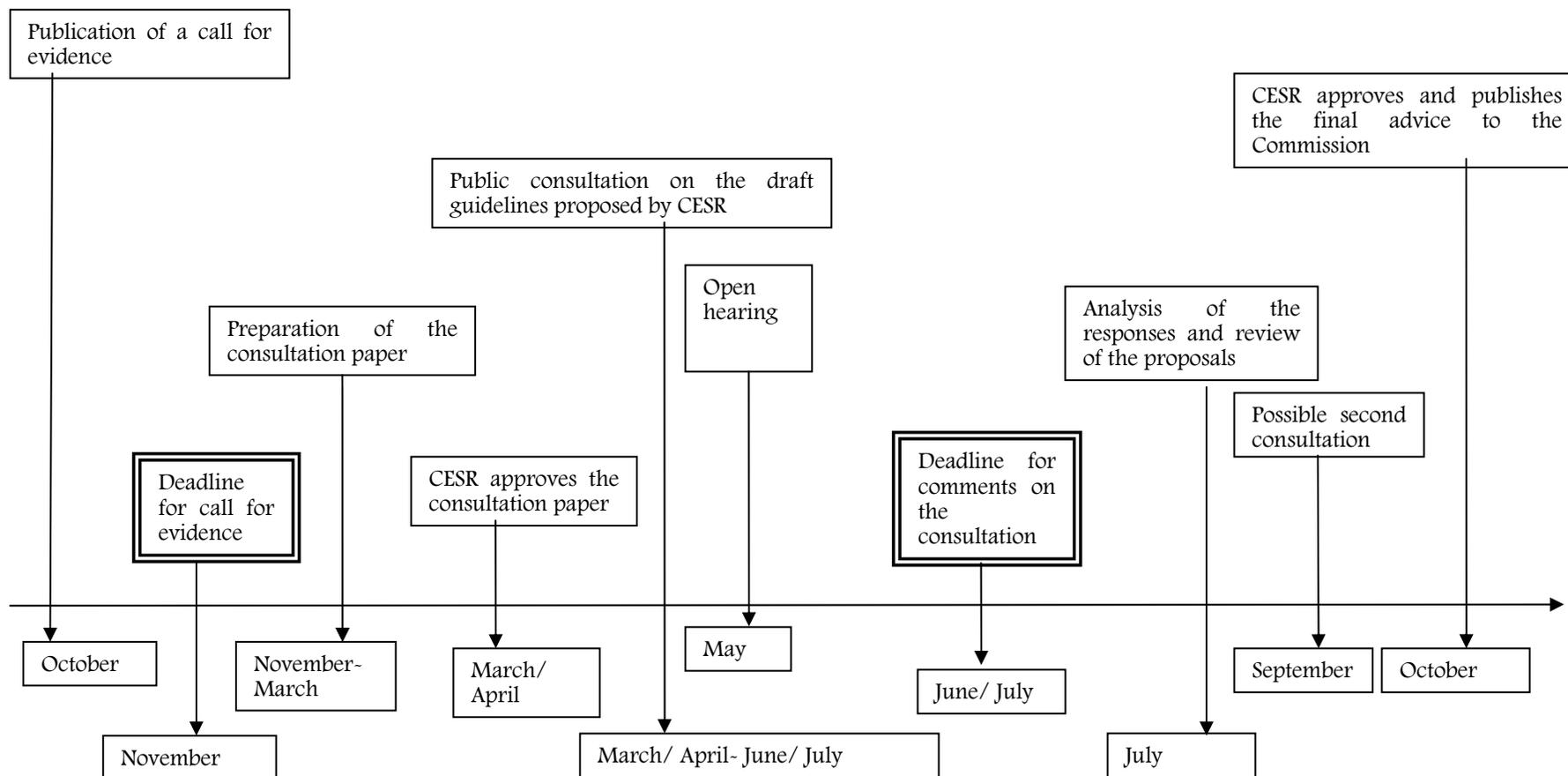
Call for evidence:

In releasing these requests for technical advice, CESR is inviting all interested parties to submit views as to what CESR should consider in its advice to the European Commission. All contributions should be posted by 28 November 2004, on CESR's website in the section "Consultations".

Timetable:

In order to meet the deadlines set by the European Commission, an indicative timetable for the work CESR will be undertaking in response to the mandate is attached. Further details on the consultation (including possible open hearings) will be disclosed once a more precise timetable is established.

Indicative CESR work plan on the clarification of definitions of the UCITS Directive





EUROPEAN
COMMISSION
Internal Market DG

FORMAL MANDATE TO CESR FOR ADVICE ON POSSIBLE MODIFICATIONS TO THE UCITS DIRECTIVE IN THE FORM OF CLARIFICATION OF DEFINITIONS CONCERNING ELIGIBLE ASSETS FOR INVESTMENT OF UCITS

1. INTRODUCTION

1.1 Institutional Background

At the Lisbon European Council in March 2000 the Heads of State or Government emphasised the need to accelerate the completion of the internal market in financial services. For such purpose, it was agreed that the Financial Services Action Plan proposed by the Commission¹ was to be fully implemented by 2005. Changes in the financial services committee architecture appeared a critical element to achieve this aim, as evidenced by the Stockholm European Council in March 2001. More generally, it was acknowledged that such changes were needed to make the regulatory process for Community securities more flexible, effective and transparent. The basis for the new committee architecture were the recommendations of the Committee of Wise Men mandated by the Council on the Regulation of European Securities Market in its report of 17 July 2000 (known as the “Lamfalussy Report”).

With respect to the experiences gathered in the securities sector following the setting up of the European Securities Committee (ESC) and the Committee of European Securities Regulators (CESR) in 2001, key components of the new committee architecture, the Council called in April 2002 for a review of how to make further improvements to the committee architecture in other sectors of financial services. On the basis of this review the Council invited the Commission to extend the committee structure applied in the securities sector to banking, insurance and UCITS in December 2002.

In November 2003, the Commission put forward a proposal for a Directive to establish a new financial services committee organisational structure on the basis of the Lamfalussy experience. This proposal provided that in view to exercise its implementing powers under Art. 53a of Directive 85/611/EEC as amended² (the UCITS Directive) (i.e. clarification of definitions and alignment of terminology, cf paragraph 1.2.2 below):

- (i) the Commission should be assisted by the European Securities Committee in lieu of the UCITS Contact Committee provided for in the original version of Directive 85/611/EEC as Regulatory Committee; and
- (ii) the comitology procedure laid down in Art. 5 of decision 1999/468/EC should apply.

This Directive, known as the “Lamfalussy extension” Directive was agreed by the European Parliament on 30 March 2004 and approved by the ECOFIN Council of 11 May 2004. Its formal adoption is expected in autumn 2004.

¹ Commission Action Plan for Financial Services, COM (1999) 232 final

² In addition to the Lamfalussy extension Directive mentioned in this sub-paragraph, Directive 85/611/EEC was amended on several occasions, most recently by (i) Directives 2001/107/EC and 2001/108/EC of 21 January 2001 and (ii) Directive 2004/39/EC of 21 April 2004 on Markets in Financial Instruments.

1.2 Opportunity of a request for advice to CESR on “eligible assets”

1.2.1 The need for clarification of certain definitions

Modern financial markets have generated a huge variety of complex financial instruments which are in constant evolution. In the context of the implementation of the UCITS III Directive³, the issue arises whether or to what extent some instruments could be considered eligible investments (i.e. “eligible assets”) for a UCITS in compliance with the relevant provisions of the UCITS Directive, in particular the definitions of “transferable securities” under Art. 1 (8), of “money market instruments” under Art. 1 (9) and the list of authorised investments under Art. 19.

The even implementation and interpretation of EU legislation is a crucial dimension of the building up of the internal market in financial services⁴. DG Internal Market has identified the need to clarify certain definitions of eligible assets of the UCITS Directive as short term priority for the implementation of the amendments made by Directive 2001/108/EC of 21 January 2002 to the UCITS Directive. This approach was endorsed at the European Securities Committee meeting of 5 July 2004.

In view of this, DG Internal Market intends to make use of the delegated powers conferred by Art. 53a of the UCITS-Directive to the Commission to clarify some of the definitions pertaining to eligible assets which are contained in the UCITS Directive.

In its preparation of possible draft comitology instruments, the Commission requests technical advice of CESR, in its capacity as an independent advisory group.

1.2.2 Comitology Powers under the UCITS Directive

At the outset, it should be emphasised that the delegated powers conferred to the Commission by Art. 53a of the UCITS Directive remain very narrow (as opposed to more recent legislation in the field of financial services). Art. 53a, first indent of the UCITS Directive, as further amended by the Lamfalussy extension Directive (see paragraph 1.1 above), empowers the Commission to adopt technical amendments to be made to clarify the definitions of the UCITS-Directive, in order to ensure uniform application of the Directive throughout the Community. The following observations can be made in respect of the scope of comitology measures to be adopted under this provision:

First, the first indent of Art. 53a merely refers to “definitions”. Thus, not all provisions of the Directive directly or indirectly regulating the eligible assets of a UCITS can be clarified by a comitology instrument but only those provisions which contain definitions, which can be understood as “statements of the precise meaning of a word or phrase, or of the nature of a thing” with an aim to ensure uniform application. The Commission Services view is that “definitions” should not be restricted to Art. 1 and 1(a) of the UCITS Directive, such a formal approach being inappropriate in this case. Second, the empowerment provided for by Art. 53a only allows for a “clarification” of definitions, i.e. a more detailed explanation or description of a legal concept or financial instrument mentioned by the Community legislator. This should also include the possibility, if need be, to establish whether a certain concrete situation falls or not under the scope of the definition. However, the expression “clarification of definitions” excludes the power to create (new) rights for or impose (new) obligations on market operators, supervisory authorities, Member States or any other legal or national person.

Third, it should be underlined that the work on the “clarification on definitions on eligible assets” is to a certain extent linked to the Recommendation on 2004/383/EC of 27 April 2004 on the use of financial derivative instruments by UCITS⁵. Therefore, where necessary and relevant CESR should take this

³ “UCITS III Directive” should be understood as Directive 85/611/EEC as amended by Directives 2001/107/EC and 2001/108/EC of 21 January 2001.

⁴ See recommendations of the “Lamfalussy Report”

⁵ Commission Recommendation of 27 April 2004 on the use of financial derivative instruments for UCITS, COM 2004/383/EC, see O.J. L 199/24 of 07.06.2004



Recommendation into account provided that this does not result in the creation of new rights and obligations by the means of the possible comitology instrument envisaged in this mandate.

Finally, it should be borne in mind that most of the issues listed in this mandate have already been substantially considered by the former UCITS Contact Committee (see paragraph 1.1) in between November 2002 and April 2003.

1.3 Timetable

As mentioned above, clarification of definitions of the UCITS Directive has been identified as a short term priority by the Commission and this approach has been endorsed within the ESC (see paragraph 1.2.1 above). This formal mandate takes into account the fact that CESR needs sufficient time to prepare and deliver its technical advice. Furthermore, it should be recalled that subsequent to the provision of CESR's advice, the Commission will have the task of drafting legal proposals for implementing measures to be scrutinised by the ESC and the EP which has three months to consider the drafting implementing measures under the Lamfalussy arrangement⁶.

In order to respect the necessary deadlines, the current mandate should therefore be completed by the end of October 2005 at the latest.

Indicative Timetable

Deadlines	Actions
October 2004	Formal mandate sent to CESR
October 2005	Technical advice from CESR
December 2005	Publication of a working document on possible Comitology instrument on the Commission's website which is open to public scrutiny
December 2005	Commission proposal for Comitology instrument sent to the ESC and the European Parliament and published on the Internet.
March 2006	Vote in the ESC on Comitology instrument
April 2006	Formal adoption by the Commission

The Commission may, whenever justified, consider proposing the adoption of directives or regulations as Comitology instrument for a number of provisions which are covered by the present formal mandate. The Stockholm European Council, the European Parliament and the Lamfalussy Report all urged the use of regulations whenever possible. The Commission will consider this issue at a later stage and its proposal will depend on the content of CESR's advice.

2. THE PRINCIPLES THAT CESR SHOULD TAKE ACCOUNT OF

2.1. The working approach agreed between DG Internal Market and the European Securities Committee

On the working approach to be followed by CESR, the mandate should be implemented on the basis of the following principles:

- CESR should take account of the principles set out in the Lamfalussy Report and mentioned in the Stockholm Resolution of 23 March 2001.
- CESR should provide comprehensive advice on the subject matters described below covered by the delegated powers included in the relevant comitology provision of the UCITS Directive, in the corresponding recitals as well as in the relevant Commission request included in the mandate.

⁶ See EP resolution B5 0173 of 15.3.2001 and Declaration from President Prodi of 05.02.02

- CESR should address to the Commission any questions they might have concerning the clarification on the text of the UCITS Directive or other parts of Community legislation, which they should consider of relevance to the preparation of its technical advice.
- The technical advice submitted by CESR to the Commission should not take the form of a legal text. However, CESR should provide the Commission with an “articulated” text, which means a clear and structured text, accompanied by sufficient and detailed explanations for the advice given, in an easily understandable language respecting whenever possible legal terminology used in the field of European securities markets and company law.
- CESR should provide advice which takes account of the different opinions expressed by the market participants (practitioners, consumers and end-users) during the various consultations. CESR will provide a feed-back statement on the consultation justifying its choices vis-à-vis the main arguments raised during the consultation.
- The act of clarifying does not include the regulation of issues that could be interpreted as creating rights for and/or imposing obligations on UCITS, for which no delegated powers exist under the UCITS Directive.
- The first indent of paragraph 1 of Art. 53a of the UCITS Directive merely refers to “definitions”. Thus only those provisions which contain definitions, which can be understood as “statement of the precise meaning of a word or phrase, or of the nature of a thing” with an aim to ensure uniform application of the Directive, can be clarified by a comitology instrument.

2.2. Consultation of the public

The Stockholm European Council endorsed the Lamfalussy recommendations on consultation and transparency. In particular, it invited the Commission to make use of early, broad and systematic consultation with the institutions and all interested parties in the securities area, especially by strengthening its dialogue with consumers and market practitioners. It also stated that CESR should “*consult extensively, in an open and transparent manner, as set out in the final report of the Committee of Wise Men and should have the confidence of market participants*”.

Art. 5 of the Commission Decision establishing the CESR provides that “*before transmitting its opinion to the Commission, the Committee [CESR] shall consult extensively and at an early stage with market participants, consumers and end-users in an open and transparent manner*”.

In this context, DG Internal Market draws CESR’s attention to the European Parliament’s Resolution on the implementation of financial services legislation of 5 February 2002 and the Commission’s formal Declaration in response⁷.

DG Internal Market will ensure that the Stockholm European Council recommendations on consultation have been fully met. In particular, it will satisfy itself that CESR has consulted all interested parties on its technical advice in accordance with the CESR Public Statement on Consultation Practices. This provisional mandate will also be posted on DG Internal Market’s website.

Once the Commission has received the CESR’s advice, it will draw up draft working documents to put forward to the ESC and the European Parliament. It simultaneously will publish those texts on its Internet site. If the Commission amends its draft to reflect discussions in the ESC, those amended drafts will also be made public on its website.

Interested parties will have the opportunity to comment on published draft working documents. The Commission has set up a dedicated e-mail address (Markt-ESC@cec.eu.int), allowing all interested parties to send their contributions to the Chairman of the ESC. All such comments will in turn be made public on the above website.

⁷ See footnote 5 above

Interested parties will have sufficient time to participate in this exercise because the ESC will not be asked for a vote until at least three months have elapsed from the publication of initial draft implementing rules. This will also allow the European Parliament to follow the process and, if it so wishes, to make its views known.

3. CESR IS INVITED TO PROVIDE ADVICE BY THE END OF SEPTEMBER 2005 ON THE FOLLOWING PRIORITY ISSUES:

3.1 Clarification of Art. 1(8) (*Definition of Transferable Securities*)

3.1.1 Treatment of “structured financial instruments”

Art. 1(8) of the UCITS Directive provides a definition of “transferable securities” which foresees that transferable securities must take one of the three forms specified in Art. 1 (8). The requirements regarding the form in which a “transferable security” must be constituted cannot however be understood without regard to other relevant provisions of the Directive.

In this regard, Art. 1(2) lays down the over-arching principles governing the investment policy of UCITS. Amongst these is the stipulation that “*the sole object of the UCITS undertaking is the collective investment in transferable securities and/or in **other liquid** financial assets referred to in Art. 19(1) ...*” Therefore, a prerequisite for all eligible investments of a UCITS as listed in Art. 19(1), including transferable securities, is that they be liquid. This aspect is also relevant taking into account the general obligation to communicate the net asset value each time units are issued or redeemed, i.e. usually daily pricing (Art. 34) and the observance of investment limits.

Art. 19(1) (a) to (d) of the UCITS Directive then specifies that, in order to be eligible for investment by UCITS, the transferable securities must be dealt in on a regulated market within the meaning of the ISD, or other equivalent regulated markets as provided for under 19 (1) (b) to (d), or that recently issued securities not yet admitted to a regulated market be in the process of being admitted to a regulated market.

Due to their continuous development, there is need for clarification of the conditions under which “structured financial instruments”, consisting of titles or claims issued on the basis of a wide range of underlyings or techniques, can be deemed to fall within the scope of the definition of “transferable security”. This is needed to ensure the consistent implementation of the UCITS Directive throughout the Community.

To this end, it would be useful to develop a common approach regarding the factors to be considered in recognising such instruments as “transferable securities” within the meaning of Art. 1(8), taking account of other relevant considerations laid down in the UCITS Directive (significantly, the UCITS Directive caters expressly for one type of these products, namely the case of transferable securities “embedding” derivatives in its Art. 21 (3) 3rd paragraph). Notably, there is a need for clarification in the case of instruments such as asset backed securities⁸, credit linked notes, similar forms of collateralised debt obligations or notes linked to the performance of a certain underlying.

Elsewhere, the Directive lays down relevant restrictions on eligible investments of UCITS, such as prohibition of investment in precious metals (Art. 19 (2) (d)) or no employment of uncovered sales (Art. 42). Given such restrictions designed to limit the UCITS to certain types of exposure, and thereby protect the investors in UCITS, the question arises as to whether ‘transferable securities’ whose underlyings consist of “structured financial instruments” such as those described above, meet the formal and general requirements for recognition as a ‘transferable security’.

⁸ asset backed securities of both types: true sale (securitized debts based on a “true sale” of assets from the originator of the securitisation to a special purpose vehicle) and synthetic asset backed securities (securitized debts based on a transfer of credit risks from the originator of the securitisation to a special purpose vehicle by the means of a credit derivative); cf. footnotes 9 and 10 below.

DG Internal Market requests CESR to provide advice on the factors to be used in determining whether financial instruments whose underlying involves products of varying degrees of liquidity and/or which may not be directly eligible for investment by a UCITS, meet the formal and qualitative requirements for recognition as a ‘transferable security’ within the meaning of the UCITS Directive. Is the fact of admission to trading on a regulated market as foreseen in Art. 19(1)(a) to (d) sufficient for them to be considered “transferable securities” of Art. 1 (8), eligible for investment by UCITS ? In view of other considerations contained in the UCITS Directive, are there other factors which should be taken into account?

3.1.2 Closed end funds as “transferable securities”

Closed end funds constitute a category of financial instruments which cannot be acquired by UCITS under the heading of ‘investments in other collective investments undertaking’ of Art. 19 (1) (g). However, units of closed end-funds may in certain circumstances, be considered “transferable securities”.

Art. 19 (1) (e) (cf. paragraph 3.4. below) regulates the extent to which investment in non-UCITS can be an eligible investment for UCITS. According to this provision, a non-UCITS has to comply with certain qualitative criteria in order to be considered as an eligible asset (e.g. no employment of uncovered sales). Art. 19 (1) (e) also excludes closed end funds as “eligible non-UCITS” due to the reference to Art. 1 (2), which limits investments in non-UCITS to open-ended funds. On the other hand, shares of closed end funds could be regarded as shares in companies, thus potentially falling within the scope of the definition of transferable securities under Art. 1(8). Closed end funds could therefore be considered as eligible investments in transferable securities to the extent that they comply with any relevant conditions foreseen in the Directive.

DG Internal Market requests CESR to provide technical advice as to whether and under which conditions shares of closed end funds or different variants of closed end-fund fall under the definition of transferable securities as provided for by Art. 1 (8), having regard to Art. 19 (1) (a) to (d) and other relevant considerations contained in the UCITS Directive.

3.1.3 Other eligible transferable securities

Art. 19 (2) (a) provides that a UCITS can invest no more than 10% of its assets in transferable securities other than those referred to under Art. 19 (1). The limit between the scopes of Art. 19 (1) and Art. 19 (2) could thus be drawn as transferable securities not listed on a regulated market in accordance with Art. 19(1) would fall accordingly under Art. 19(2). By inference from the clarification of the definition of “transferable securities” under 3.1.1. above, and considering the additional requirements for recognition as an eligible asset under Art. 19(1), it would be useful to determine whether there are any factors which should identify those transferable securities falling under the scope of “other” transferable securities as set out at Art. 19(2).

DG Internal Market requests CESR to provide technical advice on any factors to be used to assess whether possible investments in transferable securities should be considered as falling within the scope of (i) transferable securities dealt in on a regulated market according to Art. 19 (1) (a) to (d) and (ii) “other transferable securities” under Art. 19 (2). Is it sufficient that a ‘transferable security’ not be dealt in on a regulated market in order to fall within the scope of “other transferable securities” under Art. 19 (2)? Are there other factors which should be taken into account in determining whether particular categories of transferable security fall within the scope of Art. 19 (2) (a)?

3. 2. Clarification of Art. 1 (9) (*Definition of Money Market Instruments*)

3.2.1 General rules for investment eligibility

Art. 1(9) makes clear that the UCITS Directive applies to those “money market instruments” which are liquid and “*have a value which can be accurately determined at any time*”. These general principles are to be complied with in the case of those money market instruments which are recognised as eligible

investments for UCITS by virtue of being admitted to trading on a regulated market in accordance with Art. 19(1)(a) to (d). In addition, the UCITS-Directive contains a number of stipulations which prohibit investment in certain products (Art. 19(2) (d) excludes investment in precious metals), or their acquisition through the use of certain techniques (Art. 42 excludes the employment of uncovered sales).

Analogous to the clarification undertaken for ‘transferable securities’, there is a need to consider whether and under which conditions ‘money market instruments’ which are based on underlyings or techniques which may not themselves be eligible for investment, can be considered as falling within the scope of ‘eligible money market instruments’ under Art. 19(1)(a) to (d).

DG Internal Market requests CESR to provide advice on the factors to be used to determine the eligibility of certain categories of money market instrument dealt in on a regulated market according to Art. 19 (1) (a) to (d). Is the fact that they are dealt in on a regulated market sufficient for them to be considered “money market instruments” meeting the general conditions specified at Art. 1 (9)? In view of other considerations contained in the UCITS Directive, are there other factors/criteria which should be taken into account ?

3.2.3 Art. 19 (1) (h)

Certain clarifications are necessary to establish whether, and under which conditions certain categories of money market instruments fall within the scope of Art. 19 (1) (h) which deals with money market instruments “*other than those dealt in on a regulated market*”. Pursuant to the 1st paragraph of Art. 19 (1) (h), it should be borne in mind that these money market instruments “*other than those dealt in on a regulated market*” shall in any event comply with the requirements of the definition of money market instruments under art. 1 (9) (*instruments [...] which are liquid, and have a value which can be accurately determined at any time*).

DG Internal Market requests CESR to provide technical advice on the following issues:

- CESR is invited to clarify the pre-requisite of the 1st paragraph of Art. 19 (1) (h) requiring that the issuer of such money market instruments other than those dealt in on a regulated market “*is itself regulated for the purpose of protecting investors and savings*”, e.g. whether this pre-requisite should encompass other issuers than credit institutions. It should also be clarified how such pre-requisite can be complied with in addition with each of the four indents of Art. 19 (1) (h). For instance, how can such pre-requisite be combined with the additional criteria of the first indent, i.e. “*issued or guaranteed by a central, regional or local authority [...]*”?
- CESR is invited provide advice on the factors to be used in deciding whether and under what conditions money market instruments other than those dealt in on a regulated market are “*issued by an establishment which is subject to and complies with prudential rules considered by the competent authorities to be at least as stringent as those laid down by Community law*” as referred to in Art. 19 (1) (h) third indent. In particular, CESR is invited (i) to clarify the concept of “*at least as stringent*” and (ii) to determine whether, and if yes, to which extent, such criteria and the abovementioned pre-requisite of the 1st paragraph of Art. 19 (1) (h) overlap each other.

- CESR is invited to clarify the concept of “*equivalent investor protection*”, i.e. to clarify the factors referred to in Art. 19 (1) (h) fourth indent which need to be taken into account in deciding whether and under what conditions money market instruments other than those dealt in on a regulated market are “*issued by other bodies provided that investments in such instruments are subject to investor protection equivalent to that laid down in the first, the second or the third indent of Art. 19 (1)(h) and provided that the issuer is*”.

(i) a company whose capital and reserves amount to at least EUR 10 million and which presents and publishes its annual accounts in accordance with Directive 78/660/EEC;

(ii) an entity which, within a group of companies which includes one or several listed companies, is dedicated to the financing of the group; or

(iii) an entity which is dedicated to the financing of securitisation vehicles which benefit from a banking liquidity line⁹”.

In the case of the last factor above (i.e. “*entity which is dedicated to the financing of securitisation vehicles which benefit from a banking liquidity line*”) CESR is invited to clarify which instruments would be covered by this provision, for instance considering the questions of (i) whether and under what conditions it encompasses asset backed securities⁹ and synthetic asset backed securities¹⁰, (ii) the quality of the “*banking liquidity line*” referred to therein and (iii) of the question as to which category of banks (credit institutions) are covered by the term “*banking*”.

Where appropriate and necessary, these clarifications should consider the Recommendation on the use of derivatives by UCITS, where relevant.

3.2.3 Other eligible money market instruments

Art. 19 (2) (a) provides that a UCITS can invest no more than 10% of its assets in money market instruments other than those referred to under Art. 19 (1). The limit between the scopes of Art. 19 (1) and Art. 19 (2) could thus be drawn as money market instruments which are not listed on a regulated market and which do not comply with the criteria set out under Art. 19 (1) (h) would fall accordingly under Art. 19 (2).

DG Internal Market requests CESR to provide technical advice on the factors to be used to determine the limit between money market instruments according to Art. 19 (1) and “other money market instruments” under Art. 19 (2). Is the fact that they are not dealt in on a regulated market sufficient for them to be considered “other money market instruments” under Art. 19 (2) ? In view of other considerations contained in the Directive, are there other factors which should be taken into account ?

3.3 Clarification of scope of Art. 1 (8) (*Definition of Transferable Securities*) and “*techniques and instruments*” referred to in Art. 21

Art. 1 (8) provides a list of certain items which are to be considered “transferable securities”, but then provides that such items shall exclude “*techniques and instruments referred to in Article 21*”. To clarify the scope of the definition given under Art. 1 (8), it is thus necessary to clarify the concept of “techniques and instruments” described under Art. 21 and to identify the general factors foreseen in the UCITS Directive which may also help to assess whether a particular category of financial instrument is to be considered as a transferable securities or derivative.

This clarification will be particularly relevant to the extent that Art. 21 (3) 2nd sub-paragraph the Directive recognises as a specific sub-category of transferable securities those embedding a derivative element (cf 3.1.1. above). In this case, the derivative element needs to be submitted to the rules set out under Art. 21.

⁹ Securitised debts based on a “true sale” of assets from the originator of the securitisation to a special purpose vehicle

¹⁰ Securitised debts based on a transfer of credit risks from the originator of the securitisation to a special purpose vehicle by the means of a credit derivative

Therefore, it seems to be necessary to clarify the factors to determine whether a transferable security contains a derivative element which will entail the application of Art. 21.

DG Internal Market requests CESR to clarify the factors which need to be taken into account in determining whether and under what conditions certain instruments should fall:

- a. under Art. 21 (2) 1st subparagraph as “*techniques and instruments relating to transferable securities and money market instruments*”. In formulating its advice, CESR is invited to clarify of the notions of “*used for the purpose of efficient portfolio management*” under Art. 21 (2).
- b. under the sub-category of transferable securities according to Art. 1(8) as set out under Art. 21 (3), i.e. transferable securities “*embedding a derivative element*”. This clarification could be used to determine the treatment of the derivative component of the “structured financial instruments” referred to under 3.1.1 above.

Where appropriate and necessary, these clarifications should also take account of the Recommendation on the use of derivatives by UCITS .

3.4. “Other collective investment undertakings”

In Art. 1 (2), the Directive refers to UCITS as undertaking “*the sole object of which is the collective investment in transferable securities and/or in other liquid financial assets referred to in Art. 19 (1)...*”. These liquid financial assets thus also include “other collective investment undertakings” which meet the additional criteria set out under Art. 19 (1) (e). Clarification of these elements is required in order to determine whether and under which conditions concrete situations fall within the scope of the definition of “other collective investments” undertaking.

DG Internal Market requests CESR to provide advice on the factors to be used to determine whether and under what conditions, in a given situation (bearing in mind its relevance for the advice to be rendered under Art. 3.1.2 above):

- a. the “other collective investment undertaking” in question is subject to supervision “*equivalent to that laid down in Community law*” as referred to in Art. 19 (1) (e) first indent.

- b. the level of protection of unit-holders is “*equivalent to that provided for unit-holders in a UCITS*” as referred to in Art. 19 (1) (e) second indent.

3.5. Derivative financial instruments

In Art. 1 (2), the Directive refers to UCITS as undertakings “*the sole object of which is the collective investment in transferable securities and/or in other liquid financial assets referred to in Art. 19 (1)...*”. These liquid financial assets thus also include financial derivative instruments according to Art. 19 (1) (g). To clarify the scope of the definition under Art. 1 (2), it is thus necessary to clarify whether and under which conditions “financial derivative instruments” as set out under Art. 19 (g) can be recognized as “other liquid financial assets” within the meaning of Art. 1(2). This work of clarification could for instance give particular consideration to credit derivatives, such as credit default or total return swaps.

DG Internal Market requests CESR to provide advice on the factors to be used to determine whether and under what conditions, in a given situation, a derivative financial instrument, especially a credit derivative instrument, falls within the scope of the definition of derivative financial instruments as set out in Art. 19 (1) (g).

Where appropriate and necessary, this clarification should take account of the Recommendation of the Commission on the use of financial derivative instruments.

3.6 “Index replicating UCITS”

Art. 22a (1) of the UCITS Directive allows UCITS to replicate the composition of a certain index, subject to certain limits on investment in shares or securities issued by a single body. Art. 22a(1) also describes an index replicating UCITS as one the aim of which “*is to replicate the composition of a certain stock or debt securities index which is recognised by the competent authorities*”, subject to compliance with three additional criteria. There is a need for further clarification of these considerations in order to determine whether and under what conditions the proposed investment policies of an index-replicating UCITS complies with these elements of definition.

DG Internal Market requests CESR to provide advice on the factors to be used to determine whether and under what conditions, in a given situation, a UCITS can be recognised as falling within the scope of the term of “replicating the composition of a certain index” of Art. 22a(1) having regard to the additional three criteria set out in the provision and the elements relating to overall limits in investment in securities issued by any one issuer.

In this regard, CESR is invited to provide advice on the following considerations:

- a. factors to be taken into account in assessing whether the composition of the index is “*sufficiently diversified*” as provided for by Art. 22a (1) 1st indent;
- b. conditions under which the index can be deemed to “represent an adequate benchmark for the market to which it refers” as provided for by Art. 22a (1) 2nd indent; and
- c. the index is “*published in an appropriate manner*” as provided for by Art. 22a (1) 3rd indent.
