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PRESS RELEASE

CESR launches a consultation on its draft advice to the European Commission on the eligible assets of UCITS

CESR publishes today a consultation paper (Ref. CESR/05-064b) on its draft advice to the European Commission on clarification of definitions concerning eligible assets for investments of UCITS. CESR requests comments and reactions to its proposal and to the specific questions raised in the document by 10 June 2005 from both market participants and from retail investors. A public hearing will also be held in Paris at CESR's premises on 9 May.

CESR's draft advice includes proposals on:

- **The eligibility of "structured financial instruments":** CESR proposes, for example, that the UCITS should take into consideration the following factors in deciding whether or not any security is a "transferable security" and eligible for a UCITS: liquidity, valuation, availability of information, transferability, consistency with the stated investment objectives of the UCITS and the possibility to assess risks related to the instrument.
- **The eligibility of closed end funds:** According to CESR's proposal, where a listed closed end fund takes the form of a transferable security, it can be eligible for a UCITS, provided that some additional criteria concerning investor protection are met. UCITS can, however, not make investments in listed closed end funds for the purpose of circumventing the investment limits provided for UCITS by the UCITS Directive.
- **The eligibility of money market instruments (MMI) not dealt in on a regulated market:** According to CESR's proposal, it remains the responsibility of the UCITS to ensure whether a MMI that is not dealt in on a regulated market is an eligible asset. The following key areas should be considered by the UCITS when assessing the eligibility of a MMI: whether an information memorandum providing information on both the issue and the legal and financial situation of the issuer is available prior to the issue of the MMI, whether this information memorandum is regularly updated and subject to control by an independent authority, whether each issuance has a minimum amount of EUR 150.000 or the equivalent in other currencies and whether free transferability and electronic settlement in book-entry form are possible.
- **The efficient portfolio management as regulated by Art. 21 (2) of the UCITS Directive:** CESR proposes, that the transactions by UCITS in this regard have to be economically appropriate. This implies that they are realized in a cost-effective way. Furthermore the transactions should be for one or more of the following three specific aims: the reduction of risk, the reduction of cost or the generation of additional capital or income for the UCITS with an acceptably low level of risk.
- **The eligibility of credit derivatives:** According to CESR's proposal, credit derivatives are eligible instruments for UCITS, provided that they fulfil, for example, the following requirements: The credit derivative complies with the conditions of eligibility of derivative instruments, the end of the transaction can only result in the delivery or in the transfer of assets eligible for UCITS, including cash, and the UCITS has taken adequate measures in order to limit risks of asymmetry of information, especially when dealing with related parties. In addition, a UCITS investing in credit derivatives has to be able to demonstrate that it has the organization and the means needed in this regard as further specified in the draft advice.



- **Index replicating UCITS:** CESR proposes that a UCITS is deemed to replicate the composition of a certain index if it has the aim to replicate the composition of its underlying assets. This aim can be achieved through the use of derivatives, or any other techniques and instruments as referred to in Art. 21 (2) of the UCITS Directive.

Background:

The original UCITS Directive (85/611/EEC, often referred to as the UCITS I Directive) was amended and the two amending Directives (2001/107/EC and 2001/108/EC, the so-called UCITS III) were published in the Official Journal on 13 February 2002.

The amending UCITS Directive 2001/108/EC focused essentially on the "product" (the investment fund). It extended the range of financial assets in which UCITS may invest. As a result, UCITS are now permitted to invest not only in listed shares and bonds as before, but also in bank deposits, money market instruments, financial derivatives (i.e. standardised option and futures contracts dealt on regulated exchanges and over-the-counter derivatives) and in units of other collective investment undertakings. The new rules also recognise investment management techniques widely employed such as "tracking" an index (i.e. investment in securities of different issuers provided for in a given index).

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 Directive, the issue has arisen 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 consistent implementation and interpretation of EU legislation is a crucial dimension of the building up of the single market in financial services. In view of this, the 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 has therefore requested CESR to prepare technical advice for this purpose.

The EU Commission's mandate, published by CESR on 28 October 2004, requested CESR to submit its advice on this mandate by the end of October 2005. When completed, CESR's advice will assist the European Commission in developing a legal text which will take the form of either a Regulation or a Directive. This legislation will set out what is known under the Lamfalussy legislative process as Level 2 technical implementing measures.

CESR's draft advice published today follows a Call for Evidence on 28 October 2004 (Ref. CESR/04-586), to which 15 responses were received. The responses can be found on CESR's website under the section "Consultations" and "Closed consultations and responses".

CESR will host a hearing at CESR's offices in Paris on 9 May for all interested parties wishing to express their views on the draft advice in person. To register for the open hearing, please visit the CESR website (www.cesr-eu.org), and book a place under the heading "Hearings". Comments on the draft advice are welcomed by 10 June 2005 and can be submitted online via CESR's website under the heading "Consultations".

A timetable for CESR's work in this area is attached in the notes to editors, and can also be found in the consultation paper (Ref. CESR/05-064b).

Notes for Editors:

1. Preparation of CESR's advice on this mandate is being 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 Syrriälä assists the Chairman and acts as rapporteur of the Expert Group.
2. Furthermore, a consultative group composed of 16 market practitioners and consumers has also been formed to provide technical advice to the Expert Group on Investment Management. The market participants are experts in different fields of investment management drawn from across the European markets. They are not intended to represent national or a specific firms' interest and do not replace the important process of full consultation with all market participants. For a full list of the individuals, please visit the page dedicated to Investment Management on the CESR website.
3. The mandate from the Commission states the following regarding the 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 UCITS¹. Therefore, where necessary and relevant CESR should take this 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."

4. CESR is an independent Committee of European Securities Regulators. The role of the Committee is to:
 - Improve co-ordination among securities regulators;
 - Act as an advisory group to assist the EU Commission, in particular in its preparation of draft implementing measures in the field of securities;

¹ 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



- Work to ensure more consistent and timely day to day implementation of community legislation in the Member States.
 - The Committee was established under the terms of the European Commission's decision of 6 June 2001 (2001/1501/EC). It is one of the two committees envisaged in the Final Report of the Group of Wise Men on the regulation of European securities markets. Baron Alexandre Lamfalussy chaired this group. The report itself was endorsed by the European Council and the European Parliament. The relevant documents are available on the CESR website.
5. Each Member State of the European Union has one member in the Committee. The members are nominated by the Member States and are the heads of the national public authorities competent in the field of securities. The European Commission has nominated the Director General of the DG Market, as its representative. Furthermore, the securities authorities of Norway and Iceland are also represented at a senior level.
6. For further information please contact:

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

