CESR’s Advice to the European Commission on Clarification of Definitions concerning Eligible Assets for Investments of UCITS

FEEDBACK STATEMENT

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INTRODUCTION

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).

Rapidly evolving financial markets are generating a huge variety of complex financial instruments. For that reason, the European Commission acknowledges that 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, DG Internal Market has indicated that it 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. Before the European Commission presents a proposal for implementing measures, so called “Level 2” measures”, it seeks technical advice on these measures from the Committee of European Securities Regulator (“CESR”) in its capacity as an independent advisory group. Annex I contains the process and work plan that have led to the preparation of CESR’s technical advice.

CESR provides this feedback statement on the consultations justifying its choices vis-à-vis the main arguments raised during the consultations. The present feedback statement covers the following areas, where CESR has given technical advice to the Commission:

a. Clarification of Art. 1 (8) (Definition of Transferable Securities)
b. Clarification of Art. 1 (9) (Definition of Money Market Instruments)
c. Clarification of scope of Art. 1 (8) (Definition of Transferable Securities) and “techniques and instruments” referred to in Art. 21
d. Other collective investment undertakings in Art. 19 (1) (e)
e. Derivative financial instruments in Art. 19 (1) (g)
f. Index replicating UCITS in Art. 22a (1)

Definitions


References in this feedback statement to terms defined in the Directive shall have the meaning given to them in the Directive unless the context requires otherwise.

In this feedback statement, the general term "UCITS" refers:
- to the investment company, if the UCITS is self-managed, and
- to the management company, if the UCITS is not self-managed, or if the UCITS is set up in a contractual form or unit trust form.

**Other horizontal issues**

The first consultation paper presented the overall draft CESR approach to the substance questions related to eligible assets. It was suggested by many consultation respondents that a distinction be made between possible comitology measures at Level 2 and issues that would need to be addressed at Level 3. The final advice makes a **distinction between suggested comitology measures and other measures.**

Many consultation respondents stressed that CESR should consider **transitional arrangements** for those UCITS which have been authorised as such by a Member State but which cease to be a UCITS as a result of the clarification of eligible assets. CESR and the Commission are currently exploring possible ways to deal with such cases, taking into account the protection of the concerned investors and the integrity of the markets.

It is to be noted that many CESR Members and also numerous market participants in their consultations have expressed the need to achieve rapidly a level playing field on the issue of eligible assets between Member States. When implementing UCITS III, some Member States have interpreted the Directive allowing large flexibility on the choice of eligible assets, while others have taken a more risk-averse approach, with a strict adherence to the investor protection safeguards of the Directive. To achieve a level playing field in the necessary timetable, the possible transitional arrangements can only be of a very limited nature. Once CESR’s advice has been transformed into a legal text by the Commission, CESR and the Commission will address the issue of adaptation to the investment criteria provided by the comitology measures of those UCITS that have invested into assets different from those provided by the comitology measures.
Clarification of Art. 1 (8) (Definition of Transferable Securities)

I Treatment of “structured financial instruments”

Although the mandate given to CESR referred specifically to Structured Financial Instruments (SFIs), most respondents supported CESR’s approach that a previous issue was to determine what investment amounts to a "transferable security". As the mandate itself states, CESR should develop a common approach regarding the factors to be considered in recognising such instruments (SFIs) as “transferable securities” within the meaning of Art. 1 (8), taking account of other relevant considerations laid down in the UCITS Directive.

In doing that, however, some objections were raised by some respondents who felt that CESR was exceeding the delegated powers of the Commission because this “redefinition” of transferable securities would affect the eligibility of all securities, not just SFI. As a matter of fact, as various representatives of the legal sector put it, in determining whether or not a SFI is a financial security, consideration should firstly be given to whether the relevant asset is a security and secondly whether it is a transferable security. In these respondent’s views, the draft advice focuses on matters that are more appropriate for consideration in the investment management process of a UCITS rather than in determining considerations of transferability.

1.1 General comments

The large majority of respondents however agreed with CESR's identification of factors to be taken into consideration 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. Two different types of issues were raised in the first consultation:

a) On one hand, some respondents opposed any attempt by CESR to establish any criteria pertaining to the general definition of “transferable security” as this would mean exceeding CESR’s mandate and impose a more restrictive regime than under UCITS I. Most of them suggested that it is the investment manager’s role to ensure that there is sufficient liquidity in a portfolio as a whole to ensure that the UCITS will meet redemption requests rather than ensuring a high level of liquidity or, for the same, transferability or availability of information. Some respondents felt these factors to be conduct of business rules, and therefore, out of the scope of Level 2.

b) On the other hand, there were quite a few respondents that welcomed CESR’s list of factors but argued that they should not be adopted cumulatively because they would unnecessarily restrict fund managers' flexibility in daily fund management operations, increase compliance costs and worsen UCITS' competitive position with regard to other vehicles.

A number of respondents criticised that, if adopted, this approach would impose a significant burden cost on investment managers (and UCITS indirectly) as investment managers would be obliged to carry out extensive due diligence on each proposed investment in a transferable security and maintain appropriate records to justify their decisions. A few respondents argued that this issue needs to be carefully and critically weighed against the potential incremental benefit that such a regulatory regime would bring to investors.

CESR’s view is that, in the context of Art. 19 (1) (a) to (d), the aforementioned factors are cumulative as they will clearly affect the transferability of the security. As reminded in the advice,
the Directive draws a distinction between transferable securities that are admitted to trading on a regulated market (Box 1) and those that are not (Box 2). Both types are eligible investment for UCITS on the condition they fulfil certain criteria.

1.2 Liquidity

CESR’s initial position was that liquidity should be assessed for individual securities and that volume and turnover in the transferable security needed be considered in that process. CESR’s also suggested that, for price-driven markets, an independent analysis of bid and offer prices over a period of time may indicate the relative liquidity and marketability of the instrument.

The majority of respondents backed the idea that liquidity is a relevant consideration but it should be pondered within the investment management process. Their view is that the investment manager’s role is to ensure that there is sufficient portfolio liquidity as a whole to ensure redemption requests. A large number of respondents defending liquidity not to be measured at the asset level stressed that financial instruments may have varying degrees of liquidity.

A significant number of respondents also questioned CESR’s view on what a UCITS must do in assessing whether an individual transferable security is sufficiently liquid for the portfolio. According to some industry representatives, volume and turnover are not good measures of liquidity, particularly in the fixed income market. For that reason, these respondents suggested these liquidity measures to serve only as guidance i.e. Level 3. Also, the independent analysis of bid and offer prices was contested by two respondents: one considered it to be “too expensive” while the other felt that UCITS managers would qualify as ‘independent’ in this context.

Other industry representatives –particularly in the stock exchange segment- argued in favour of considering liquidity as derived from a stock exchange listing i.e. if the security is admitted to trading on a regulated market, its liquidity should be presumed.

In addition, two respondents asked for a consistent EU interpretation on whether the redemption of units -as provided in Art. 37- should be limited to the frequency as laid down in Art. 34 of the UCITS Directive or whether unit holders may redeem their units on a daily basis since this issue bears an impact on portfolio liquidity.

As a result of that input, CESR acknowledged in its second consultation paper that some financial instruments are more liquid than others and therefore the need for instrument liquidity should be related to Art. 37. But, at the same time, it reminded that it is not possible to assess the liquidity of the portfolio without paying attention to some degree to the liquidity of its constituent parts. At Level 3, CESR also considered that, in order to be compliant with the portfolio liquidity requirement, the UCITS’s prudent approach should not follow a predetermined checklist but still should judge a number of matters offered as an example: volume and turnover in the transferable security; if price is determined by supply and demand in the market; the issue size; and the portion of the issue that the asset manager plans to buy among others.

CESR also recognizes that there is a presumption, but not a guarantee, that transferable securities admitted to trading on a regulated market, as defined in Art. 19(1) are liquid. CESR’ final advice also contains an observation made several times throughout the consultations (first and second consultation): although the need for liquidity is in order to meet foreseeable redemptions -as required by Art. 37- the level of liquidity has also to take into account the frequency of those redemptions i.e. UCITS dealt on different time frames will need to maintain different liquidity profiles.
1.3 Valuation

On the issue of valuation, CESR’s first draft advice agreed on the need for accurate, reliable and generally independent valuation systems to be available in relation to the instrument. On this issue, there were some respondents that felt that it is not practical to require independent prices for all securities. Many fixed interest securities do not have independent prices i.e. pricing that’s independent of the issuer. In other cases, there may be only a single price quoted which is "independent" of the issuer, but from only one broker/lead manager. Also, if the security is not regularly traded the quoted price may be stale. A few respondents argued that the overarching requirement for the manager to act in the best interests of unit holders and to avoid conflicts of interest should mean that assets are valued correctly at arm’s length and on normal commercial terms.

Also, some respondents wondered about the initial omission of market prices as a source for accurate, reliable and independent pricing. One market participant mentioned that the Directive already has a simple mechanism to ensure ease of valuation on the transferable security, i.e. 90% of the transferable securities of a UCITS must be traded on an eligible market.

In its second consultation paper, CESR explicitly recognised markets prices as a source for accurate, reliable and regular pricing. At the same time, it restricted the scope of suitable valuation systems to those that were independent from the issuer. This gave rise to opposing comments because, as it was suggested, there are exceptional occasions for which the issuer makes the price available e.g. tailor-made assets.

After due consideration of those arguments, CESR has decided not to modify its final advice in Box 1. Transferable securities for which the issuer makes the price available could be eligible under other provisions of the UCITS Directive e.g. under Box 2.

1.4 Information

CESR’s first draft advice recommending that a UCITS should assess the extent to which the issuer makes information available received some comments from market participants. Some respondents argued that UCITS should assess the availability of the information and not the extent to which the issuer of the transferable security makes the information available. It was suggested that other sources of information be taken into account e.g. information received by a broker or a service provider.

Regarding the features of the information -accurate and comprehensive- it was pointed out that the fact that a security is listed in a regulated market implied that the issuer has to respect information duties on itself and on the listed security.

Taking into consideration those remarks, CESR’s second consultation paper established that UCITS should make sure that the information was available to the market, thus recognising the safeguards provided by the market authorities in admitting or listing a security. During the second consultation, some asset management associations questioned the meaning of the terms regular, accurate and comprehensive. In their view, they could create additional uncertainty. Regarding “regular, accurate and comprehensive information”. In the context of the advice the expression refers to information to be disclosed by issuers in the sphere of securities markets. It is contained almost verbatim in other pieces of Community Law e.g. Directive 2004/109/EC on Transparency Obligations.
1.5 Transferability

According to CESR’s initial stance, UCITS managers should assess whether the transferable security is offered on a limited basis and whether it has constraints on who may buy and/or sell the securities. This wording split respondents in the first consultation along the lines of two major issues: (i) transferability as a precondition for listing and (ii) private placements.

a) Concerning the first, some markets respondents, particularly market regulators, claimed that the admission to trading in a regulated market should be sufficient to make a security be considered as a transferable security. In the view of many respondents, the fact that a security is listed in a regulated market implies that the market itself has already done an appropriate evaluation on the transferability of the security.

b) On the other hand, some members of the industry pointed out that the assessment of the transferability should be made by looking at the possibility of a security being moved from one investor to another by registration on the register of shareholders or other equivalent means. This would not preclude, in the contestant’s view, the eligibility of private placements as transferable securities.

In its second consultation paper, CESR tried to take into account both comments. Reference to transferability was deleted. Instead, eligible transferable securities should be freely negotiable on the capital markets.

A substantial number of respondents to the second consultation questioned the exact meaning of the requirement ‘the security must be freely negotiable on the capital markets’. CESR has reflected on this and has deleted the reference to ‘freely and to ‘in the capital markets’, concluding that a UCITS may invest in ‘not freely negotiable’ transferable securities, provided that it is aware of the existence of limitations to their transferability and that notwithstanding that it will be able to redeem units at the request of the unit holders. In addition, it has been clarified that where a security is listed, a presumption of negotiability applies, but as with the presumption of liquidity, it is not guaranteed, for example in the case there are specific restrictions on the transferability of the security (i.e. the presence of a lock-in clause or of a clause submitting the transfer of a share to the agreement of the other shareholders).

1.6 Structured Financial Instruments

Structured Financial Instruments (SFIs) are mentioned in the Commission’s mandate as an example of recent financial innovations. A clear majority of respondents supported CESR’s approach that there should be no reason to consider that SFIs that take the form of transferable securities should not be treated as such.

However, some respondents to the second consultation expressed they would welcome a statement from CESR clarifying that transferable securities (other than SFI) that themselves invest or are linked to the performance of other assets such as commodities, properties or loans are eligible. On behalf of a group of leading banks, it was asked to CESR whether a look-through approach was required for shares. In CESR’s view, it is not necessary to look at the assets held or activity conducted by the issuer of the transferable security. That is, given a share/ a debt security qualifies as a transferable security, it would not be necessary to look through the activities of its issuer.

The final advice also reminds that both SFI taking the form of transferable securities and other transferable securities that embed a derivative will need to be treated in the way as developed concerning embedded derivatives further in the advice (Box 11).
2 Other eligible transferable securities

CESR’s first stance on this issue was three-fold:

- For an investment to be eligible under Art. 19(2)(a), it must be a transferable security that does not comply with the conditions respectively described in Art. 19(1)(a) to (d).

- Criteria discussed in Box 1 will apply, as appropriate, also to transferable securities that fall within Art. 19(2)(a).

- CESR considered unlikely that closed end funds would meet the requirements as stated in Box 1.

Many respondents were contrary to CESR’s approach. They called for requirements in Box 1 not to be applied to investments eligible under Art. 19(2)(a). Their view could be summed up as follows: if the intention of the European legislator was to impose to the non-listed transferable securities the same liquidity and reliable valuation criteria than the ones imposed to listed transferable securities, there would be no need to limit investments in such securities to 10% of the UCITS. The liquidity factor was the most contested as unlisted investments are by their nature to be illiquid, therefore unlikely to meet the criteria in Box 1.

CESR’s statement on closed end funds not likely to meet criteria in Box 1 also drew some respondent’s attention. Some members of the legal sector remarked that non-listed closed end funds may be as likely to meet those requirements as any other non-listed company.

CESR’s second consultation paper clarified that securities falling within Art. 19(2)(a) should be subject to the same basic criteria as discussed in Box 1 but taking into account their special situation i.e. non-listed securities. The advice introduced two exceptions with regard to Box 1:

- Valuation will not be based on market prices, and yet securities should be acquired with a view as to their value; and

- Information available on a transferable security eligible under Art. 19(2)(a) will not have to be “comprehensive” and may not be made available with the same regularity. The final advice has even determined that it will be enough if information is available to the UCITS rather than to the market. This is more appropriate for investments in unlisted securities which Box 2 is concerned with.

Regarding the question of liquidity, CESR believes that the same liquidity assessment operating in Box 1 applies for securities eligible under Art. 19(2)(a), and under the same conditions i.e. meet the requirements of Art. 37. However, CESR has acknowledged comments that unlisted investments tend by their nature to be illiquid and has therefore included under Level 3 a recommendation not to take liquidity for transferable securities falling within Box 2 automatically for granted.

With a view to uphold coherence with Box 1, CESR has decided to include under Level 3 a recommendation for UCITS to assess the negotiability of securities held in their portfolio.
3 Closed end funds as “transferable securities”

3.1 Eligibility

According to CESR’s first advice, listed closed end funds were potentially eligible if they were constituted as a transferable security. CESR agreed to apply to closed end funds (CEF) constituted as transferable securities the same analysis applicable to the later.

In addition, CESR was of the opinion that UCITS had to take account of certain following matters in deciding the eligibility of a listed CEF:

- Consider whether the CEF may be engaging in cross-holdings in other CEF that take the form of transferable securities in such a way as to cause unacceptable risk for the CEF and through it, for the UCITS itself
- Ensure that the asset management activity carried on by or on behalf of the listed CEF is subject to appropriate investor protection safeguards; and
- Not to make investments in listed CEFs for the purpose of circumventing the investment limits provided for UCITS by the UCITS Directive.

The majority of respondents to the first consultation expressed that as a general rule there should be a presumption of listed CEFs being “transferable securities” as per Art. 1(8) and therefore, regarded eligible provided that they meet the definition of a transferable security and the listing requirements of the market concerned. Therefore, whilst agreeing that listed CEF should meet the criteria of transferable securities, they do not need to meet indents (a) to (c) in Box 3 i.e. additional matters in deciding the eligibility of a listed CEF. According to these respondents listed CEF should be treated as shares on a regulated market. This reasoning would also be applicable to investment trusts. A trade association of unit trusts and their shareholders expressed that investment trusts have to comply with more prescriptive requirements than other listed securities and have qualified as transferable securities since UCITS I.

Concerns about a level playing field were also raised. According to some respondents, units of listed US and Canadian CEFs are considered in those countries as transferable securities. If the treatment were different in Europe, this would reduce the competitiveness of European products vis-à-vis US/Canadian products.

CESR’s second consultation paper was modified to encompass not only listed CEFs but any CEF. Therefore, CEFs constituted as a transferable security should comply with either Box 1 or Box 2 to be eligible.

3.2 Cross-holdings in other CEFs

According to CESR’ first advice, a UCITS should consider whether the CEF in which it is invested may be engaging in cross-holdings in other CEFs that take the form of transferable securities in such a way as to cause unacceptable risk for the CEF and through it, for the UCITS itself.

Some market participants did not see the need to require UCITS to consider the risks which might be caused by cross-holdings in other CEFs. It was pointed out that, on the assumption that the underlying fund diversifies risk, no further detailed assessment of the underlying scheme is needed. One industry representative observed that with regard to investments in securities of holding companies no comparable conditions apply even though, on a general basis, a CEF is structurally less risky compared to any corporate issuer. Therefore there was not any material reason why such obligation should apply for listed CEFs. As mentioned in some responses, the look-through would
require disclosure of portfolio information from the underlying fund, which is in principle difficult to obtain.

Since both Box 1 and Box 2 already establish that the risk of the security must be adequately captured in the risk management process of the UCITS, the requirement concerning cross-holdings in other CEFs was deleted for the second consultation.

### 3.3 Circumvention of investment limits

In the first consultation paper CESR recommended that UCITS should not make investments in listed CEFs for the purpose of circumventing the investment limits provided for UCITS by the UCITS Directive. All CESR members agreed that the acquisition of any transferable security by a UCITS must be consistent with the stated investment objectives of the UCITS, and that these objectives will have to be consistent with the requirements of the UCITS Directive.

However, CESR members’ views differed on whether UCITS should be allowed to invest only in such listed CEFs, that invest in transferable securities, that would themselves be eligible under the UCITS Directive; or whether it is not necessary to require UCITS to invest only in such listed CEFs.

In the first consultation, several respondents were unsure what the expression “for the purpose of circumventing the investment limits provided for UCITS by the UCITS Directive”. CESR’s second consultation paper clarified that the expression is a reference to the UCITS’ purpose in dealing for its portfolio.

Regarding the option presented to the consultation, the majority of respondents disagreed with the idea of imposing restrictions i.e. “only” regarding the kind of CEFs in which UCITS could invest. The main arguments submitted were:

- Restricting UCITS to invest only in listed CEFs that invest in transferable securities that would themselves be eligible under the UCITS Directive would contradict current understanding of the Directive, restrict innovation, and reduce the attractiveness of UCITS funds to investors.

- Investing in listed CEFs for the purposes of "circumventing" the investment limits for UCITS would not ordinarily form the basis of prudential portfolio management and stock selection. A fund must be managed within its investment objectives and if these are, for example, the generation of growth and income from a portfolio of investment trusts (companies) then diversification potential should be absolute (within the guiding principles of a UCITS in terms of liquidity and risk diversification).

- Imposing restrictions will mean that firms with the ability will use alternative vehicles to UCITS in offering retail investors investment solutions to meet their needs. As such these proposals will not protect investors.

In its final advice, CESR has taken the view that UCITS could invest in closed real estate funds and private equity funds, notwithstanding other types of closed end funds (i.e. hedge funds) could also be eligible provided they meet requirements of Box 1 or 2. At the same time, the final advice reminds that any of these investments will have to be consistent with the stated objectives of the UCITS whilst these objectives will have to be consistent with the requirements of the UCITS Directive.
3.4 Appropriate investor protection safeguards

In CESR’s first consultation, one of the additional relevant matters in deciding on the eligibility of a listed CEF was that UCITS should ensure that the asset management activity carried on by or on behalf of the listed CEF is subject to appropriate investor protection safeguards.

Numerous comments from asset management associations raised objections to this matter. A common opinion was that CESR’s guidance was not relevant to a CEF because respondents did not consider that investment in the listed CEF should be subject to verification that does not apply to investments made in other listed companies, the latter being already subject to investor protection safeguards such as information duties, liquidity and market pricing. Some calls were also made urging CESR to set out the potential gains from establishing further requirements for investor protection.

In the second consultation information was collected on two alternative approaches that had emerged on this point:

a) Some CESR Members believed that meeting the standards for listing is a sufficient standard. There have been many enhancements of corporate governance arrangements in recent years which require investment companies to be properly managed.

b) Several CESR Members believed that the necessary standard is met where the asset management activity of the CEF is carried out by an asset management firm which is itself regulated by national authorities for the purpose of investor protection.

CESR’s second consultation paper also referred explicitly to contractually based funds. CESR agreed that the starting position should be to treat all CEF in the same way. CEF in contractual form would be therefore potentially eligible assets where they amounted to "securities equivalent to shares in companies". Crucially, CESR believed that corporate governance mechanisms equivalent to those applicable to companies must apply to such funds in order for the requirement of "equivalence" to be met.

There was much comment in the second consultation about the nature of "appropriate investor protection safeguards" to apply to CEF. Most respondents were of the view that it is sufficient for a CEF to meet the standards for listing without having to verify that it is subject to appropriate investor protection safeguards. Otherwise, it was stated, the verification of whether a closed end fund is subject or not to investor protection safeguards will be burdensome and will give rise to conflicting interpretations.

There were also comments opposing the requirement that CEF in contractual form need to have corporate governance mechanism equivalent to those applied to companies. It was argued that this would create a distinction between open end and closed end funds set up in a contractual form. Some respondents also mentioned that if CESR is intent that there should be additional safeguards for CEF set up in a contractual form, then the requirement should be for the management company.

Following discussion, in its final advice, CESR believes that “appropriate investor protection safeguards” means that where the asset management activity of the CEF is carried out by a firm which carries out asset management activity, that firm must itself be regulated by national authorities for the purpose of investor protection. This means that self-managed CEFs need not themselves be regulated for the purpose of investor protection.
Regarding corporate governance mechanisms that must apply to CEF set up in a contractual form, CESR’s final advice has added Level 3 criteria to help a UCITS make an assessment of equivalence with those applicable to companies.
Clarification of Art. 1 (9) (Definition of Money Market Instruments)

1 General rules for investment eligibility

CESR’s first consultation paper put forward a number of factors to be taken into account when assessing whether a given instrument is a MMI as defined by Art. 1(9) of the UCITS Directive. These were:

- Liquidity
- Valuation
- Dealt in on the money market

There was overall agreement among the respondents with the suggested draft advice. On the other hand, as it happened with transferable securities, some market participants believed that the criteria outlined in Box 4 should be considered as rules of conduct by fund manager rather than additional requirements for UCITS. Imposing any additional criteria, be it at Level 2 or 3 could restrict eligibility of new categories of MMIs in the future.

1.1 Liquidity

CESR was of the opinion that liquidity of the MMI must be taken into account in the context of Art. 37 of the UCITS Directive (i.e. the portfolio must retain sufficient liquidity so that the UCITS can repurchase or redeem its units at the request of any unit holder). Also, at an instrument level, liquidity means that it must be possible to repurchase, redeem or sell the MMI in a short period (e.g. 7 business days), at limited cost, in terms of low fees, narrow bid/offer spread, and with a very short settlement delay.

Some respondents to CESR’s first consultation reminded that the only legal liquidity requirement of the Directive is Art. 37 which regulates the liquidity of UCITS itself and not of the individual MMI. These respondents were the same that reiterated this argument in Boxes 1-3. To their view, the definition of liquidity at an instrument level is beyond the scope of CESR's mandate. However, a few respondents pointed out that should CESR wish to apply several criteria for the definition of liquidity, those criteria should be alternative, not cumulative. It was also noted that if the ECB definition of liquidity is retained, many investments that are traditionally regarded as MMI and acquired by money market funds will not be eligible any more (e.g. a Floating Rate Note may have a low liquidity and not a narrow bid/offer spread).

One respondent warned CESR that evidencing that each MMIs satisfies all of the liquidity conditions proposed will be costly given the subjective nature of some of those conditions. This market participant supported the view that if CESR persists in defining liquidity at instrument level, then the fact that a MMI is dealt in on a regulated market means it ought to be regarded as having satisfied the instrument level liquidity requirement of Art. 1(9).

In CESR’s second consultation paper, in parallel with rewording of Boxes 1 and 2, and having taken into account the industry’s considerations, CESR clarified the definition of MMI as instruments which can be sold at a limited cost in an adequately short timeframe taking into account the requirement of Art. 37 of the UCITS Directive. Any reference to liquidity being assessed at the instrument level was removed from the advice at Level 2. At Level 3, however, it recommended a
number of factors to be taken into account when assessing the liquidity of a MMI. And it reiterated that those factors were cumulative.

Again, throughout the second consultation, there were responses in favour of deleting the reference to “cumulative” when considering the liquidity of a money market instrument. It was highlighted by many respondents that Level 3 advice is inconsistent with the main body of the paper, i.e. paragraph 50. CESR recognises in paragraph 50 that the fact that some of these conditions are not fulfilled does not imply that the financial instrument should be automatically considered as non-liquid.

However, CESR continues to consider that these factors should be examined by the UCITS on a cumulative basis. As indicated during the open hearing arranged by CESR on 7th November 2005, it is indeed hardly conceivable how a MMI could fulfill the liquidity requirement without taking into account all the criteria mentioned in the CESR advice. This exercise to be undertaken by the UCITS does not mean that all these criteria should be fulfilled as it is indicated in paragraph 50 stating that “the fact that some of them are not fulfilled does not imply that the financial instrument should be automatically considered as non-liquid”. The CESR advice only strives to provide UCITS the necessary flexibility in the daily management of funds. It should be nevertheless reminded that it is the responsibility of the UCITS to check the liquidity of instruments and funds in order to ensure that the MMI "can be sold at a limited cost in an adequately short timeframe taking into account the requirements of Art. 37 of the UCITS Directive that the UCITS should repurchase and redeem its units at the request of any unit holder" which is the key element of the CESR regulatory framework regarding the liquidity of the MMI. In order to address market participants’ concern, it was added in the Box 4 of CESR’s advice at Level 3 the expression that “The fact that some of these conditions are not fulfilled does not automatically imply that the financial instruments should be considered as non-liquid”.

1.2 Valuation

UCITS should ensure that accurate and reliable valuations are available so as to meet the obligation by the UCITS Directive to calculate the NAV of the UCITS’ units. CESR’s opening attitude to valuation of a MMI was that it should be based on:

- market data, when available and relevant, or
- valuation models, such as models based on discounted cash flows. When using such models, any changes in the credit risk of the issuer must be taken into account.

It was also noted that a method that would discount cash flows using the initial discount rate of the MMI without adjusting that discount rate to take into account changes in the credit spread of the issuer would not comply with these requirements.

The majority of respondents felt that CESR’s first advice needed some clarification on two issues:

- The use of an amortised cost methodology
- The quality of available valuation systems

1.2.1 Amortised cost methodology

In the first consultation some members of the asset management industry argued this method to be used at least to value MMI with short maturities.

CESR’s second draft advice reconsidered its position and allowed the use of an amortization method for MMI provided certain conditions are met:
• MMI with a residual maturity of less than 3 months and with no specific sensitivity to market parameters, including credit risk or
• The fund invests in high-quality instruments with maturity or remaining maturity of at most one year; and its weighted average maturity is at most 60 days or fewer.

UCITS that use this method will be required to revalue the NAV using alternative valuation methods if significant events happen that could have a significant impact on it (sudden changes in interest rates or in the credit ratings in the underlying instrument). This modification was warmly welcomed by the industry although, during the second consultation, some respondents noted that having done that, CESR should establish in its final advice some kind of escalation procedure for occasions when the value of the fund under the amortised cost method and the value calculated by reference to market prices of a given MMI differs by more than a marginal amount. CESR’s final advice was changed accordingly to reflect on this concerned.

Some comments were also raised on the feasibility of funds with a weighted average maturity of up to 90 days to be allowed to use the amortised cost methodology. It was argued that, according to current market conventions, firms appealing to the money market are doing so within that timeframe. Money market funds investing in those issues are willing to stick to that valuation methodology. This would also apparently bring into line regulatory approaches in Europe and the United States, where a weighted average maturity of 90 days is permitted. CESR has decided to leave this criteria unchanged on the ground of lack of unanimity among asset managers.

1.3 Dealt in on the money market

A MMI, according to CESR’s first consultation paper, should be normally dealt in on the money market, that meaning that the instrument has a low interest risk and a residual maturity of up to and including one year, or regular yield adjustments in line with money market conditions at least every 12 months.

One association of trustees and depositaries questioned the use of the phrase “dealt in on the money market” to define MMI since all these instruments would be dealt in on money markets. According to this respondent, the phrase is not intended to define these instruments beyond the subsequent requirements of Art. 1(9) that MMIs be liquid and have a value which can be determined at any time. Another industry representative was critical on this issue by other reasons. This respondent wondered at the need to use a definition which potentially restricts the types of eligible MMIs. CESR felt nonetheless that this requirement was useful to establish the eligibility of these instruments.

With regard to CESR’s particular identification of factors, some respondents, who were overall supportive of CESR’s approach suggested the draft advice should refer both to the criteria of maturity at issuance (as a feature of MMIs) and of residual maturity. It was proposed “maturity at issuance up to 12 months as a key feature of MMI” to be added. Some representatives of the banking industry also recommended the deletion of the phrase “low interest risk”. According to these respondents “low interest risk” equals “residual maturity of up to one year”. If maintained, CESR would be introducing a separate criterion that could imply, for example, that emerging markets MMIs were excluded from Art. 1(9). Also the expression “at least every 12 months” should be deleted because, according to this respondent, different jurisdictions have different timeframes for such adjustments.

Finally, a number of respondents were interested in a clarification from CESR establishing what kind of instruments will usually comply with criteria “normally dealt in on a money market”.

Following these comments, CESR modified the advice for the second consultation deleting the reference to “low interest risk”. Therefore, the factor “normally dealt in on the money market” in MMIs should be assessed, as a general rule, in terms of their maturities or yield adjustments. In that regard, it recognized maturity at issuance up to 12 months as a key feature of any given MMI.
Should UCITS wish to invest in instruments which do not comply with these maturities criteria, the advice requires UCITS to conduct an in depth analysis of the risk profile of those instruments to check that they have the risk profile of money market instruments.

In Level 3, CESR gives some examples of instruments that will usually comply with the provision “normally dealt in on the money market”: treasury and local authority bills, certificates of deposit, commercial paper, and banker's acceptances.

The paper put to second consultation received general approval on this issue. However, many comments have been made in respect to permitting money market instruments with maturities of 397 days. If left unchanged, requirements applied to MMI will prevent UCITS from investing in a number of MMI issued in the USA as these will often have a maturity of issuance of 397 days (13 months). American regulation provides this flexibility in order to prevent inadvertent breaches arising due to any slight delay in settlement of the instrument.

CESR has considered those remarks and has extended maturity criteria to 397 days or even longer, provided it can be demonstrated that these instruments have the risk profile of money market instruments.

2 Eligibility of MMI under Art. 19 (1) (a) to (d) of the UCITS Directive

In CESR’s first consultation paper, the assessment on the eligibility of any given MMI under Art. 19(1)(a) to (d) of the Directive was subject to consideration within the overall coherence of the provisions set by the Directive.

2.1 Liquidity and accurate valuation

It was recognised that the fact of the admission to trading on a regulated market of a MMI provides a presumption that the condition of "liquidity" (i.e. "the MMI can be converted into cash in no more than seven business days at a price closely corresponding to the current valuation of the financial instrument on its own market") and “accurate valuation” are complied with. The first consultation paper placed on the UCITS the responsibility to ensure that the liquidity criterion was met.

Some respondents expressed disagreement with the admission to trading requirement because in their view, admission to trading in on regulated market does not provide as such a presumption of liquidity of the financial instruments as listing cannot guarantee that the assets issued under a programme will have a high secondary market liquidity.

An institutional respondent had a different view and supported CESR’s presumption but recalled the “incoherence” of imposing upon a UCITS the requirement to check liquidity and valuation where an MMI is traded on a regulated market.

In CESR’s view there is no conflict between those two opinions and they can be made compatible. For that reason, in its second consultation paper, CESR recommended that, while preserving the cited presumption, it would not work automatically in the event that a UCITS believed that this presumption should not be relied upon. In that case, the MMI should be subject to an appropriate assessment.

2.2 Exposure to precious metals and short selling

A number of respondents questioned CESR’s explicit position on this issue: that there is no scope for gaining exposure to precious metals through the investment in a MMI; and that short selling of MMIs by a UCITS is not authorised.
Some industry representatives said not to understand what CESR would like to cover by these points and reminded that Art. 42 clearly prohibits acquisition of precious metals and short selling. To most respondents’ views, this question is totally unrelated to other contents in Box 5 and should therefore be deleted. Other responses noted that there is no requirement in the Directive to look-through at MMI to see if there is an exposure to commodities or metals.

In the second consultation paper, CESR moved these two questions from Level 2 to Level 3 but did not delete them because in its opinion, the Commission’s request for advice had been drafted in such way that it had to answer to that question.

3 Eligibility of MMI under Art. 19 (1) (h) of the UCITS Directive

3.1 Protection of investors and savings

The UCITS Directive provides general criteria to assess whether a MMI that is not dealt on a regulated market is an eligible asset. The overarching criterion - pre-requisite of the first paragraph of Art. 19(1)(h)- is that the issuer of MMIs not admitted to or dealt in on a regulated market "is itself regulated for the purpose of protecting investors and savings". When discussing this principle, CESR found appropriate to take into account previous work on common standards in this regard, e.g. ECB-regulation and the work of the ACI-STEP Task Force.

3.1.1 The STEP initiative

A majority of respondents supported the STEP project as a means of standardizing dealing practices in Europe, and therefore favoured CESR’s positioning towards that initiative. As one participant put it, the quality of the investment support chosen to issue commercial paper would be the best tool to be used to enhance market transparency, safety and normalization.

Some other comments reminded CESR that the purpose of the Art. 19(1)(h) is to allow UCITS to invest in high quality, liquid MMI that are not dealt in on a regulated market. It was reminded that the Commission’s mandate invited CESR to clarify the pre-requisite of the issuer to be regulated for the purpose of protecting investors and savings and not to fix certain “market standards”.

CESR acknowledged the concern of most market participants regarding the push for harmonising initiatives such as the STEP programme and in its second consultation paper it took into account most of their suggestions in the way of key features, as explained below. This way CESR addressed the concerns that any formal endorsement of it at the UCITS level - in spite of not being explicitly mentioned in Box 6 - would lead to a reduction in borrower choice of short term issuance methods.

3.1.2 Information memorandum

With regard to the pre-requisite of the first paragraph of Art. 19(1)(h) requiring that the issue or issuer of such MMI is itself regulated for the purpose of investor protection, CESR decided that a UCITS should consider some key areas when assessing the eligibility of such MMI. Those key areas were:

- 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 (i.e. on an annual basis or whenever a significant event occurs);
- whether this information memorandum is 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.

### 3.1.2.1 Issue and the legal and financial situation of the issuer

Some previous comments were made related to a technical question: replacement of the expression “issue” by “issuance programme”. At least three respondents believed it more appropriate as issuances of MMIs are always part of wider programs (i.e. series of issues). CESR advice was modified accordingly.

However, it was the nature, quantity and quality of the information to be made available by the issuer of the MMI that attracted a lot of attention. One respondent put forward a rather elaborated proposal concerning this issue. In the participant’s view, the information memorandum should be:

- Available in an English version, updated annually or in the case of material change of the issuer
- Easily and publicly available at a central access point by the independent authority

One participant recommended the quality of issuance programmes to be monitored by the independent authority which would publish statistics with the aim to help investors (dealers, corporate and institutional investors) to have a straightforward and reliable view of the activity of an issuer.

Some minority comments reminded that some issuers are not required to provide a prospectus when issuing MMI. These MMI would then not be eligible assets for UCITS. In their view, this requirement should be dropped to enable these MMI to be eligible.

During the second consultation, a number of respondents considered that obliging MMIs to fulfil the criteria of availability of information on both the issue and the issuance programme was overly restrictive and could have the effect of eliminating certain acceptable money market instruments. It was argued that, very often, the investment manager will make an information decision based on the information available on the issuer and not the issue directly. It was also pointed out that certain types of MMIs do not have an issuance program in practice and it is the information on the issuer that is relied on (e.g. certificates of deposit). This comment was pondered by CESR and the final advice has been modified to allow for relaxed information criteria for certain types of instruments issued by establishments subject to prudential supervision regimes equivalent to those defined by Community Law. Instruments issued by a certain entities will also, according to the final advice enjoy less stringent information requirements.

### 3.1.2.2 Control by an independent authority

Numerous comments arising from the first consultation were contrary to the view that, in order to be eligible, MMI should have their information memorandum scrutinised by an independent authority, as envisaged by STEP promoters and CESR’s first advice. It was mentioned that many issues e.g. ECP do not have such control by an authority and would therefore not qualify as eligible MMI. Other market participants endorsed that view: the requirement for an independent authority does not reflect current market practice and it is not a necessary regulatory requirement. For example, as one issuer pointed out, information memoranda issued by MMIs like ABS Floaters are not subject to control by an independent authority.

The majority of respondents, however, were favourable to some kind of control but exercised through some kind of independent “entity” (as opposed to “authority”). Those respondents
particularly in favour of the STEP initiative put aside the nominal debate but urged CESR to make clear that, whatever the outcome, the foreseen STEP market committee (an ad hoc organisation) would qualify as an independent authority within the meaning of the CESR’s advice. According to these responses, that committee would be composed of “persons with a high degree of expertise with due consideration given to geographic diversity, representing all the aspects of the market, requiring to meet the highest standards of integrity and not subject to instructions from the companies or organisations to which they belong”.

CESR’s second consultation paper used the expression “independent body” meaning a body specialised in the verification of legal and financial documentation. However, arising from the second consultation, some respondents considered this reference to be unclear, expensive and unpractical as it would require the appointment of a third person not related to the MMI. This appointment would also lead to the possible production of conflicts of interest among the appointees, the organization to which they belong and the issuer, conflicts whose resolution CESR’s advice leaves unresolved. Some other respondents demanded CESR some kind of example on who may act as an independent body.

CESR’s final advice has sticked to the wording put up for second consultation but recommends some transitional measures be put in place to comply with these criteria.

3.1.2.3 Availability of reliable statistics

An objection raised during both consultations was that the availability of reliable statistics would be too costly and onerous for most MMI as often this information is not freely available. As some participants pointed out; there are no current statistics available on the CD market and it would be overly costly to develop a programme with few defined benefits. However, CESR’s final advice establishes that for eligible MMIs under Art. 19(1)(h) reliable statistics regarding the issue or issuance programs should be available, subject to some exceptions as defined in Box 6.

3.2 Compliance with prudential rules

The Commission’s mandate asked CESR to clarify the concept of “at least as stringent” referred to prudential rules under which an establishment issues MMI not dealt in on a regulated market. CESR’s first advice stressed that it was the responsibility of the UCITS to check that the requirement that prudential rules are at least as stringent as those laid down by Community Law is met. It also established the presumption that establishments located in the European Economic Area and G10 countries (USA, Canada, Japan and Switzerland) or having investment grade rating are subject to prudential rules at least as stringent as those laid down by Community Law.

In the view of the majority of respondents to the first consultation, particularly asset management associations, CESR’s advice should stick to the wording in the Directive which in Art. 19(1)(h) third indent states that “competent authorities” (and not UCITS) will consider whether those rules are as stringent as those laid down by Community Law.

A few respondents requested CESR to enlarge the list of eligible countries by accepting all the OECD countries and even all the countries which are members of the IOSCO.

CESR’s second consultation paper exempted UCITS of the aforementioned responsibility but refrain from enlarging the list of eligible countries because that would not be consistent with the UCITS Directive without enough requirements. Nonetheless, the final advice includes a final clause that allows for the eligibility of any MMI for which it can demonstrated based on an in-depth analysis of the issuer that the prudential rules that it is subject to and complies with are at least as stringent as those laid down by Community Law.
3.3. Entities dedicated to the financing of securitisation vehicles which benefit from a banking liquidity line

CESR was invited to clarify which instruments would be covered by the last sub-category in the fourth indent of Art. 19(1)(h) of the UCITS Directive. According to the first consultation paper, this provision refers to a specific category of asset backed commercial papers that are built on a two-tier structure and that are secured by banking credit enhancement. The banking liquidity line has to be secured by a financial institution subject to and complying with prudential rules that are at least as stringent as those laid down by Community Law. Credit institutions providing this protection must have a rating that is at least equal to that of the program in question.

### 3.3.1 Asset Backed Commercial Papers (ABCP)

In its first draft, CESR was of the opinion that asset backed securities and synthetic asset backed securities do not fall in the category defined by the fourth indent of Art. 19(1)(h) whenever they are not dealt in on a regulated market. This would not preclude them from being eligible under the provisions of Art. 19(1)(a) to (d) or Art. 19(2)(a).

A large number of respondents acknowledged the exclusion of ABS and synthetic ABS from this part of the advice but took the opportunity to remind CESR the economic importance of these kinds of instruments and demanded a clarification to ensure that ABS remain eligible assets if they are considered transferable securities under Art. 19(1)(a) to (d) or MMI under Art. 19(1)(h).

In this regard, CESR acknowledges that the mandate from the Commission has limited CESR to a strict interpretation of the text of Art. 19(1)(h) fourth indent. With regard to ABS and synthetic ABS, CESR reminds that it was not under the scope of the mandate to indicate under which other provisions of the UCITS Directive these instruments could be eligible. CESR’s advice however recognises explicitly in Box 8 that these instruments may be eligible under other provisions of the Directive. Some associations’ comments have supported CESR’s decision and have called for an amendment of the Directive on this aspect.

### 3.3.2 Banking credit enhancement

CESR first approach on this issue was that credit institutions providing protection must have a rating that is at least equal to that of the program in question. A number of respondents to the first consultation thought that arrangement to be unpractical and expensive. They put forward an alternative. Their argument was that very often investor protection is provided by banks through credit enhancement schemes and thanks to liquidity facilities commitments. Therefore, the credit quality of the structure will be at least equivalent to the quality of the bank.

Regarding the specific need for a rating, several respondents pointed out that current market practice diverts from the advice. For example, in the case of ABS -financial instruments with a high rating (AAA) - it would probably be impossible to find credit institutions which are AAA rated. Besides, the creditworthiness of the credit institution which grants the protection will also be reflected in the ratio of the ABS, so there is no need to set up further requirements regarding the quality of the banking liquidity line.

CESR’s final advice is sensitive to these remarks and has consequently erased any reference to the quality of the protection structure in the understanding that the creditworthiness of the credit institution is incorporated in the instrument’s own rating and, as such, it is assessed by UCITS’s managers when making investment decisions.
4 Other eligible money market instruments

CESR’s advice was meant to provide some criteria to determine what other MMIs could be. In the first consultation paper, CESR recommended that other MMIs are those instruments that comply with the definition of a MMI as set by Art. 1(9) of the UCITS Directive, i.e. are normally dealt in on the money market and fulfil the requirements of liquidity and accurate valuation, and which have been clarified above in the advice, but do not, however, fall in the categories defined by Art. 19(1)(a) to (d) or (h).

The same wording appears in the final advice since it has been a topic upon which no comments have been received.
**1 Compliance with risk management process**

Respondents agreed in general terms with the approach suggested by CESR in its first consultation paper. However, some respondents questioned that the use of these techniques were made dependant on the prior adoption of adequate measures to ensure compliance with the requirements of an adequate risk management process, in line with Art. 21(1) of the Directive. They argued that this requirement only applies to financial derivative instruments. Therefore, no reference should in their view be made to Art. 21(1) to justify the requirement of an adequate risk-management process for the use of techniques and instruments. One asset management association reminded that the Commission’s Recommendation on the use of derivatives by UCITS does not expressly provide for a risk management process for the use of techniques and instruments (other than financial derivative instruments) to be put in place.

In addition to those comments, one member of the legal sector asked references in Box 10 not to be used by competent authorities to pass judgement on managers, for example, as to what constitutes “acceptable low levels of risk”. It reminded that it is for the UCITS' manager to determine whether adequate measures are adopted.

CESR’s opinion is that requirement of a risk management process should still apply to the use of these techniques and, in order to remove any possible controversy on the interpretation of the Directive, it derives this obligation from the general requirement foreseen in the UCITS Directive regarding UCITS' operations.

During the second consultation, those previously opposed to any reference to Art. 21, asked CESR to clarify the general provisions from which the requirement of a risk management process stems. CESR has decided not to enter into details for brevity and complexity’s sake, leaving the wording unchanged.

**2 Efficient portfolio management**

Respondents were critical with one of the aims upon which transactions could be entered with a view to manage the portfolio more efficiently: the generation of additional capital or income for the UCITS with an acceptably low level of risk. Many respondents were of the opinion that the use of techniques and instruments should not be restricted to those with a low level of risk. In fact, they argued that no restrictions should be put on the risk level of the techniques and instruments, provided the other provisions of the Directive are fulfilled (including provisions on risk management).

In its second consultation paper, CESR took those remarks into account and modified the wording accordingly, changing “low level of risk” for "appropriate level of risk". This appropriate level of risk should be assessed with regard to the risk profile of the UCITS and general provisions of the UCITS Directive, in particular articles 19, 21 and 22.

Some asset management associations opposed during the second consultation to any reference to those articles be included in the advice on the grounds that it would imply a look through approach that it is not required by the Directive. However, CESR has decided to stick to its original wording as a way to ensure consistency of the advice with the Directive. This has also been done at
Level 3, introducing a reference to the global exposure of the fund regarding the impact of the reuse of collaterals.
I Clarification of definition and list of instruments

1.1 Definition

CESR’s first consultation paper considered, taking into account IAS 39, that a hybrid (combined) instrument including a non-derivative host contract embeds a derivative if:

- some or all of the cash flows that otherwise would be required by the contract can be modified according to a given variable, and therefore vary in a way similar to a stand-alone derivative; and

- the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract.

Some comments coming from asset management associations during the first consultation suggested that, in order to clarify the UCITS Directive, CESR should not align itself with an IAS definition which was developed in a totally different context. CESR, however, considered that in the context of this mandate, IAS 39 should be taken into account, particularly as a basis to develop criteria tailored to the specific objectives of the UCITS Directive.

Some respondents asked CESR to narrow the scope of this definition and suggested an embedded derivative to be an instrument that embeds a derivative materialised by a contract with a third party and which does not benefit from clauses that modify its risk (i.e. active management, credit enhancement and capital guarantee). CESR has rejected this approach on two grounds: (i) it focuses on the legal feature of the embedded derivative and does not take into account the economic profile of the financial instrument; and (ii) it would leave out of the scope of embedded derivatives financial instruments which can have a significant impact on the risk profile of the UCITS, jeopardizing the overall coherence of the UCITS Directive. As a matter of fact, in its second consultation paper CESR introduced a third criteria to help determine when a transferable security or a money market instrument embeds a derivative: when it contains a component which has a significant impact on the risk profile and pricing of the transferable security or money market instrument in question.

During the second consultation two respondents expressed concerns about the wording used to define an embedded derivative. According to them, the advice, as currently drafted, could potentially include closed end funds that themselves invest in derivatives. These respondents suggested that a criterion be added regarding the existence of an “optional content” in the hybrid instrument. In CESR’s view the definition it suggested will not lead to including closed end funds in the scope of embedded derivatives. The requirement set by the first bullet point of the Level 2 advice implies that the component that “modifies” the cash flows of the host contract be precisely defined. This will, as a rule, exclude closed end funds since these are usually managed through a discretionary mandate with very broad predefined rules. Closed end funds that might be included in the scope of embedded derivatives would be very specific products which, though listed as closed end funds, would probably be closer to structured products offering a pay-off linked to predefined market parameters. Given this situation, CESR felt that there was no need to add an additional layer of criterion to the definition it suggests.
Finally, one asset management association suggested that, in accordance with CESR’s adherence to the IAS definition, CESR should modify its advice to recognize that a transferable security or MMI shall not be deemed to embed a derivative where it contains a component that has a different counterparty from that of the instrument. However, in CESR’s view, introducing the component of IAS 39 definition in the definition of embedded derivatives would imply to clarify the IAS definition and that could possibly give rise to diverging interpretations among market participants and regulators. Therefore, the advice was not modified.

1.2 **Principles entailing UCITS when using SFIs embedding derivatives**

In its first draft, CESR stated a number of principles to be respected by UCITS using SFIs embedding derivatives. A significant number of comments were raised on this issue. A majority of respondents expressed a concern that, given the broadness of the scope of embedded derivatives -the advice provided an illustrative and non-exhaustive list- it would imply accordingly high compliance costs because, in these respondent’s view, checking compliance with the various provisions of the Directive would require to compute the individual contribution of all embedded derivatives to the different ratios. Having considered that argument, in its second draft CESR adjusted their impact introducing a statement that made compliance with the mentioned principles dependent on the characteristics of the embedded derivative and on its impact on the risk profile and pricing of the hybrid instrument. If this impact is not significant, controls could be tailored accordingly.

The reduction of the scope of those provisions was welcomed by the asset management sector. However, some associations suggested CESR that if SFI embedding derivatives do not exceed 10% of the NAV of the fund, requirements to split the host contract and the embedded derivative should be waived. One banking federation pointed out that the administrative burden to calculate the embedded dormant risk for over 10% of the investment in the structured financial instruments would be very high for little gain in investor protection. It is CESR’s opinion that the 10% threshold does not guarantee that the embedded derivative will not have a significant impact on the risk profile of the UCITS. Besides, introducing such a waiver would raise a legal issue, since this could be interpreted as introducing new requirements on UCITS.
In its first draft advice, CESR identified a number of factors to be used as guidance as to determine whether a collective investment undertaking was subject to supervision equivalent to that laid down in Community Law. It also identified a set of factors to help determine whether the level of protection of unit holders in other collective undertakings was equivalent to that provided for unit holders in a UCITS.

This question did not raise any major comments through the consultation, either in the first or second consultation. The second draft rearranged some factors on the basis of which requirements relate more to equivalent supervision and which requirements to equivalent protection of unit holders. It was also decided that binding requirements to assess equivalence regarding other collective investment undertakings were in CESR’s view not necessary. Therefore CESR presents these criteria under Level 3 only as indicators of equivalence.
Financial derivative instruments

1 Financial derivative instruments: General considerations

For the purpose of applying Art. 1(2) in conjunction with Art. 19(1)(g), CESR’s first consultation paper determined that underlyings of financial derivative instruments must be eligible assets. CESR’s conclusion rested in Recital 13 of the Directive that read that operations in derivatives may never be used to circumvent the principles and rules set out in the Directive.

Respondents agreed with the advice in general terms but some of them made minor comments with reference to its the wording: in the final advice, the word “assets” was changed to “underlyings” since it was not accurate to state that “financial indices”, or “interest rates” or “foreign exchange rates” were assets in their own right as it is only the instrument that is related to any of the foregoing that constitutes an “asset”.

One comment made by two members of the banking sector for the sake of the development of structured funds was that all cash-settled derivatives should be eligible, regardless of their underlyings. Furthermore, they proceeded, all indices should be regarded as financial indices. According to CESR’s view, the first point is a Level 1 issue which is outside the scope of the mandate. The second point has not been taken into account: the fact that the Directive uses the term “financial indices” implies that non-financial indices do exist.

2 The eligibility of derivative instruments on financial indices

CESR’s first approach to FDI on indices was that they should only be eligible provided the index complies with the requirements set by Art. 22a (1), that is:

- Be sufficiently diversified
- Represent an adequate benchmark for the market to which it refers; and
- Be published in an appropriate manner

In addition to those criteria, CESR announced that it was considering the following options:

- Only financial indices based on eligible assets should be considered as eligible underlyings for derivatives; or that
- The wording of Art. 19(1)(g) does not require UCITS to apply a look through approach when concluding derivatives on financial indices. These financial indices should nevertheless comply with the three criteria set down by Art. 22a.

2.1 Underlying assets

A majority of respondents stressed that all financial indices should be eligible underlyings for derivative instruments, whatever their underlying assets (derivatives on non-eligible assets, non-eligible assets such as commodities or hedge funds). As one asset manager explained the no look through approach is justified by the fact that, to the extent FDI based on indices are necessarily cash settled, investment by a UCITS in such kind of instruments cannot result in the delivery at maturity of non-eligible assets. Another respondent reminded that exposure to non-eligible assets can already be obtained through investment in shares (for instance investment in a company that invests in the commodity sector).
In its second consultation paper, CESR concluded that indices based on financial derivatives on commodities may be eligible provided they comply with the criteria developed. CESR also made a special reference to indices based on hedge funds. CESR recognised that these products presented specific issues and noted that relevant criteria for their construction had not been considered at international level. Therefore, financial derivatives based on indices in hedge funds would not be eligible for the time being.

During the second consultation, both index providers and asset managers supplied CESR with their analysis of the specific issues raised by CESR regarding these types of indices (i.e. survivor bias, selection bias...). Many respondents felt that those foregoing issues did not apply in general to all hedge fund indices, but rather to “non-investable” indices. However, according to this respondent, since at least 2003, major index providers have created “investable indices” that do not warrant the traditional criticism about survivor bias, selection bias, consistency, backfilling and, by definition, investability. One index provider remarked that these “investable indices” have been in existence and used for long enough that the results and experience have been demonstrated to benefit the industry.

CESR welcomed these comments and, as said in the final advice, will consider them by October 2006, after gaining sufficient experience. However, CESR stresses that the consensus reached on the eligibility of financial indices is very fragile and does not wish to jeopardize it by opening the issue of hedge fund indices at this stage.

Regarding other financial indices, the advice also received numerous comments. Some respondents asked that it be clarified whether indices on property could fall within the scope defined by CESR. In CESR's view, the eligibility of these indices should be assessed using the criteria developed in paragraph 1 of Box 14. Regarding the specific case of property indices, CESR notes that it would be highly unlikely that a property index based on private transactions would meet all these criteria. However, this does not rule out the eligibility of other property indices, such as for example property indices based on the share price of companies investing in property. Property indices have therefore been included in the indicative list of paragraph 3.

One asset management association questioned CESR that given FDI on commodity indices were eligible, the same should apply to futures on commodities. To this remark, CESR wishes to remind that that is a Level 1 issue which cannot be dealt with in the advice.

Finally, one respondent asked CESR to clarify that free float and equal weighted indices were eligible but its petition was not attended because the aim of the advice was not to enter in that level of detail.

### 2.2 Criteria for eligibility

CESR's first approach to these criteria was limited to the scope of Art. 22a(1). Yet, CESR’s second draft established that derivative instruments on financial indices should be eligible only if the index complies with the requirements set by Art. 22a. Taking into account the impact of derivatives on financial indices on non-eligible assets, CESR also decided in order to ensure an adequate level of investor protection and to prevent any circumventing of the Directive, to impose upon financial indices certain criteria regarding index management process, transparency and contract design i.e. IOSCOs provisions regarding indices.

Regarding the fulfillment of the diversification ratios introduced by Art. 22a, respondents split into two main groups. A minority of respondents questioned whether indices should be required to comply with them since from a legal point of view, these ratios only applied to direct investments in order to track an index. One asset management association felt that the idea that recognised indices should be subject to the formal limits on issuers—which were made for portfolio management- seems to be no longer up-to-date when taking into consideration the statements of
the Commission’s Green Paper on Investment Funds, according to which it seems that the Commission considers abolishing of formal investment limits with respect to actively managed funds, i.e. in the very area of application of the limits on issuers.

CESR has acknowledged that Art. 22a implies that only indices which comply with the diversification ratios of that article can be tracked by UCITS. Yet, index tracking funds can also be built by combining an investment in risk free assets and an OTC derivative which swaps the performance of these risk free assets with the performance of the index. If this OTC derivative is considered as a financial derivative instrument on a financial index and if no look-through approach is therefore required on the exposure of the investment fund on the individual components of the index, then UCITS tracking financial indices which do not comply with Art. 22a could be managed using that alternative management technique. This would circumvent the provisions of Art. 22a. Therefore, if an index composed by eligible assets would not be at least as diversified as provided for by Art. 22a(2) the assets composing the index have to be combined with the other assets in the fund in accordance with Art. 21(3) and Art. 22.

Some respondents also opposed diversification requirements from a practical viewpoint. According to one ETF provider, it should be possible to issue derivative financial instruments on sector indices, which, as a rule have a specific focus and whose performance components are usually limited. Two asset management associations called for country indices that are recognized as being representative be exempt from the requirements to fulfill the diversification rules defined in Art. 22a. CESR notes that these remarks are a Level 1 issue and, therefore, not within the scope of the mandate.

Finally, some respondents made a few comments about IOSCO’s provisions regarding indices. Three asset management associations asked these provisions be deleted. A number of them made some minor drafting suggestions. Most of them were incorporated to the final advice. For example, five asset management associations called for the liquidity criteria applicable to the component stocks to be redrafted to allow for a few minor components of the index to be illiquid. Some other market participants asked for these provisions to be Level 3 advice. One representative of the asset management sector expressed that IOSCO criteria should be addressed to the index provider and not to the UCITS because the latter has no control on the index construction. However, CESR feels that it is essential that these criteria remain at Level 2 if a harmonized implementation of the Directive is to be ensured. It is also crucial that they stay as Level 2 advice to maintain the consensus reached regarding the eligibility of FDI based on indices whose underlyings are non-eligible financial instruments.

3 OTC derivatives

CESR decided in its first consultation paper to clarify the fair value of financial derivative instruments dealt on OTC markets on the basis of the IAS 39. CESR opted to stick to a previous, standard reference in order to ensure a harmonized implementation of the Directive throughout Europe.

Accordingly, the fair value of an OTC derivative corresponds to the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm’s length transaction. The first advice also read that the valuation of the contracts by the UCITS should be:

1. Made on a daily basis. Regarding this requirement, many respondents emphasized that it was not consistent with the fact that UCITS may calculate their NAV on a less frequent basis. Also, some respondents asked to establish a distinction between the valuation of the OTC derivative for the purpose of calculating the NAV of the UCITS and indicative valuation of OTC derivatives for the purpose of risk management. However, these comments seem to have disregarded the requirement set by the provisions of Art. 19(1)(g)
of the Directive which precisely states that OTC derivatives should be valued on a daily basis. The final advice remains unchanged in this respect.

2. Compared with an estimate provided by an independent third party at least on a monthly basis. Many respondents to the first consultation requested CESR to clarify this requirement. Various suggestions were made:

- Waive this requirement. One asset management association felt that this requirement should be deleted as it represents an unnecessary cost for the UCITS. However, in CESR’s view, a UCITS should have an adequate organization to ensure the reliability of the valuation of OTC derivatives and that would always imply that the valuation of the OTC be reviewed by someone independent from the UCITS operator.

- Authorize cross-valuation by independent entities or departments within the asset management company. CESR took this remark into consideration and modified its advice accordingly. However, if the review of valuation by a department independent from the UCITS operator is not sufficient to ensure a reliable valuation of OTC derivatives, then the foregoing review should be conducted by an independent third party.

- Restrict this requirement to OTC derivatives whose valuation is delicate. According to a few asset management associations, this requirement should constitute only a best practice recommendation for the UCITS management, the need to require an independent valuation to be analysed on a case-by-case basis depending on the complexity of the instrument and its weight in the UCITS portfolio. Taking that remark into consideration, CESR introduced some flexibility in the advice allowing for the possibility to adapt the scope of the means involved in the UCITS organization by taking into account the degree of complexity of the financial product.

Regarding the adequate risk-management process for OTC derivatives, the first consultation paper noted that UCITS should have the organization and the means to allow for a risk analysis realised by a department independent from commercial and operational units, and submitted to the supervisory bodies of the UCITS in order to set risk limits at least on a semestrial basis. Many respondents to the first consultation indicated that this time reference goes beyond the requirements of the UCITS Directive that the UCITS inform the competent authorities of its risk-management processes. Taking this comment into consideration, CESR’s has replaced it by a reminder stating that the organization of the UCITS implies that risk limits to be defined.

Comments to CESR’s second consultation paper revealed general acceptance to CESR’s approach. Some representatives of the banking sector nonetheless expressed that the industry calculates that the substantial costs of putting in places systems for the accurate and independent assessment and reliable and verifiable valuation of OTC derivatives would not be offset by the limited potential added value to risk management. Moreover, CESR’s requirements would de facto disincentive the industry from using derivatives to manage portfolios. CESR notes that no justification has been given for this statement and that the requirements enclosed in the advice are already in force in some Member States where no elements seem to indicate that their cost/benefit analysis is problematic.

Finally, three asset management associations made comments about the pricing model on which fair value of the OTC derivative should be based in the event no reliable up-to-date market value were available. According to CESR’s view, this pricing model should have been agreed between the UCITS and the depositary. However, respondents pointed out that there was no requirement in the Directive that the pricing model be agreed upon with the depositary. These respondents felt that it is sufficient for the depositary to agree to the valuation process, which would include the type of
methodology utilised for valuation of OTC derivatives. CESR’s final advice has taken that remark into account.

4 Credit derivatives

The UCITS Directive does not explicitly exclude credit risk as a potential underlying to a derivative. Therefore, in principle, credit derivatives were eligible assets for a UCITS provided they complied with the conditions of eligibility of derivative instruments and coherence with the requirements set for OTC derivatives was met. However, these kinds of instruments posed a specific issue; the usual asymmetry of information between buyer and seller of a financial institution was exacerbated here by the leverage generally associated with credit derivatives.

CESR pondered whether the eligibility of this kind of financial derivatives should be made dependent on any requirement on the issuer’s part (i.e. the issuer on which the credit risk lies) to be subject to a regulation requiring it to provide public information on their financial statements.

One general remark during the first consultation was that it would be very difficult for UCITS to take relevant measures to deal with the issue of the asymmetry of information on any given financial product. A significant number of asset management associations stated that the risk of asymmetry of information is not specific to credit derivatives and accordingly a specific treatment of credit derivatives is not relevant. A few respondents expressed that the risk of asymmetry of information should be regarded as one of the risks associated with credit derivatives and should be taken into account and limited through an adequate risk management process by the UCITS.

Among those respondents that acknowledged the existence of a specific risk of asymmetry of information with credit derivatives, three asset management associations considered proposals on issuer’s transparency to be unrealistic, taking into account the scarcity of third party information required to produce meaningful data for risk asymmetry measurement. Other comments emphasised that restricting issuers on which a UCITS may conclude a credit derivative would not deal with the issue of asymmetry of information.

One large asset management association, on the contrary, felt that limiting the nature of the issuers could be a possibility to deal with the risk of asymmetry of information but it should be left to the UCITS to decide how to deal with this issue and to establish adequate measures within its risk management process.

CESR considered the comments and eventually recommends not to make the eligibility of these instruments dependent on any duty of transparency by the issuer i.e. regulation requiring them to provide public information on their financial statements. However, CESR is of the opinion that the risk-management process of the UCITS with respect to credit derivatives has to take into account the risks of asymmetry of information.

CESR’s second draft advice did not raise many comments, indicating that respondents overall agreed with the drafting suggested. Two respondents welcomed the clarification that it is sufficient for a UCITS to take into account the risks of asymmetry of information rather than imposing a standard which might require them to “limit” such risks. However, they questioned whether this proposal is realistic especially with regard to the defining the standard by which UCITS will be held accountable. To this regard, CESR feels that the final advice strikes an adequate balance between the necessity to point out this specific risk in this kind of instrument and the risk of setting requirements at a level that UCITS cannot meet.
Index replicating UCITS

I. **UCITS replicating the composition of a certain index**

According to CESR’s view and within the context of the mandate received i.e. index replicating UCITS investing primarily in shares and/or debt securities, and using the more flexible spreading rules allowed by Art. 22a of the UCITS Directive, 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. In CESR’s view, managers may improve the quality of index replication through:

- Use of derivatives
- Use of other techniques and instruments
- Direct or indirect investment in the components of the index. This allows for UCITS using ETF to replicate and index. During the first consultation, this option had not been considered but one large asset management association’s comment brought CESR’s attention to this issue.

However, two issues remained unclear: whether CESR advice should require UCITS to provide an estimate of the quality of the index replication and what estimate would be appropriate.

Regarding the first question, industry associations tended to be in favour of a flexible approach i.e. UCITS would be left free to provide such an estimate or not. However, some other market participants were in favour of a more prescriptive approach and noted that standardized methods are necessary for the sake of comparability between index tracking funds. Finally, some comments questioned altogether the reason why UCITS should be required to provide an estimate of the quality of the replication.

To those who thought that UCITS should provide an estimate of the quality of the index replication, CESR’s first consultation paper presented two options for respondents to comment upon:

- One formula based on the performance error during weeks between the UCITS and its reference index, based on the evolutions of the UCITS net asset value and the index value.
- Another based on the difference between the weighting of equity in the index and the applicable weighting of the equity in the equity portion of the fund.

During the first consultation, no majority opinions were raised regarding the choice between option A and B presented, but some respondents pointed out that option B was relevant only for index tracker funds that did not use derivatives. CESR decided to call for professional associations to achieve standardization in this field.

Very few issues were raised during the second consultation regarding Box 17, thus indicating that respondents globally agreed with its drafting. One big asset manager who has many index funds under management expressed its disappointment that CESR had felt unable to comment on the quality of replication. This comment was in line with those in favor of such a measure made during the first consultation by other asset managers. CESR reiterates its view that it would be best if this matter was dealt with by professional associations. However, CESR is willing to monitor this issue and to consider issuing Level 3 regulation if no significant steps towards standardization are achieved within a reasonable timeframe.
Index characteristics

CESR’s first consultation paper has remained unchanged throughout the drafting process and participation on this issue has been rather limited. CESR’s approach to the conditions an index had to meet to assess whether it can be eligible for replication by an index replicating UCITS relies on the same aspects that were analysed in Box 14 (derivatives on indices). That is, the index must meet the three conditions set by Art. 22a(1) of the Directive:

- Be sufficiently diversified
- Represent an adequate benchmark for the market to which it refers
- Be published in an appropriate manner

2.2 Diversification

According to CESR, a minimum condition for estimating that an index is sufficiently diversified is that it respects the risk diversification rules set by the Art. 22a of the Directive. However, some respondents to the first consultation encouraged CESR to allow some exemptions to the dispersion rules for sector indices stemmed from a large index.

Also, a large asset management association asked CESR to remove form the advice the requirement that UCITS should inform subscribers in their simplified prospectus if they avail of the 20-35% ratios. However, this comment disregards the fact that this requirement stems from Art. 24a(2) of the UCITS Directive and is, therefore a Level 1 issue.

2.3 Adequate benchmark

In CESR’s view, an index will represent an adequate benchmark for the market to which it refers only if, as a general rule, the methodology employed by index providers to construct the index does not result in the exclusion of a major issuer of the market to which the index refers. This wording raised two different types of concerns during the consultations:

- On the one hand, some respondents suggested CESR to delete this requirement since it would be difficult to meet in the case of style indices constructed to meet specific rules. CESR decided to leave its advice unchanged but reminded that most problems encountered with indices were addressed by the IOSCO document “Indexation: securities indices and derivatives” (Feb 2003) also earmarked as a text for Level 2 reference in Box 14.

- On the other hand, because the wording refers to the “not exclusion” of a major issuer, one industry association felt that indices that use negative screening i.e. indices that identify, rule out and exclude companies that violate the index’s ”values”, could not be eligible for replication by a UCITS. This is the case of sustainable indices. However CESR feels that the wording of the advice already allows for such a possibility since it indicates that the methodology used should “generally” not result in the exclusion of a major issuer.

2.4 Appropriate publication

To be an index published in an appropriate manner CESR understands that the provider must be independent from the index replicating UCITS in question. Independence does not preclude however, forming part of the same economic group. In spite of that, this requirement was opposed by one large asset management association because in its view, criteria set by Art. 22a were already sufficient. In CESR’s view, the fact that the issue was not raised by other respondents means that markets participants are apparently satisfied with this requirement.
1. On 28th October 2004 the European Commission published “The Formal Mandate to CESR for Advice on Possible Modifications to the UCTIS Directive in the Form of Clarification of Definitions concerning Eligible Assets for Investments of UCITS”. The Commission requested CESR to submit its advice on this mandate by the end of October 2005. When CESR published its first consultation paper on its draft technical advice (CESR/05-064b) on 18th March 2005 many consultation respondents asked for the possibility of a second consultation, taking into account the difficult nature of this exercise and the interests involved. In response to this feedback, CESR requested an extension of the mandate from the Commission, of its original deadline of end of October 2005 to mid-January 2006. The Commission confirmed its consent to the prolongation of the deadline of the mandate. CESR published a second consultation paper (Ref. CESR/05-490b) on 28th October 2005.

2. CESR’s technical advice has been prepared by the Expert Group on Investment Management. The Group is chaired by Mr Lamberto Cardia, Chairman of the Italian securities regulator, the Commissione Nazionale per le Società e la Borsa (CONSOB). Two members of the CESR Secretariat, Mr. Jarkko Syyrilä and Mr. Enrique Velázquez assist the Chairman, the former acting as Rapporteur of the Expert Group. The Group set up two working sub-groups on this issue, coordinated by Mme Pauline Leclerc-Glorieux from the AMF and Mr. Dan Waters from the FSA. The Expert Group is assisted by the Consultative Working Group on Investment Management composed of 16 market practitioners and consumers’ representatives.

3. CESR published a Call for Evidence for this mandate on 28 October 2004 (Ref.: CESR/04-579) seeking input on the respective key issues which it should consider in dealing with the mandates. The deadline for responses was 28 November 2004 and CESR received 15 submissions.

4. On 18 March 2005 CESR published its first consultation paper (CESR/05-064b). The public consultation closed on 10 June and more than 50 responses were received. The second public consultation was published on 20 October (CESR/05-490b). Deadline for submission of responses was 21 November. CESR received almost 50 responses.

**Public hearings**

5. Two public hearings on the Clarification of Definitions concerning Eligible Assets for Investments of UCITS took place at CESR’s premises in Paris. The first was held on 9 May and the second on 7 November 2005. More than 100 participants attended in total.
CESR work plan on the clarification of definitions of the UCITS Directive
ANNEX 2
LIST OF MEMBERS OF THE CONSULTIVE WORKING GROUP

Mr Martin Burda, Member of the Board and Chief Investment Officer of Investicni spolecnost Ceske sporitelny, a.s.
Mr François Delooz, Global Head of Risk Management, Compliance and Legal of BNP Paribas Asset Management
Dr Stefan Duchateau, Chairman of the Board of KBC Asset Management
Mr Göran Espelund, President of Lannebo Fonder AB
Mr James Firn, General Counsel - Europe, Middle East and Africa of Russell Investment Group
Mr Rafik Fischer, Chief Operations Officer of Kredietbank S.A. Luxembourgeoise
Mr Felix López Gamboa, Chairman of BBVA Gestión
Dr Wolfgang Mansfeld, Member of the Board of Union Asset Management Holding AG
Mr Marco Mazzucchelli, Head of European Investment Banking, Credit Suisse First Boston Ltd.
Mr Zoltán Nagy, Managing Director of IE Investment Fund Management Co. Ltd
Mr William Nott, Chief Executive Officer of M&G International Investments Ltd
Mr Vesa Puttonen, Professor in Finance at Helsinki School of Economics
Mr Peter Reisenhofer, Board Member of C-Quadrat Investment AG
Mr E. Willem van Someren Grève, Senior Executive Vice President of Robeco Asset Management
Ms Ana Rita Viana, Deputy Manager of AF Investimento – Fundos Mobiliários, SA
Mr Jean-Pierre Paelinck, Secretary General of Euroshareholders
### ANNEX 3. LIST OF RESPONDENTS TO VARIOUS CONSULTATIONS

#### 3.1 Respondents to the call of evidence of the mandate (Ref.: CESR/04-579)

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#### 3.2 Respondents to the first consultation paper (Ref.: CESR/05-064b)

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### 3.3 Respondents to the second consultation paper (REF.: CESR/05-490b)

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<td>Issuers</td>
<td>ETF Securities Limited</td>
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<tr>
<td>Issuers</td>
<td>Gold Bullion Holdings Limited</td>
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<tr>
<td>Legal &amp; Accountancy</td>
<td>A &amp; L Goodbody</td>
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<tr>
<td>Regulated markets, exchanges &amp; trading systems</td>
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