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JAC Response to EC Consultation Document – UCITS Product Rules, Liquidity Management, Depositary, Money Market Funds, Long-Term Investments

This letter is a response to the European Commission's consultation document published on 26 July 2012 on UCITS Product Rules, Liquidity Management, Depositary, Money Market Funds, Long-term Investments (the **Consultation Document**).

The Joint Associations Committee on Retail Structured Products (the **JAC**)[1] welcomes the opportunity for a public discussion of the matters raised in the Consultation Document.

The members of the JAC comprise most of the major firms (both financial institutions and law firms) involved in the creation within the EU of structured products that are distributed to retail investors. Many also deal with UCITS – both exchange-traded and traditional.

While the wider consultation focuses on eight specific topics, the specific focus of the JAC is on the first three topics, namely:

1. Eligible assets and use of derivatives

2. Efficient portfolio management techniques

3. Over the Counter (OTC) Derivatives

This response therefore covers only the above aspects of the Consultation Document.

Yours sincerely,

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Chairman, Joint Associations Committee

[1] The JAC is sponsored by multiple associations with an interest in structured products. In the first instance, queries may be addressed to ajacobs@isda.org.

RESPONSES TO SPECIFIC QUESTIONS

Eligible Assets

1) **Do you consider there is a need to review the scope of assets and exposures that are deemed eligible for a UCITS fund?**

The JAC considers that UCITS provides a balanced and considered approach to eligible assets. The introduction to this question in the Consultation Document seems to mix elements of eligibility of assets with actual risk management/diversification issues. Although not mutually exclusive, concerns relating to one (risk management/diversification) should perhaps be dealt with separately from the Eligible Assets regime.

There is, however, a need to review the scope of the assets and exposures that are deemed eligible for UCITS. Not necessarily to impose limits or change the eligibility of assets under the current regime, but to ensure that adequate controls in relation to exposure and consequently risk are indentified and dealt with, and uniformity is imposed on the approval of such products and monitoring of risk.

The current Eligible Assets regime is appropriate for UCITS, but due to its complexity specifically in the area of risk management, use of derivatives (including embedded derivatives) and leverage, would benefit from some clarification.

For example, the JAC considers that the existing rules on embedded derivatives are complicated, ambiguous and consequently interpreted differently by national regulators and market participants.

Commission Directive 2007/16/EC (**Eligible Assets Directive**) provides that a transferable security will embed a derivative if it contains a component which fulfils the following criteria:

(a) *by virtue of that component some or all of the cash flows that otherwise would be required by the transferable security which functions as host contract can be modified according to a specified interest rate, financial instrument price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, and therefore vary in a way similar to a stand-alone derivative;*
(b) *its economic characteristics and risks are not closely related to the economic characteristics and risks of the host contract;*
(c) *it has a significant impact on the risk profile and pricing of the transferable security.*

The JAC would welcome clarity as to whether a particular product embeds a derivative and/or leverage and how this affects global and counterparty exposure. Such clarity and uniformity of approach by national regulators would strengthen the UCITS brand.

2) **Do you consider that all investment strategies current observed in the marketplace are in line with what investors expect of a product regulated by UCITS?**

Investors do not currently associate the UCITS brand with specific investment strategies. Rather, the UCITS framework is perceived to provide a standardised investor protection framework at the product level, including requirements as to liquidity, information and reporting, governance and risk diversification.

It is important to distinguish between the expectations of different types of investor. A significant proportion of investors in UCITS, for example, insurance companies, pensions schemes and other institutional investors (many of which have a mandated minimum exposure to UCITS) well understand the extent of product-level regulation under UCITS and the range of strategies available. On the other hand, there are individual retail investors who may not have any expectations as to the strategies available under a product regulated by UCITS but may assume that the UCITS wrapper offers a sufficient level of investor protection. For investors in this latter category, there is perhaps a question as to whether the product-level regulation under UCITS delivers such protection. In this regard, the JAC notes that UCITS have stood up well in the face of the financial crisis.

A separate question is whether all investment strategies currently observed in the marketplace are suitable for pure retail investors. In this regard, there may be some particularly sophisticated UCITS in the market which were not launched with the basic retail investor in mind. While in practice, a number of these more ‘structured UCITS’ are only marketed to sophisticated investors, there is an argument that, where an underlying strategy is possibly deemed by the investment manager / distributor of the UCITS too complex for unsophisticated investors, it should most likely not be promoted to them in line with the MiFID requirements on suitability and appropriateness.

The UCITS wrapper should nevertheless continue to be available to structured UCITS on the basis that the high level of product-level regulation and the risk controlled environment that this implies is of benefit to all investors, including those who are sophisticated (eg insurers and pension schemes acting on advice). Excluding more complex strategies from the UCITS brand entirely may result in investors seeking equivalent exposures through alternative investment funds (AIFs), where there is very little product-level regulation. It is preferable to keep what is currently within the scope of UCITS ‘in scope’ rather than pushing certain strategies into AIFs or an otherwise less well-regulated environment.

It should be noted that a sophisticated investment strategy does not necessarily increase investment risk and will often be less risky than a more simple strategy (eg investing in emerging market debt). Provided that the UCITS complies with the requirements of the rules, and the risk disclosures are adequate, the JAC considers that a particular strategy should not be ineligible simply because it is complex. The JAC notes that investors invest with a manager to benefit from that manager’s expertise and fiduciary obligations. The investor does not have to understand the economics and risks of every trade. What the investor is primarily concerned with is the intended outcome of the strategy and that it has a clear understanding of the risks in seeking to bring about such an outcome and the potential for alternative (less favourable) outcomes.

3) **Do you consider there is a need to further develop rules on the liquidity of eligible assets? What kind of rules could be envisaged? Please evaluate possible consequences for all stakeholders involved.**

The overarching aim of UCITS rules on liquidity must be to ensure that the UCITS is able to redeem units at the request of a unitholder. This portfolio level liquidity is more important than the liquidity of any particular asset. It is noted that UCITS managers are required to have an appropriate liquidity risk management process forming part of their overall risk management policy.

The JAC considers that the current rules on the liquidity of eligible assets are satisfactory and that their effectiveness has been demonstrated during the financial crisis.

Any development of the rules on the liquidity of eligible assets should not require managers to liquidate assets currently held as this would not be in the interests of investors.

4) **What is the current market practice regarding the exposure to non-eligible assets? What is the estimated percentage of UCITS exposed to non- eligible assets and what is the average proportion of these assets in such a UCITS' portfolio? Please describe the strategies used to gain exposure to non-eligible assets and the non-eligible assets involved. If you are an asset manager, please provide also information specific to your business.**

UCITS gain exposure to non-eligible assets by investing either directly (to the extent permitted by relevant local law implementation of Article 52(2) of the UCITS Directive) or indirectly by investment or exposure through permitted derivatives to: (i) closed-end funds; (ii) transferable securities backed by or linked to the performance of other assets, which may differ from those in which a UCITS can invest; and (iii) financial indices.

5) **Do you consider there is a need to further refine rules on exposure to non- eligible assets? What would be the consequences of the following measures for all stakeholders involved:**

- **Preventing exposure to certain non-eligible assets (e.g. by adopting a "look through" approach for transferable securities, investments in financial indices, or closed ended funds).**

- **Defining specific exposure limits and risk spreading rules (e.g. diversification) at the level of the underlying assets.**

The ability of UCITS to gain indirect exposure to otherwise non-eligible assets is seen by members of the JAC as being of significant benefit to investors as it enables UCITS to use this component to hold assets which might complement strategies or hedge risks in a portfolio and which might otherwise be unavailable for investment.

Preventing exposure to such non-eligible assets by imposing a “look through” would remove a significant investment tool and deprive the UCITS framework of this helpful degree of flexibility. For example, exposure to commodities through indices is motivated by the operational complexity, higher cost and liquidity constraint of the physical commodities market. A “look through” approach is legitimate in terms of diversification, but since the other limitations applicable to physical holding are not present in indirect exposure, the rationale for such prohibition is unclear.

The risks inherent in holding such instruments should be addressed by applying well understood criteria to the instrument itself and by ensuring that the risks of the underlying exposure are adequately captured in the risk management process of the UCITS. This combination is already enshrined in Article 2 of the Eligible Assets Directive. The JAC considers that the current failing is in the lack of consistency and rigour with which these provisions are interpreted and enforced across Member States.

With regard to financial indices, the JAC’s view is that the existing requirements as to diversification are sufficient (as detailed in ESMA’s Guidelines on UCITS ETFs and other issues dated 25 July 2012 – ESMA/2012/474 (**ESMA Guidelines**)).

6) **Do you see merit in distinguishing or limiting the scope of eligible derivatives based on the payoff of the derivative (e.g. plain vanilla vs. exotic derivatives)? If yes, what would be the consequences of introducing such a distinction? Do you see a need for other distinctions?**

The JAC does not see any merit in distinguishing or limiting the scope of eligible derivatives based on the payoff of the derivative.

The terms ‘plain vanilla’ and ‘exotic’ for example, are unlikely to be meaningful to the large majority of investors and in practice there is likely to be considerable room for interpretation as to whether a particular instrument is one or the other.

In terms of limiting the scope of the derivative based on the payoff, it should be noted that a ‘plain vanilla’ derivative may be a far less effective tool for mitigating risk or obtaining the desired exposure than a more complex ‘exotic’ derivative. The JAC is firmly against any such limitation.

The complexity of the products in which a UCITS invests should not be confused with the complexity of the UCITS itself or of its overall investment policy. Intra-day trades of equities by a manager following a purely active strategy are arguably more complex to understand for the investor than the maturity pay-off formula of an option. While the former strategy only requires plain vanilla equity or listed futures investment, the latter may require exotic options. Complex derivatives do not of themselves necessarily give rise to additional market risk for the investor when compared with plain vanilla derivatives or investments. For example, complex derivatives are commonly used by UCITS to provide forms of capital protection to investors.

Where complex instruments are held by the UCITS, there is an even greater requirement for clear and intelligible language to be used in marketing documents. This distributor/investor relationship is currently addressed through the Key Investor Information Document (UCITS IV and PRIPS initiative) and further developed by the MiFID 2 proposals.

The UCITS manager is an investment professional selected by investors to exercise its investment skill and expertise subject to its fiduciary obligations. The manager should be able to invest in more complex derivatives where it considers this to be in the best interests of investors and in compliance with the investment objective and restrictions of the UCITS.

7) **Do you consider that market risk is a consistent indicator of global exposure relating to derivative instruments? Which type of strategy employs VaR as a measure for global exposure? What is the proportion of funds using VaR to measure global exposure? What would be the consequence for different stakeholders of using only leverage (commitment method) as a measure of global exposure? If you are an asset manager, please provide also information specific to your business.**

VaR is a helpful means of showing how exposed a portfolio is, particularly in circumstances where the commitment method does not adequately capture the market risk of a portfolio. It is a methodology used throughout the financial services industry as an effective measure of exposure (eg prudential regulations).

The commitment approach is a blunt tool for UCITS employing a sophisticated (which should not be taken as meaning risky) derivatives strategy. It does not, for example, capture non-directional risks such as volatility risk, gamma risk or basis risk. VaR offers the ability to monitor these risks. UCITS which make use of certain options strategies and market neutral strategies are examples of investment strategies where the commitment approach might be inadequate.

Removing VaR as a measure of global exposure would have a significant impact on the industry and would make unviable a number of strategies which have produced good returns for investors with an acceptable degree of risk.

Both VaR and the commitment approach could benefit from further refinement. VaR could be refined to reflect the risks of different portfolios, while the commitment approach might allow for the netting of risks.

8) **Do you consider that the use of derivatives should be limited to instruments that are traded or would be required to be traded on multilateral platforms in accordance with the legislative proposal on MiFIR? What would be the consequences for different stakeholders of introducing such an obligation?**

The JAC does not consider that the use of derivatives should be limited to instruments that are traded or would be traded on multilateral platforms.

It is submitted that the protections for end-users under EMIR, both in respect of cleared and uncleared trades, should be sufficient for UCITS without further restrictions. UCITS are financial counterparties under EMIR, and therefore subject to central clearing obligations for instruments subject to mandatory clearing and to risk mitigation techniques for all other OTC derivatives. Consequently, counterparty risk is addressed by EMIR for both cleared and uncleared transactions. There is no need for the UCITS Directive to provide additional protections or limitations in this regard.

The introduction of any such obligation would be a significant limitation on the ability of UCITS to trade derivatives and as a result detrimental to investors.

The size of the OTC market traded on multilateral platforms is currently small. It is conceivable that certain types of derivatives will never be sufficiently standardised to be traded in this way. A requirement for instruments to be traded on a multilateral platform would significantly limit the types of derivative in which a UCITS can invest, depriving investors of possible investment returns or risk mitigation tools that would otherwise be available.

If such an obligation is introduced, there will almost certainly be an increase in the number of non-UCITS funds established in individual Member States where the restriction will not apply. Narrowing the UCITS brand by limiting choice in this way will likely result in investors looking to the less well-regulated environment outside of UCITS for their desired investment exposure.

Given the marked developments in the protection of derivatives counterparties (including UCITS) under EMIR, it is hard to see what the benefit would be of introducing such an obligation.

Provided that OTC derivatives which are subject to the mandatory clearing obligation are cleared (and traded on multilateral platforms where required under MiFID), and uncleared trades are subject to the risk mitigation tools provided under EMIR, there is not a good argument for further restrictions for UCITS.

Efficient Portfolio Management ("EPM")

1) **Please describe the type of transaction and instruments that are currently considered as EPM techniques. Please describe the type of transactions and instruments that, in your view, should be considered as EPM techniques.**

The following are considered to be EPM techniques under the ESMA Guidelines:

- Repos and reverse repos
- Securities lending agreements
- Reinvestment of cash collateral

The JAC consider that these are the types of transactions and instruments that should be considered EPM techniques.

2) **Do you consider there is a specific need to further address issues or risks related to the use of EPM techniques? If yes, please describe the issues you consider merit attention and the appropriate way of addressing such issues.**

The JAC does not consider that there is a need to further address issues or risks related to the use of EPM techniques. These have been adequately covered by the ESMA Guidelines.

3) **What is the current market practice regarding the use of EPM techniques: counterparties involved, volumes, liquidity constraints, revenues and revenue sharing arrangements?**

Members of the JAC have responded that these techniques are currently used only to a limited extent by UCITS. However, it is likely that once the collateral obligations under EMIR apply, some UCITS will be required to use EPM techniques to ensure that they have cash or the right type of securities for posting to clearing members. At this point, we expect to see a marked increase in the use of EPM techniques.

4) **Please describe the type of policies generally in place for the use of EPM techniques. Are any limits applied to the amount of portfolio assets that may, at any given point in time, be the object of EPM techniques? Do you see any merit in prescribing limits to the amount of fund assets that may be subject to EPM? If yes, what would be the appropriate limit and what consequences would such limits have on all the stakeholders affected by such limits? If you are an asset manager, please provide also information specific to your business.**

Repos are in essence a form of secured loan and are principally used to generate cash. Reverse repos are precisely the same transaction viewed from the perspective of the buyer. Given the nature of such arrangements, the JAC does not consider that there would be merit in prescribing limits to the amount of a UCITS' assets that may be subject to EPM. Any such limit would place UCITS at a competitive disadvantage over other funds (including other authorised funds), with limited benefit. The counterparty exposure requirements applicable to UCITS takes into account exposures under EPM and this should be sufficient.

5) **What is the current market practice regarding the collateral received in EPM? More specifically:**

- **are EPM transactions as a rule fully collateralized? Are EPM and collateral positions marked-to-market on a daily basis? How often are margin calls made and what are the usual minimum thresholds?**

- **does the collateral include assets that would be considered as non- eligible under the UCITS Directive? Does the collateral include assets that are not included in a UCITS fund's investment policy? If so, to what extent?**

- **to what extent do UCITS engage in collateral swap (collateral upgrade/downgrade) trades on a fix-term basis?**

EPM transactions are generally fully collateralised (subject to any threshold) and typically include a haircut to ensure that the collateral has a market value greater than the value of cash delivered. Positions and collateral are marked-to-market daily. Thresholds levels vary and are often set at zero. Where there is a threshold, this is to avoid the need to transfer a "nuisance" amount of collateral.

The collateral received must comply with the ESMA Guidelines. There is no requirement for the collateral to match the UCITS' investment policy.

Collateral should not be required to conform with a UCITS' investment policy. It has a separate and distinct purpose - the mitigation of counterparty risk. Collateral by definition is something to the side of the principal investment: it is not intended to produce an investment return in itself.

In an enforcement scenario, the UCITS would be able to sell the collateral and invest the proceeds in assets which reflect the UCITS' investment policy.

Requiring collateral to reflect the investment policy of the UCITS would potentially result in worse quality assets being provided – an emerging market small cap fund may not be able to receive as collateral government bonds of first credit rating.

6) **Do you think that there is a need to define criteria on the eligibility, liquidity, diversification and re-use of received collateral? If yes, what should such criteria be?**

The JAC does not consider that there is a need to define further criteria on the eligibility, liquidity, diversification and re-use of collateral. These are already covered in the ESMA Guidelines (in respect of which please see comment below).

Collateral received in the context of EPM is required to comply with the criteria for collateral received in the case of OTC derivatives set out in paragraph 40 of Annex III to the ESMA Guidelines.

Collateral received by UCITS is required to be sufficiently diversified to ensure that at any time the portfolio comprised of collateral and the assets not subject to EPM techniques comply with the UCITS diversification rules.

The ESMA Guidelines provide that non-cash collateral received should not be sold, re-invested or pledged and that cash collateral should only be (broadly): (i) placed on deposit; (ii) invested in high quality government bonds; (iii) used for the purpose of reverse repo; and (iv) invested in short-term money market funds, and subject to the diversification rules for non-cash collateral.

The JAC disagrees with the restriction in the ESMA Guidelines that non-cash collateral should not be pledged. Where EPM techniques are used for collateral management purposes in order, for example, to facilitate central clearing (or risk mitigation in respect of non-cleared trades), UCITS should be entitled to use the relevant collateral for that purpose by pledging or otherwise transferring such collateral for margin purposes.

In terms of collateral diversification, the JAC notes that under the ESMA Guidelines, collateral for EPM and OTC derivatives must be sufficiently diversified in terms of country, market and issuers. This requirement is considered by ESMA to be satisfied with respect to issuer concentration where the UCITS receives from a counterparty for EPM and OTC trades a basket of collateral with a maximum exposure to a given issuer of 20% of its net asset value. Where the UCITS is exposed to different counterparties, the different baskets of collateral are aggregated to calculate the 20% limit.

There are two points in respect of the diversification requirements. Firstly, it is submitted that the 20% limit should not apply in respect of government bonds of the same government issuer. On the basis that a UCITS is entitled to invest 100% of its assets in such bonds, it is inconsistent to impose such a limit on such assets when used as collateral. Secondly, the 20% limit per issuer, which applies to both OTC derivatives and EPM techniques and is aggregated where there is more than one counterparty, is difficult for UCITS to monitor or control and does not reflect the realities of the market.

The ESMA Guidelines would require UCITS to have the right to call counterparties for a particular composition of collateral and to be able to require each counterparty to substitute collateral where the 20% limit is breached.

The JAC is concerned that these guidelines will be very difficult to meet in practice. Putting in place an arrangement under which the UCITS has a right to determine the composition of collateral and a right as collateral taker to require substitution will be expensive to implement and, in the event that counterparties are prepared to agree to such arrangements, is likely to adversely affect both OTC and EPM transaction pricing for UCITS - which would ultimately be detrimental to investors.

7) **What is the market practice regarding haircuts on received collateral? Do you see any merit in prescribing mandatory haircuts on received collateral by a UCITS in EPM? If you are an asset manager, please provide also information specific to your business.**

The JAC does not see any merit in prescribing mandatory haircuts on collateral received. Haircuts reflect the perceived volatility of the relevant asset being used as collateral and it is submitted that views on this are likely to vary over time. A set of mandatory haircuts are likely to become out-of-date as perceptions change and markets move. Flexibility is therefore required and it should be for the UCITS manager to determine the appropriate level of haircut. The appropriate level of haircut should be determined by the UCITS manager in accordance with the risk management process of the UCITS.

8) **Do you see a need to apply liquidity considerations when deciding the term or duration of EPM transactions? What would the consequences be for the fund if the EPM transactions were not "recallable" at any time? What would be the consequences of making all EPM transactions "recallable" at any time?**

The JAC does not consider that there should be a requirement for EPM trades to be 'recallable' on demand. It should be sufficient that the UCITS is able to meet redemptions at any time.

A requirement for UCITS to be able to terminate an EPM trade on demand will result in counterparties requiring a reciprocal right. This would weaken UCITS' funding and investment arrangements which will be problematic generally and particularly where the EPM technique is being used to facilitate margin requirements for clearing. It is also likely to mean that UCITS are given unfavourable terms compared with other end-users (including other authorised funds) not subject to such restrictions. The increased cost of such an arrangement would undermine the purpose of EPM and may make such transactions unviable. This would be detrimental to investors.

9) **Do think that EPM transactions should be treated according to their economic substance for the purpose of assessment of risks arising from such transactions?**

Yes - the JAC agrees with a substance over form approach when considering such risks.

10) **What is the current market practice regarding collateral provided by UCITS through EPM transactions? More specifically, is the EPM counterparty allowed to re-use the assets provided by a UCITS as collateral? If so, to what extent?**

Where collateral is provided by UCITS, this is by way of absolute title transfer. The counterparty is therefore entitled to re-use the assets for its own business subject to an obligation to return equivalent assets in accordance with the terms of the contract. Imposing a restriction on the counterparty's ability to re-use the assets would be a radical departure from market practice which may result in UCITS being excluded from such markets.

11) **Do you think that there is a need to define criteria regarding the collateral provided by a UCITS? If yes, what would be such criteria?**

The JAC does not consider that there is a need to define criteria regarding the collateral provided by UCITS. It is not clear what benefit this would achieve.

12) **What is the market practice in terms of information provided to investors as regards EPM? Do you think that there should be greater transparency related to the risks inherent in EPM techniques, collateral received in the context of such techniques or earnings achieved thereby as well as their distribution?**

The ESMA Guidelines impose a number of disclosure requirements on UCITS using EPM techniques. The JAC considers these to be sufficient.

OTC Derivatives

1) **When assessing counterparty risk, do you see merit in clarifying the treatment of OTC derivatives cleared through central counterparties? If so, what would be the appropriate approach?**

Yes - the JAC sees merit in clarifying the treatment of OTC derivatives cleared through central counterparties (CCPs).

UCITS should not face any limits in respect of exposure, direct or indirect, to a CCP. The requirements of EMIR in respect of CCPs should provide adequate protection to UCITS and other investors. Requiring a UCITS to diversify between CCPs would reduce netting benefits and may increase costs.

The counterparty risk limit (5/10%) should be disapplied, or at least significantly increased, for transactions cleared through CCPs.

2) **For OTC derivatives not cleared through central counterparties, do you think that collateral requirements should be consistent between the requirements for OTC and EPM transactions?**

The JAC does not consider that the collateral requirements should be consistent between the requirements for OTC derivatives and EPM transactions other than in the most general sense (eg sufficiently liquid and capable of being enforced by the UCITS at any time). The purpose, duration, terms, and market practices applicable to different types of EPM techniques and OTC trades are sufficiently varied that conformity will be difficult to achieve. As mentioned in the response to question 6 of EPM above, the JAC is particularly averse to any requirement to look at the diversification of collateral received in respect of OTC or EPM trades in aggregate.

3) **Do you agree that there are specific operational or other risks resulting from UCITS contracting with a single counterparty? What measures could be envisaged to mitigate those risks?**

Where a UCITS contracts with a single counterparty in respect of a bespoke trade designed specifically to allow the UCITS to achieve its investment objective, there is a risk that the investment objective will not be reached if that counterparty becomes insolvent and the relevant trade cannot be recreated with a different counterparty on the same or similar terms.

In such cases, a clear risk warning that the investment objective might not be achieved in the event of a counterparty default should be required. The UCITS should also be required, as at present, to have robust conflicts management and risk management arrangements.

Otherwise, provided that the trades are collateralised in accordance with the existing rules, we consider that investors are sufficiently protected from loss in the event of a single counterparty default.

The JAC notes that, where a UCITS contracts with a single counterparty, this is often a relatively bespoke (but not necessarily risky) trade. As such, it is perhaps unlikely that the derivative will be subject to mandatory clearing. The trade is therefore likely to remain bilateral and be subject to the risk management tools under EMIR. It is hoped that these will not impose initial margin requirements on the UCITS as this would result in the UCITS being over-collateralised to the counterparty.

It is submitted that the duties of UCITS managers to avoid conflicts of interest is sufficient to deal with any possible conflicts arising as a result of a UCITS trading with a single counterparty.

4) **What is the current market practice in terms of frequency of calculation of counterparty risk and issuer concentration and valuation of UCITS assets? If you are an asset manager, please also provide information specific to your business.**

Members of the JAC have confirmed that current market practice is to calculate daily.

5) **What would be the benefits and costs for all stakeholders involved of requiring calculation of counterparty risk and issuer concentration of the UCITS on an at least daily basis?**

See response to question 4 directly above.

6) **How could such a calculation be implemented for assets with less frequent valuations?**

For assets with less frequent valuations, the JAC suggests that the manager should be able to use fair value pricing (or similar methodology) - in the same way as it values assets within the UCITS' portfolio in respect of which no reliable or up-to-date price exists.

Fair value pricing is essentially the manager's best estimate of the amount the UCITS might receive on a sale, or pay on a purchase, in respect of the asset in question at the time of calculation.

The rules should be sufficiently flexible to enable UCITS to apply fair value to every relevant class of asset in respect of which less frequent valuations would otherwise be available.

Participating Associations

About UK SPA

The UK Structured Products Association (UK SPA) is an organisation established by the UK's leading companies that create and distribute structured products to the UK financial services market in order to provide a useful and responsive source of information, education and comment on structured products by promoting their contribution to effective financial planning.

The UK Structured Products Association is committed to publishing research, information and educational material about structured products and so create greater acceptance about their potential.

The UK Structured Products Association is not a commercial organisation and education and research are its core activities.

About ISDA

Since 1985, ISDA has worked to make the global over-the-counter (OTC) derivatives markets safer and more efficient. Today, ISDA is one of the world's largest global financial trade associations, with over 840 member institutions from 59 countries on six continents. These members include a broad range of OTC derivatives market participants: global, international and regional banks, asset managers, energy and commodities firms, government and supranational entities, insurers and diversified financial institutions, corporations, law firms, exchanges, clearinghouses and other service providers. Information about ISDA and its activities is available on the Association's web site: www.isda.org.

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