

I

(Resolutions, recommendations, guidelines and opinions)

OPINIONS

EUROPEAN CENTRAL BANK

OPINION OF THE EUROPEAN CENTRAL BANK

of 12 December 2006

on a draft Commission Directive implementing Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards the clarification of certain definitions

(CON/2006/57)

(2007/C 31/01)

Introduction and legal basis

The ECB is submitting this opinion on its own initiative to the Commission on a draft Commission Directive implementing Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) ⁽¹⁾ as regards the clarification of certain definitions ⁽²⁾ (hereinafter the 'proposed directive'). The main objective of the proposed directive, which is an implementing measure issued on the basis of Article 53a of the UCITS Directive, is to clarify the meaning and the scope of certain definitions under the UCITS Directive in order to ensure its uniform application throughout the European Union and improve the functioning of the UCITS product passport ⁽³⁾.

The ECB's competence to deliver an opinion on the proposed directive is based on Article 105(4) of the Treaty establishing the European Community, since the proposed directive is linked to the implementation of the monetary policy of the euro area, particularly with regard to the functioning of European money markets. In this respect, the ECB considers that proposed Level 2 acts constitute 'proposed Community acts' within the meaning of Article 105(4) of the Treaty. The ECB would therefore have expected the Commission to take the initiative to formally consult the ECB on the proposed directive, in accordance with the relevant Treaty provisions. Considering that the ECB has several comments with respect to the proposed directive, the ECB has decided to submit this opinion on its own initiative. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council has adopted this opinion.

⁽¹⁾ Council Directive 85/611/EEC of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (OJ L 375, 31.12.1985, p. 3). Directive as last amended by Directive 2005/1/EC (OJ L 79, 24.3.2005, p. 9), (hereinafter the 'UCITS Directive').

⁽²⁾ Commission Working Document ESC/43/2006.

⁽³⁾ The ECB notes that both the European Monetary Institute, precursor to the ECB, and the ECB itself were consulted by the Council on the UCITS Directive in 1995 and 1999, respectively. See Opinion of the European Monetary Institute CON/1994/8 of 27 July 1995 on a Commission proposal for a Directive relating to undertakings for collective investment in transferable securities (UCITS); ECB Opinion CON/98/54 of 16 March 1999 at the request of the Council of the European Union under Articles 109l(2) and 109f(6) of the Treaty establishing the European Community and Article 5.3 of the Statute of the European Monetary Institute on two European Commission proposals for European Parliament and Council Directives amending Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS), ref. 98/0242 — COM(1998) 451 final and ref. 98/0243 — COM(1998) 449 final, OJ C 285, 7.10.1999, p. 9.

1. General observations

- 1.1 An efficient and well-integrated financial system is important for the smooth and effective transmission of monetary policy throughout the euro area. While this applies to all segments of the financial system, it is of particular importance with regard to the market segment most directly relevant for the implementation of monetary policy, namely the money market. The European short-term securities market is the least integrated money market segment in the EU. Therefore, the ECB follows with particular attention regulatory as well as market-led initiatives that aim at enhancing the integration, development and transparency of short-term securities markets in Europe ⁽⁴⁾.
- 1.2 The even implementation and interpretation of EU legislation is a crucial dimension for building up the internal market in financial services. Against this background, the choice of a directive as the legal instrument to achieve this even implementation in this case seems to contradict the objective of the implementing measures in relation to the UCITS Directive, which is to clarify the definitions 'in order to ensure uniform application of this Directive throughout the Community' ⁽⁵⁾, to 'enhance a common reading as to whether certain assets are eligible for investment under the UCITS Directive', to 'reduce the potential of divergent interpretations of the UCITS Directive' and to 'improve legal certainty and enable a more coherent interpretation of the UCITS Directive' ⁽⁶⁾. A proposed implementing measure in the form of a regulation containing detailed provisions capable of direct application to all UCITS could more appropriately remedy the current uneven application of some general principles contained in the UCITS Directive (for instance, regarding the rules on the eligibility of money market instruments).

2. Specific comments

- 2.1 *First*, as regards disclosure and information requirements, the proposed directive introduces various requirements depending on the legal nature of the issuer. For example, for money market instruments issued by establishments subject to prudential supervision ⁽⁷⁾, the information can be confined to either information on the issue or issuance programme or on the legal and financial situation of the issuer prior to the issue of the money market instrument ⁽⁸⁾. Whereas for non-financial corporations ⁽⁹⁾ the requirements include information on the issue and issuance programme as well as on the legal and financial situation of the issuer. The Commission indicates that this differentiation takes into account that 'e.g. certain certificates of deposits would have difficulties to comply with certain criteria under Article 5(2)' of the proposed directive. In general, the ECB considers that for the smooth and efficient functioning of the market, it is important that adequate and standardised information, as well as standardised statistics, are accessible to market participants. Therefore, it is recommended to adopt the same wording for Article 5(3)(a) as for Article 5(2)(a) of the proposed directive.
- 2.2 *Second*, the inclusion of money market instruments issued by a Member State's local or regional authority (or, in the case of a Member State that is a federal State, a member of the federation) that are not guaranteed by a Member State under Article 5(2) ('other' issuers), rather than under Article 5(4) of the proposed directive (i.e. alongside other public entities of Member States), might require further consideration. Local, regional and federal authorities in the EU generally enjoy financial support from their respective Member States as well as a special status under national insolvency laws. Moreover, the question of whether the liabilities of local, regional and federal authorities in the EU are formally guaranteed by their Member States could raise complex questions in certain cases, and might not therefore provide an appropriate basis for differentiating instruments with or without guarantee. Consideration could be given to treating all regional, local and (for the UCITS Directive) federal authorities of Member

⁽⁴⁾ For this reason, the ECB supports the Short-Term European Paper (STEP) initiative, which is a market-led initiative promoted by the Financial Markets Association (ACI) and the European Banking Federation (FBE), which aims to foster the integration and development of the European markets for short-term securities through the convergence of market standards. The STEP Market Convention indicates the criteria and requirements that need to be fulfilled for an issuance programme to be STEP-compliant and thus obtain the STEP label. These criteria refer to disclosure, documentation format, settlement and the provision of data for the production of STEP statistics.

⁽⁵⁾ See Article 53a (1) of the UCITS Directive (emphasis added).

⁽⁶⁾ See Background note, p.1, third paragraph.

⁽⁷⁾ I.e. the issuers covered by Article 5(3) of the proposed directive.

⁽⁸⁾ Article 5(3)(a) of the proposed directive.

⁽⁹⁾ Article 5(2)(a) of the proposed directive.

States in the same way in both the 'Level 1' UCITS Directive (the first indent of Article 19(1)(h)) and the Prospectus Directive 2003/71/EC⁽¹⁰⁾. Similar arguments can be made for public international bodies. Thus, the Commission might consider amending Article 5(2) of the proposed directive by deleting the reference to local, regional and federal authorities of Member States, as well as public international bodies, in order to treat all such public entities in the same way.

- 2.3 *Third*, Article 5(3)(c) of the proposed directive refers to the need for reliable statistics on the issue or issuance programme 'or other data enabling an appropriate assessment of the credit risks related to the investment in such instruments'. It should be noted in this respect that the availability of reliable statistics and the availability of other data enabling an assessment of credit risks are two distinct and desirable features of a market, which overlap only partially. Therefore, one should not be treated as equivalent to the other. Furthermore, this criterion is partly redundant if read in conjunction with Article 5(1)(b) which already provides that, for the financial instruments referred to in Article 19(1)(h) of the UCITS Directive, information should be available allowing 'an appropriate assessment of the credit risks related to the investment in such instruments'. Therefore, the reference to 'or other data enabling an appropriate assessment of the credit risks related to the investment in such instruments' in Article 5(3)(c) of the proposed directive should be deleted.
- 2.4 *Fourth*, the reference to the 'control of the information' by 'an appropriately qualified third party' in Article 5(2)(c) of the proposed directive gives rise to some important difficulties of interpretation. In its previous explanatory notes⁽¹¹⁾, the Commission indicated that dealers, auditors, public bodies or other market structures could be eligible to the extent that they are not subject to instructions from the issuer. According to the Commission, the purpose of this criterion is to ensure that information on instruments issued by corporate entities — particularly considering that these entities are not supervised or regulated — is reliable and subject to a qualified scrutiny. However, the Commission's proposal leaves some flexibility as to how this can be achieved and does not impose a specific structure. It is not clear who should ultimately decide on the 'appropriateness' of the third party. In addition, Article 5(2)(c) of the proposed directive provides that the control of the information concerns both the issue or the issuance programme and the legal and the financial situation of the issuer. However, depending on the nature of the third party, the controlling entity will not necessarily 'control' both of these elements. For instance, an auditor will control the financial situation of the issuer but not the programme. It is doubtful that law firms and dealers could be considered as controlling financial information. Moreover, a public entity might control the programme but not necessarily the financial situation of the issuer. Lastly, the introduction of unspecified information control mechanisms by 'an appropriately qualified third party'⁽¹²⁾ into the proposed directive would seem to approximate the information requirements for money market instruments to those applied for formal prospectuses. In this respect it should be underlined that prospectus requirements appear to be exhaustively covered by the Prospectus Directive, under which money market instruments are exempted from the definition of securities⁽¹³⁾.
- 2.5 Evidently, the discretion granted to Member States regarding the application of this criterion contradicts the objective of these implementing measures, which is to provide more legal certainty and to ensure uniform application. Therefore, unless it is possible to clarify the meaning of the provision, which seems to be problematic in view of the various situations possibly covered, it is suggested to drop this criterion altogether.
- 2.6 *Fifth*, Article 5(4) of the proposed directive provides that, for all money market instruments covered by the first indent of Article 19(1)(h) of the UCITS Directive (except those referred to in paragraph 2 of this Article), appropriate information shall consist of information on the issue or issuance programme or on the legal and financial situation of the issuer prior to the issue of money market instrument. In terms of issuers, the first indent of Article 19(1)(h) of the UCITS Directive covers in particular non-Member States, the EU, the European Investment Bank, the ECB and central banks of a Member State.

⁽¹⁰⁾ Article 1(2)(d) of Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC (OJ L 345, 31.12.2003, p. 64).

⁽¹¹⁾ See Working document ESC/24/2006.

⁽¹²⁾ Article 5(2)(c) of the proposed directive.

⁽¹³⁾ Article 2(1)(a) of Directive 2003/71/EC.

This proposed provision would therefore apply to the investment by collective investment undertakings in certain instruments issued by central banks and used in the implementation of monetary policy ⁽¹⁴⁾. Taking into account the fact that the information on the issuer's legal and financial situation would not be of direct relevance for UCITS investors in the case of central banks, and also having regard to the Eurosystem's prerogatives regarding the conditions of issuance of such instruments ⁽¹⁵⁾, the ECB proposes to amend Article 5(4) of the proposed directive in order to exclude all money market instruments issued by either the ECB or a Member State central bank from the application of that paragraph.

2.7 Finally, Article 3(2) of the Commission's proposed directive defines money market instruments as instruments normally dealt in on the money market which fulfil one of the following criteria: (i) they have a maturity at issuance of up to 397 days; or (ii) they have a residual maturity of up to 397 days; or (iii) they undergo regular yield adjustments in line with money market conditions at least every 397 days; or (iv) their risk profile corresponds to that of financial instruments which have a maturity of up to 397 days or are subject to a yield adjustment as referred to in point (iii). The Commission's attention is drawn to the fact that this definition is not consistent with the definition of money market instruments in Regulation ECB/2001/13 ⁽¹⁶⁾, which refers to 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. The ECB is aware that the proposed 397 day period is the outcome of a suggestion by CESR that the 12-month maturity be extended to 397 days to include the risk of settlement delays which may result in a breach in the event of a delay in settling the instrument ⁽¹⁷⁾. It is suggested to return to the solution proposed by the Commission in earlier drafts of the proposed directive, which set a maturity period of one year 'without prejudice to any additional delay for settlement as provided for in the issue or the issuance programme'.

3. Drafting proposals

Where the above advice would lead to changes in 'the proposed directive', drafting proposals are set out in the Annex.

Done at Frankfurt am Main, 12 December 2006.

The President of the ECB
Jean-Claude TRICHET

⁽¹⁴⁾ For example, as part of the Eurosystem's open market operations the ECB may issue debt certificates with the aim of adjusting the Eurosystem's structural position vis-à-vis the financial sector so as to create or enlarge a liquidity shortage in the market. These debt certificates have a maturity of less than 12 months. The terms and conditions for such debt certificates are established by the ECB (see European Central Bank, *The Implementation of Monetary Policy in the Euro Area: General Documentation on Eurosystem Monetary Policy Instruments and Procedures*, September 2006, p. 17).

⁽¹⁵⁾ See Article 105(2), first indent, of the Treaty Establishing the European Community (the 'Treaty'), as well as Articles 18(2) and 20 of the Protocol annexed to the Treaty on the Statute of the European Central Bank and of the European System of Central Banks.

⁽¹⁶⁾ See the fifth indent of point 7 in Annex 1 to Regulation ECB/2001/13 of 22 November 2001 concerning the consolidated balance sheet of the monetary financial institutions sector, (OJ L 333, 17.12.2001, p. 1). Regulation as last amended by Regulation ECB/2004/21 (OJ L 371, 18.12.2004, p. 42).

⁽¹⁷⁾ CESR's Advice to the European Commission on Clarification of Definitions concerning Eligible Assets for Investments of UCITS (January 2006) (CESR/06-005), p. 20, points 63-64.

ANNEX

Drafting proposals

Text proposed by the Commission

Amendments proposed by the ECB ⁽¹⁾

Amendment 1

Article 5(2)

For money market instruments covered by the second and the fourth indents of Article 19(1)(h) of Directive 85/611/EEC, or for those which are issued by a local or regional authority of a Member State or by a public international body but are not guaranteed by a Member State or, in the case of a federal State which is a Member State, by one of the Members making up the federation, appropriate information as referred to in point (b) of paragraph 1 of this Article shall consist in the following:

- (a) information on both the issue or the issuance programme and the legal and financial situation of the issuer prior to the issue of the money market instrument;
- (b) up-dates of the information referred to in point (a) on a regular basis and whenever a significant event occurs;
- (c) control of the information referred to in point (a) by an appropriately qualified third party not subject to instructions from the issuer;
- (d) availability of reliable statistics on the issue or issuance programmes.

For money market instruments covered by the second, **third** and the fourth indents of Article 19(1)(h) of Directive 85/611/EEC, ~~or for those which are issued by a local or regional authority of a Member State or by a public international body but are not guaranteed by a Member State or, in the case of a federal State which is a Member State, by one of the Members making up the federation,~~ appropriate information as referred to in point (b) of paragraph 1 of this Article shall consist in the following:

- (a) information on both the issue or the issuance programme and the legal and financial situation of the issuer prior to the issue of the money market instrument;
- (b) up-dates of the information referred to in point (a) on a regular basis and whenever a significant event occurs;
- ~~(c) control of the information referred to in point (a) by an appropriately qualified third party not subject to instructions from the issuer;~~
- (c)** availability of reliable statistics on the issue or issuance programmes.

Justification — See paragraphs 2.1-2.5 of the opinion

Amendment 2

Article 5(3)

For money market instruments covered by the third indent of Article 19(1)(h) of Directive 85/611/EEC, appropriate information as referred to in point (b) of paragraph 1 of this Article shall consist in the following:

- (a) information on the issue or issuance programme or on the legal and financial situation of the issuer prior to the issue of the money market instrument;
- (b) up-dates of the information referred to in point (a) on a regular basis and whenever a significant event occurs;
- (c) availability of reliable statistics on the issue or issuance programme or other data enabling an appropriate assessment of the credit risks related to the investment in such instruments.

~~For money market instruments covered by the third indent of Article 19(1)(h) of Directive 85/611/EEC, appropriate information as referred to in point (b) of paragraph 1 of this Article shall consist in the following:~~

- ~~(a) information on the issue or issuance programme or on the legal and financial situation of the issuer prior to the issue of the money market instrument;~~
- ~~(b) up-dates of the information referred to in point (a) on a regular basis and whenever a significant event occurs;~~
- ~~(c) availability of reliable statistics on the issue or issuance programme or other data enabling an appropriate assessment of the credit risks related to the investment in such instruments.~~

Justification — See paragraphs 2.1-2.5 of the opinion

⁽¹⁾ Bold in the body of the text indicates where the ECB proposes inserting new text. Strikethrough in the body of the text indicates where the ECB proposes deleting the text.

Amendment 3

Article 5(4) would become Article 5(3)

For all money market instruments covered by the first indent of Article 19(1)(h) of Directive 85/611/EEC except those referred to in paragraph 2 of this Article, appropriate information as referred to in point (b) of paragraph 1 of this Article shall consist in information on the issue or issuance programme or on the legal and financial situation of the issuer prior to the issue of the money market instrument.

For all money market instruments covered by the first indent of Article 19(1)(h) of Directive 85/611/EEC except ~~those referred to in paragraph 2 of this Article and those~~ **issued by the European Central Bank or a central bank of a Member State**, appropriate information as referred to in point (b) of paragraph 1 of this Article shall consist in information on the issue or issuance programme or on the legal and financial situation of the issuer prior to the issue of the money market instrument.

Justification — See paragraphs 2.6 of the opinion

Amendment 4

Article 3(2)

The reference in Article 1(9) of Directive 85/611/EEC to money market instruments as instruments normally dealt in on the money market shall be understood as a reference to financial instruments which fulfil one of the following criteria:

- (i) they have a maturity at issuance of up to and including 397 days;
- (ii) they have a residual maturity of up to and including 397 days;
- (iii) they undergo regular yield adjustments in line with money market conditions at least every 397 days;
- (iv) their risk profile, including credit and interest rate risks, corresponds to that of financial instruments which have a maturity as referred to in points (i) or (ii), or are subject to a yield adjustment as referred to in point (iii).

The reference in Article 1(9) of Directive 85/611/EEC to money market instruments as instruments normally dealt in on the money market shall be understood as a reference to financial instruments which, **without prejudice to any additional delay for settlement as provided for in the issue or the issuance programme**, fulfil one of the following criteria:

- (i) they have a maturity at issuance of up to and including **one year** ~~397 days~~;
- (ii) they have a residual maturity of up to and including **one year** ~~397 days~~;
- (iii) they undergo regular yield adjustments in line with money market conditions at least every **one year** ~~397 days~~;
- (iv) their risk profile, including credit and interest rate risks, corresponds to that of financial instruments which have a maturity as referred to in points (i) or (ii), or are subject to a yield adjustment as referred to in point (iii).

Justification — See paragraph 2.7 of the opinion
