IRISH FUNDS INDUSTRY ASSOCIATION

Mr. Martin Moloney,
Head of Markets Policy Division,
Central Bank of Ireland,
Block D,
Iveagh Court,
Harcourt Road,
Dublin 2.

23rd October 2013

<u>Re: ESMA Guidelines on ETFs and other UCITS issues</u>

Dear Martin,

ESMA issued guidelines for competent authorities and UCITS management companies – "Guidelines on ETFs and other UCITS issues" in December 2012 (the "Guidelines"). The Guidelines cover a number of compliance and reporting obligations covering inter alia efficient portfolio management techniques and financial derivative instruments. We are seeking clarification on what specifically is included in the definition of efficient portfolio management techniques for the purposes of the Guidelines and the corresponding UCITS Notices issued by the Central Bank. This clarification is necessary to ensure that UCITS are correctly addressing the requirements of the Guidelines and, in particular, the requirement at paragraph 35 of the Guidelines (repeated in UCITS Notice 8, Appendix A, paragraph 9(iv)) that the annual report of the UCITS must disclose "the revenues arising from efficient portfolio management techniques for the entire reporting period together with the direct and indirect operational costs and fees incurred".

In its original consultation paper dated, 30 January 2012, ESMA defines efficient portfolio techniques in a number of sections. A copy of this consultation paper is attached for your reference. Section VI "Efficient portfolio management techniques" sets out the draft guidelines on the employment of efficient portfolio techniques by UCITS and the related disclosure requirements. Specifically, in section 42 on page 17, ESMA states *that "EPM techniques include sales and repurchase agreements (repo) and resale agreements (reverse repo) and securities lending. ESMA considers it important to impose additional requirements on UCITS that make use of these techniques, particularly with respect to the collateral that the UCITS receives from the relevant third party."*

The text which eventually became Part VI (Efficient Portfolio Management techniques) of the final Guidelines only discusses securities lending, repos and reverse repos (see paragraphs 43 to 49) and none of the subsequent drafts expressly extended the provisions or related discussion to FDI. Indeed if ESMA's intention in drafting this section was to allow investors to identify revenues and costs arising from securities lending, repos and reverse repos, then the inclusion of gains or losses from FDI entered into for hedging purposes might distort the information in relation to revenues and costs from securities lending, repos and reverse repos.

The other text which seems relevant in understanding what ESMA means by efficient portfolio management "techniques" is the CESR Guidelines on Risk Measurement and the Calculation of Global Exposure and Counterparty Risk for UCITS (CESR 10-788) which in Box 9, dealing with EPM techniques, refers only to repurchase

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transactions and securities lending transactions. A copy of these CESR Guidelines is also attached for ease of reference.

Based on this wording we have interpreted the requirements in the Guidelines that relate to efficient portfolio techniques as relating solely to sales and repurchase agreements (repo) and resale agreements (reverse repo) and securities lending.

We agree that there is a distinction to be made between efficient portfolio management "techniques" (which are within the scope of the provisions of the Guidelines referred to) and efficient portfolio management "instruments" which are subject to the provisions relating to financial derivative instruments. A review of the Guidelines and the UCITS Notices confirm that, in this context, the terms "techniques" and "instruments" are not used interchangeably and are intended to refer to distinct categories. We would be grateful therefore if you could confirm that your understanding is that efficient portfolio management techniques are sales and repurchase agreements (repo) and resale agreements (reverse repo) and securities lending for the purpose of implementing the Guidelines and the corresponding UCITS Notices.
We would be happy to discuss this further if required.

Yours faithfully,

D. Casey

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