

**COMMISSION de SURVEILLANCE  
du SECTEUR FINANCIER**

In case of discrepancies between the French and the English text, the French text shall prevail

Luxembourg, 4 June 2008

To all Luxembourg undertakings for collective investment (“UCIs”) subject to the amended law of 20 December 2002 relating to undertakings for collective investment and to those who act in relation to the operation and supervision of such undertakings

**CSSF CIRCULAR 08/356**

**Re: Rules applicable to undertakings for collective investment when they employ certain techniques and instruments relating to transferable securities and money market instruments**

Ladies and Gentlemen,

The purpose of this circular is to clarify the conditions and limits under which an undertaking for collective investment in transferable securities (“UCITS”) is authorised to employ techniques and instruments relating to transferable securities and to money market instruments. The techniques and instruments covered by this circular are securities lending transactions, sale with right of repurchase transactions<sup>1</sup> and reverse repurchase transactions/repurchase transactions<sup>2</sup>.

The conditions and limits stated hereafter apply, in principle, also to other undertakings for collective investment (“UCIs”).

These techniques and instruments must be used for the purpose of efficient portfolio management, which supposes that they must fulfil the following criteria:

- (a) they are economically appropriate in that they are realised in a cost-effective way;
- (b) they are entered into for one or more of the following specific aims:
  - (i) reduction of risk;

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<sup>1</sup> “Opérations à réméré”

<sup>2</sup> “Opérations de prise/mise en pension”

- (ii) reduction of cost;
  - (iii) generation of additional capital or income for the UCITS with a level of risk which is consistent with the risk profile of the UCITS and the risk diversification rules applicable to it;
- (c) their risks are adequately captured by the risk management process of the UCITS.

In no case may the use of these operations by the UCITS result in a change of its investment objectives as laid down in its management regulations/its constitutive documents/its prospectus, or result in additional risk higher than its risk profile as described in its sales documents.

When a UCITS wants to make use of the techniques and instruments described hereafter, it must mention this specifically in its prospectus. The prospectus must indicate the different types of transactions considered and clarify the purpose of these transactions as well as the conditions at and limits within which they are conducted. If the UCITS intends to reinvest cash received as a guarantee<sup>3</sup> as a result of its transactions, the UCITS' prospectus must specify the conditions and limits applicable to these reinvestments. If need be, the prospectus must contain a description of the risks inherent to the envisaged operations.

The UCITS must make sure that the principles of corporate governance comprise provisions, as regards the transactions referred to in this circular, for a period during which is held an annual shareholders' meeting of the issuing company of the securities lent or temporarily sold.

## **I. Techniques and instruments that may be used by UCITS**

The techniques and instruments that may be used by UCITS are more fully described hereafter.

### ***A. Securities lending transactions***

A UCITS may enter into securities lending transactions provided it complies with the following rules:

#### *1. Rules intended to ensure the proper completion of the securities lending transactions*

- The UCITS may lend the securities included in its portfolio to a borrower either directly or through a standardised lending system organised by a recognised clearing institution or through a lending system organised by a financial institution subject to prudential supervision rules considered by the CSSF as equivalent to those prescribed by Community law and specialised in this type of transactions.

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<sup>3</sup> See footnote 8. below

In all cases, the counterparty to the securities lending agreement (i.e. the borrower) must be subject to prudential supervision rules considered by the CSSF as equivalent to those prescribed by Community law. In case the aforementioned financial institution acts on its own account, it is to be considered as counterparty in the securities lending agreement.

If the UCITS lends its securities to entities that are linked to the UCITS by common management or control, specific attention has to be paid to the conflicts of interest which may result therefrom.

- The UCITS must receive, previously or simultaneously to the transfer of the securities lent, a guarantee which complies with the requirements expressed under section II (b) of this circular. At maturity of the securities lending transaction, the guarantee will be remitted simultaneously or subsequently to the restitution of the securities lent.

In case of a standardised securities lending system organised by a recognised clearing institution or in case of a lending system organised by a financial institution subject to prudential supervision rules considered by the CSSF as equivalent to those prescribed by Community law and specialised in this type of transactions, securities lent may be transferred before the receipt of the guarantee if the intermediary in question assures the proper completion of the transaction. Such intermediary may, instead of the borrower, provide to the UCITS a guarantee in compliance with the requirements expressed under section II (b) hereafter.

## *2. Limits to securities lending transactions*

The UCITS must ensure that the volume of the securities lending transactions is kept at an appropriate level or that it is entitled to request the return of the securities lent in a manner that enables it, at all times, to meet its redemption obligations and that these transactions do not jeopardise the management of the UCITS' assets in accordance with its investment policy.

## *3. Periodical information of the public*

In its financial reports, the UCITS must disclose the global valuation of the securities lent on the date of reference of these reports.

### ***B. Sale with right of repurchase transactions***

#### (a) Purchase of securities with a repurchase option<sup>4</sup>

Acting as buyer, the UCITS may agree to purchase securities with a repurchase option. These transactions consist of the purchase of securities with a clause reserving for the seller (counterparty) the right to repurchase the securities sold from the UCITS at a price and time agreed between the two parties at the time when the contract is entered into.

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<sup>4</sup> “Achat de titres à r  m  r  ”

Its involvement in such transactions is, however, subject to the following rules:

*1. Rules intended to ensure the proper completion of the purchase with a repurchase option transactions*

The UCITS may enter into these transactions only if the counterparties to these transactions are subject to prudential supervision rules considered by the CSSF as equivalent to those prescribed by Community law.

*2. Limits applicable to the purchase with a repurchase option transactions*

During the duration of a purchase with a repurchase option agreement, the UCITS may not sell the securities which are the subject of the contract, before the counterparty has exercised its option or until the deadline for the repurchase has expired, unless the UCITS has other means of coverage.

The UCITS must ensure to maintain the value of the purchase with repurchase option transactions at a level such that it is able, at all times, to meet its redemption obligations towards unitholders/shareholders.

Securities that are the subject of purchase with a repurchase option transaction are limited to:

- (i) short term bank certificates or money market instruments such as defined within Directive 2007/16/EC of 19 March 2007 implementing Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to certain UCITS as regards the clarification of certain definitions;
- (ii) bonds issued or guaranteed by a Member State of the OECD or by their local public authorities or by supranational institutions and undertakings with EU, regional or world-wide scope;
- (iii) shares or units issued by money market UCIs calculating a daily net asset value and being assigned a rating of AAA or its equivalent;
- (iv) bonds issued by non-governmental issuers offering an adequate liquidity;
- (v) shares quoted or negotiated on a regulated market of a European Union Member State or on a stock exchange of a Member State of the OECD, on the condition that these shares are included in a main index.

The securities purchased with a repurchase option must be in accordance with the UCITS' investment policy and must, together with the other securities that the UCITS holds in its portfolio, globally comply with the UCITS' investment restrictions.

### 3. *Periodical information of the public*

In its financial reports, the UCITS must provide separate information on securities purchased with a repurchase option, disclosing the total amount of the open transactions on the date of reference of these reports.

#### (b) Sale of securities with a repurchase option<sup>5</sup>

Acting as the seller, the UCITS may agree to sell securities with a repurchase option. These transactions consist of the sale of securities with a clause reserving for the UCITS the right to repurchase the securities from the purchaser (counterparty) at a price and at a time agreed between the two parties at the time when the contract is entered into.

Its involvement in such transactions is, however, subject to the following rules:

#### 1. *Rules intended to ensure the proper completion of the sale with repurchase option transactions*

The UCITS may enter into these transactions only if the counterparties to these transactions are subject to prudential supervision rules considered by the CSSF as equivalent to that prescribed by Community law.

#### 2. *Limits applicable to the sale with repurchase option transactions*

The UCITS must ensure that, at maturity of the repurchase option, it holds sufficient assets to be able to settle, if applicable, the amount agreed for the restitution of the securities to the UCITS.

#### 3. *Periodical information of the public*

In its financial reports, the UCITS must provide separate information on securities sold with a repurchase option, disclosing the total amount of the open transactions on the date of reference of these reports.

### ***C. Reverse repurchase and repurchase agreement transactions***

#### (a) Reverse repurchase agreement transactions<sup>6</sup>

The UCITS may enter into reverse repurchase agreement transactions, which consist of a forward transaction at the maturity of which the seller (counterparty) has the obligation to repurchase the asset sold and the UCITS the obligation to return the asset received under the transaction.

Its involvement in such transactions is, however, subject to the following rules:

#### 1. *Rules intended to ensure the proper completion of the reverse repurchase agreement transactions*

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<sup>5</sup> “Vente de titres à réméré”

<sup>6</sup> “Opérations de prise en pension”

The UCITS may enter into these transactions only if the counterparties to these transactions are subject to prudential supervision rules considered by the CSSF as equivalent to those prescribed by Community law.

## *2. Limits applicable to reverse repurchase agreement transactions*

During the duration of the reverse repurchase agreement, the UCITS may not sell or pledge/give as security the securities purchased through this contract, except if the UCITS has other means of coverage.

The UCITS must take care to ensure that the value of the reverse repurchase agreement transactions is kept at a level such that it is able, at all times, to meet its redemption obligations towards unitholders/shareholders.

Securities that may be purchased in reverse repurchase agreements are limited to:

- (i) short-term bank certificates or money market instruments such as defined within Directive 2007/16/EC of 19 March 2007 implementing Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to certain UCITS as regards the clarification of certain definitions;
- (ii) bonds issued or guaranteed by a Member State of the OECD or by their local public authorities or by supranational institutions and undertakings with EU, regional or world-wide scope;
- (iii) shares or units issued by money market UCIs calculating a daily net asset value and being assigned a rating of AAA or its equivalent;
- (iv) bonds issued by non-governmental issuers offering an adequate liquidity;
- (v) shares quoted or negotiated on a regulated market of a European Union Member State or on a stock exchange of a Member State of the OECD, on the condition that these shares are included within a main index.

The securities purchased through a reverse repurchase agreement transaction must conform to the UCITS' investment policy and must, together with the other securities that the UCITS holds in its portfolio, globally respect the UCITS' investment restrictions.

## *3. Periodical information of the public*

In its financial reports, the UCITS must provide separate information on securities purchased under reverse repurchase agreements, disclosing the total amount of the open transactions on the date of reference of these reports.

(b) Repurchase agreement transactions<sup>7</sup>

The UCITS may enter into repurchase agreement transactions, which consist of a forward transaction at the maturity of which the UCITS has the obligation to repurchase the asset sold and the buyer (the counterparty) the obligation to return the asset received under the transaction.

Its involvement in such transactions is, however, subject to the following rules:

1. *Rules intended to ensure the proper completion of the repurchase agreement transactions*

The UCITS may enter into these transactions only if the counterparties to these transactions are subject to prudential supervision rules considered by the CSSF as equivalent to those prescribed by Community law.

2. *Limits applicable to repurchase agreement transactions*

The UCITS must ensure that, at maturity of the agreement, it has sufficient assets to be able to settle the amount agreed with the counterparty for the restitution to the UCITS.

The UCITS must take care to ensure that the volume of the repurchase agreement transactions is kept at a level such that it is able, at all times, to meet its redemption obligations towards unitholders/shareholders.

3. *Periodical information of the public*

In its financial reports, the UCITS must provide separate information on securities sold under repurchase agreements, disclosing the total amount of the open transactions on the date of reference of these reports.

## **II. Limitation of the counterparty risk and receipt of an appropriate guarantee**<sup>8</sup>

(a) Limitation of the counterparty risk

For each securities lending transaction, the UCITS must receive, in accordance with the fourth paragraph of section I. A. 1. of this circular, a guarantee the value of which is, during the lifetime of the lending agreement, at least equivalent to 90% of the global valuation (interests, dividends and other eventual rights included) of the securities lent.

The risk exposure to a single counterparty of the UCITS arising from one or more securities lending transactions, sale with right of repurchase transactions and/or reverse repurchase/repurchase transactions may not exceed 10% of its assets when the counterparty is a credit institution referred to in article 41, paragraph (1) (f) of the law of 20 December 2002 or 5% of its assets in other cases.

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<sup>7</sup> “Opérations de mise en pension”

<sup>8</sup> “Sûreté”. The term “guarantee” used in this translation is to be understood as “collateral” where appropriate.

UCITS may take into account a guarantee conforming to the requirements set out under section II (b) below in order to reduce the counterparty risk in sale with right of repurchase transactions and/or reverse repurchase and repurchase transactions.

(b) Receipt of an appropriate guarantee

The UCITS must proceed on a daily basis to the valuation of the guarantee received.

The agreement concluded between the UCITS and the counterparty must include provisions to the effect that the counterparty must provide additional guarantees at very short term in case the value of the guarantee already granted appears to be insufficient in comparison with the amount to be covered. Furthermore, the aforementioned agreement must, if appropriate, provide for safety margins that take into consideration exchange risks or market risks inherent to the assets accepted as guarantee.

The guarantee must normally take the form of:

- (i) liquid assets,  
liquid assets include not only cash and short term bank certificates, but also money market instruments such as defined within Directive 2007/16/EC of 19 March 2007 implementing Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to certain UCITS as regards the clarification of certain definitions. A letter of credit or a guarantee at first-demand given by a first class credit institution not affiliated to the counterparty are considered as equivalent to liquid assets;
- (ii) bonds issued or guaranteed by a Member State of the OECD or by their local public authorities or by supranational institutions and undertakings with EU, regional or world-wide scope;
- (iii) shares or units issued by money market UCIs calculating a daily net asset value and being assigned a rating of AAA or its equivalent;
- (iv) shares or units issued by UCITS investing mainly in bonds/shares mentioned in (v) and (vi) below;
- (v) bonds issued or guaranteed by first class issuers offering an adequate liquidity, or
- (vi) shares admitted to or dealt in on a regulated market of a Member State of the European Union or on a stock exchange of a Member State of the OECD, on the condition that these shares are included in a main index.

The guarantee given under any form other than cash or shares/units of a UCI/UCITS must be issued by an entity not affiliated to the counterparty.

The guarantee given in the form of cash may expose the UCITS to a credit risk vis-à-vis the trustee of this guarantee. If such risk exists, the UCITS must take it into consideration for the purpose of the limits on deposits prescribed by article 43 (1) of the amended law of 20 December 2002 concerning undertakings for collective investment. As a principle, the guarantee given must not be safekept by the counterparty, except if it is legally protected from consequences of default of the latter.

The guarantee given in a form other than cash must not be safekept by the counterparty, except if it is adequately segregated from the latter's own assets.

The UCITS must make sure that it is able to claim its rights on the guarantee in case of the occurrence of an event requiring the execution thereof. Therefore, the guarantee must be available at all times, either directly or through the intermediary of a first class financial institution or a wholly-owned subsidiary of this institution, in such a manner that the UCITS is able to appropriate or realise the assets given as guarantee, without delay, if the counterparty does not comply with its obligation to return the securities.

Also, the UCITS must make sure that its contractual rights relating to the relevant transactions permit, in case of a liquidation, of a reorganisation<sup>9</sup> or in any other situation of equal ranking<sup>10</sup>, to discharge its obligation to return the assets received as a guarantee, if and to the extent that the restitution cannot be undertaken on the terms initially agreed.

During the duration of the agreement the guarantee cannot be sold or given as a security or pledged, except when the UCITS has other means of coverage.

### **III. Reinvestment of cash provided as a guarantee**

If the guarantee was given in the form of cash, such cash may be reinvested by the UCITS in:

- (a) shares or units in money market UCIs calculating a daily net asset value and being assigned a rating of AAA or its equivalent;
- (b) short-term bank deposits;
- (c) money market instruments as defined in Directive 2007/16/EC of 19 March 2007;
- (d) short-term bonds issued or guaranteed by a Member State of the European Union, Switzerland, Canada, Japan or the United States or by their local authorities or by supranational institutions and undertakings with EU, regional or world-wide scope;
- (e) bonds issued or guaranteed by first class issuers offering an adequate liquidity, and

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<sup>9</sup> “Mesure d'assainissement”.

<sup>10</sup> “Toute autre situation de concours”.

- (f) reverse repurchase agreement transactions according to the provisions described under section I (C) (a) of this circular.

Financial assets other than bank deposits and units or shares of UCIs acquired by means of reinvestment of cash received as a guarantee, must be issued by an entity not affiliated to the counterparty.

Financial assets other than bank deposits must not be safekept by the counterparty, except if they are segregated in an appropriate manner from the latter's own assets. Bank deposits must in principle not be safekept by the counterparty, unless they are legally protected from consequences of default of the latter.

Financial assets may not be pledged/given as a guarantee, except when the UCITS has sufficient liquid assets enabling it to return the guarantee by a cash payment.

Short-term bank deposits, money market instruments and bonds referred to in (b) through (d) above must be eligible investments within the meaning of Article 41 (1) of the law of 20 December 2002.

The reinvestment of cash received as a guarantee is not subject to the diversification rules generally applicable to UCITS, provided however, that the UCITS must avoid an excessive concentration of its reinvestments, both at issuer level and at instrument level. Reinvestments in assets referred to in (a) and (d) above are exempt from this requirement.

If the short-term bank deposits referred to in (b) are likely to expose the UCITS to a credit risk vis-à-vis the trustee, the UCITS must take this into consideration for the purpose of the limits on deposits prescribed by article 43 (1) of the amended law of 20 December 2002 concerning undertakings for collective investment.

The reinvestment must, in particular if it creates a leverage effect, be taken into account for the calculation of the UCITS' global exposure. Any reinvestment of a guarantee provided in the form of cash in financial assets providing a return in excess of the risk free rate<sup>11</sup>, is subject to this requirement.

Reinvestments must be specifically mentioned with their respective value in an appendix to the financial reports of the UCITS.

Yours sincerely,

COMMISSION DE SURVEILLANCE DU SECTEUR FINANCIER

Simone DELCOURT  
Director

Jean-Nicolas SCHAUS  
Director general

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<sup>11</sup> "procurant un rendement supérieur au taux sans risque".