



FINANCIAL REGULATOR
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Undertakings for Collective
Investment in Transferable Securities
(UCITS) – Collateral passed by
UCITS to OTC derivative
counterparties

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Undertakings for Collective Investment in Transferable Securities (UCITS) – collateral passed by UCITS to OTC derivative counterparties

Regulation 18 of the European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations 2003 (“the Regulations”) provides that the assets of a unit trust and the assets of a common contractual fund shall be entrusted to a trustee for safe-keeping. Regulation 37 makes the same provision in relation to the assets of an investment company.

Regulation 45(g) of the Regulations permits UCITS to invest in financial derivative instruments, including OTC derivatives. This note addresses the passing of collateral by a UCITS to an OTC derivative counterparty.

The Committee of European Securities Regulators (“CESR”) issued advice on Level 2 measures related to the UCITS management company passport to the European Commission in October 2009. This advice addressed, *inter alia*, matters related to OTC derivatives, including the passing of collateral by a UCITS to an OTC counterparty or broker in respect of financial derivative instruments.

The advice noted that market practice may require collateral or margin to be passed by the UCITS to an OTC counterparty or broker in respect of OTC financial derivative instruments. As such these arrangements do not offend Regulations 18 and 37 of the Regulations.

The CESR advice also noted that

- collateral passed must be taken into account in calculating risk exposure to the OTC counterparty as referred to in Article 52(1) of the UCITS Directive.¹

¹ The equivalent provision from the Regulations is Regulation 49(1)(c).

- collateral passed may be taken into account on a net basis only where there is a legally enforceable netting arrangement in place.

CESR work in relation to risk measurement, including the calculation of counterparty risk for UCITS, is ongoing with the intention to provide detailed Level 3 guidelines in these areas.

The UCITS Notices and related Guidance Notes issued by the Financial Regulator will be amended in due course to reflect the provisions of Directive 2009/65/EC, the implementing measures required under that Directive and any guidelines issued by CESR.