



The International Securities Lending Association

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The International Securities Lending Association response to Central Bank of Ireland's consultation CP77: Consultation on publication of UCITS rulebook.

On behalf of our members, The International Securities Lending Association (ISLA) appreciates the opportunity to contribute to the Central Bank of Ireland's consolidation on the publication of the UCITS Rulebook ("Rulebook").

UCITS regulated by the CBI represent an important set of market participants for securities lending. By engaging in securities lending UCITS earn additional returns which can substantially offset the management and administrative costs that end investors bear when investing in funds. Securities lending activity by UCITS and other institutional investors also contributes to the efficiency of the market and is increasingly seen by policymakers as playing an important role in the mobilisation of collateral within the financial system. Given the focus of our members, our comments are restricted to matters pertaining to Efficient Portfolio Management (EPM). We hope that you find the comments made on behalf of our members to be helpful in your considerations.

General Comments

We note that the CBI has incorporated a number of points from the ESMA Guidelines for ETFs and other UCITS ("Guidelines"), and we welcome the consistency of language that this provides. However, ESMA has clarified a number of issues in their subsequent Q&A document and we think it important that these clarifications should be carried across to the Rulebook to ensure a consistent interpretation. For example, Chapter 1 vi. Paragraph 7 is qualified by ESMA by their Q&A 6 (e) which provides important clarification re delegated custody allowing the use of tri-party collateral managers for title transfer collateral.

More generally, we would welcome clarification on the CBI's approach to incorporating any further amendments to the Guidelines such as those that have recently been made following recent consultation on collateral diversification (ESMA CP 2013 1974).

A matter which we believe is not fully addressed in either the Rulebook or Guidelines concerns the use of Central Counterparties (CCPs) for UCITS EPM techniques. CCPs are relatively new for securities lending but in some markets (such as Brazil and India) they are effectively the only option for engaging in securities lending. Outside of these markets we expect the use of CCPs to grow given their perceived risk management benefits and

generally preferential regulatory treatment. CCP arrangements vary but in some cases the rules of the CCP do not allow for a UCITS to comply with some of the collateral requirements (for example the CCP may require that collateral is held centrally in order to provide the highest level of protection to all users of the clearing system). As the use of CCPs is considered by many regulators to be an important counterparty and systemic risk mitigant we assume that this is an unintended consequence of the UCITS rules and not an intended outcome.

Comments pertaining to specific clauses

Chapter 1. Section 1. vi. Paragraph 5(c): *Issuer credit quality: Collateral should be of high quality*

The definition of 'high quality' is not provided in the Rulebook for this clause, although we note that definitions are provided elsewhere pertaining to this term in other contexts. Issuer credit quality is generally a consideration for fixed income assets as for other types of collateral such as equity, liquidity and volatility measures are more relevant considerations. We assume this requirement is specific to fixed income securities and would be grateful if a clear definition is provided in the final Rulebook

Chapter 1. Section 1. vi. Paragraph 5 (e): *Diversification*

Further to our general comment above, we would request that the derogation of this requirement recently agreed by ESMA be incorporated into the Rulebook.

Chapter 1. Section 1. vi. Paragraph 9(b) & 16: *Repurchase agreements*

We note that in the Guidelines, ESMA made provisions for the treatment of repurchase and reverse repurchase agreements with a maturity of up to seven days to be treated as callable at any time, but do not believe that this has been included within the Rulebook. We believe that such arrangements are necessary for UCITS to effectively manage cash (including cash collateral) in secure short term transactions. The ability to enter into modest term transactions (securities lending and repo) provides both the borrower (and the UCITS) with more certainty around the transactions entered into and used alongside callable transactions can provide the UCITS with the ability to use EPM techniques in the most productive and efficient way.

Chapter 1. Section 1. vi. Paragraph 9 (d) & 10: *Diversification rules in respect of cash collateral invested in Money Market Funds*

Paragraph 10 states that cash collateral which is re-invested in short-term money market funds ("MMF") must meet the same diversification requirements as non-cash collateral which is defined in paragraph 5 (e); namely a 20% per issuer restriction. However the paragraph may be interpreted as referring to applying to the units of the MMF, or to the underlying investments within the fund. This is an important distinction as UCITS may interpret this clause to mean that no more than 20% of the UCITS NAV can be received as cash collateral and re-invested in an individual MMF without further consideration of the underlying investments within the fund and we would be grateful if clarification and guidance could be provided in this matter.

Chapter 1. Section 1. vi. Paragraph 13: Counterparty requirements

This provision requires a minimum credit rating for a counterparty of EPM transactions. We recognise that the quality of the counterparty is an important consideration when undertaking EPM transactions but we are concerned that this paragraph is not aligned with the Guidelines (which do not reference credit ratings for counterparty selection). Whilst we acknowledge that CBI may choose to add to the Guidelines for the purpose of its UCITS rules we believe it is better wherever possible that the national rules are consistent. The Guidelines rely on Article 52 of the UCITS Directive 2009/65/EC (as amended) to ensure that there is counterparty diversification. The ESMA guidelines also decree counterparty risk is adequately captured within the risk management process and fully disclosed within the prospectus and annual report and we believe that this twofold approach ensure UCITS fully consider their counterparties.

In addition this provision states that UCITS can transact with unrated entities where it has a guarantee or indemnity from a rated entity. Whilst we acknowledge that this provision is included in the current CBI rules, indemnities and guarantees vary significantly in their terms and are expected to become less prevalent due to new bank capital requirements. Consequently we do not believe that it is appropriate for regulation to promote reliance on indemnities or guarantees in place of the counterparty risk considerations and mitigants already reflected in the Guidelines.

On behalf of our members I would like to take this opportunity to thank you for the opportunity to contribute to your considerations in this matter and I trust you find the comments made useful. We hope to continue further dialogue with the regulatory community and policy makers and welcome the opportunity to discuss in depth the responses provided in this paper at your convenience.

Yours sincerely,



Kevin McNulty

Chief Executive

The International Securities Lending Association (ISLA) is a trade association established in 1989 to represent the common interests of participants in the securities lending industry. It has approximately 100 full and associate members principally from across Europe comprising banks, securities dealers, asset managers, insurance companies and pension funds. For more information please visit the ISLA website www.isla.co.uk.