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Release on 4 June 2008 of CSSF Circular 08/356 regarding rules applicable to UCIs which employ certain techniques and instruments relating to transferable securities and money market instruments (the "Circular")

The techniques and instruments covered by the Circular are securities lending transactions, sale with right of repurchase transactions and reverse repurchase transactions/repurchase transactions.

The Circular, which mainly reflects the current flexible administrative CSSF practice, may be resumed as follows:

1. Scope of application

The Circular is applicable to UCITS subject to Part I of the law of 20 December 2002 (the "2002 Law") and is in principle also applicable to UCIs subject to Part II of the 2002 Law¹. The Circular does however not apply to Specialized Investment Funds ("SIFs") subject to the law of 13 February 2007.

2. Criteria to be fulfilled by the techniques and instruments subject to the Circular

The Circular sets out that the relevant techniques and instruments must be used for efficient portfolio management purposes. The techniques and instruments have to comply with 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;
 - ii) reduction of cost;
 - iii) generation of additional capital or income for the UCITS, with a level of risk which is consistent with its risk profile and the risk diversification rules applicable to it;
- c) the risks they entail are adequately captured by the risk management process of the UCITS.

The use of such transactions must however not result in a change of the investment objective of the UCITS or entail additional risks higher than the risk profile of the UCITS.

3. Disclosure of information

The types of envisaged transactions, the purpose of the transactions and the conditions and limits applicable to the relevant transactions must be described in the fund prospectus. Furthermore, in case of reinvestment of the cash received as collateral, the conditions and limits applicable to such reinvestments must be disclosed, together with the risks associated therewith.

4. Quality of the lending system/ counterparty

Regarding securities lending transactions, the lending system which the fund uses for securities lending purposes as well as the counterparty to these transactions need to be subject to prudential supervision rules which are considered by the CSSF as equivalent to those provided by Community law. The requirement regarding the quality of the counterparty is also applicable for sale with right of repurchase transactions, sales of securities with a repurchase option and (reverse) repurchase transactions.

¹ Any reference in this document to the term "fund" covers generally both UCITS and UCIs.

5. Securities lending transactions

The Circular does no longer set out conditions pertaining to the fact that securities lending transactions may not extend beyond a period of 30 days and that as a general rule, they may not be carried out on more than 50% of the aggregate market value of the securities in the portfolio.

6. Limitation of the counterparty risk/ Provision of collateral

In order to limit the counterparty risk, the value of the collateral received by the fund in securities lending transactions must during the lifetime of the agreement equal at any time at least 90% of the value of the securities lent.

For any transactions covered by the Circular, the counterparty risk of the fund vis-à-vis one same counterparty may as a general rule not exceed 10% of its assets when the counterparty is a credit institution having its registered office in the European Union or if this is not the case, if it is subject to prudential supervision rules considered by the CSSF as equivalent to those of Community law (in any other case, the counterparty risk may not exceed 5% of its assets).

The collateral must be valued on a daily basis and in those cases where it appears that the value of the collateral received is insufficient, additional collateral must be promptly provided by the counterparty.

For any transactions covered by the Circular, the following assets may be admitted as collateral:

- (i) liquid assets (cash, short term bank deposits, money market instruments, letter of credit, guarantee on first demand issued by a first class financial institution),
- (ii) sovereign OECD bonds,
- (iii) shares or units issued by specific money market UCIs,
- (iv) shares or units issued by UCITS investing in bonds issued or guaranteed by

first class issuers offering an adequate liquidity,

(v) shares or units issued by UCITS investing in shares listed or dealt in on a regulated market of the European Union or on a stock exchange of a Member State of the OECD, provided they are concluded in a main index, or

(vi) direct investments in bonds or shares with the characteristics mentioned in (iv) and (v).

The fund must at any time be able to realize the collateral received.

7. Reinvestment of cash provided as collateral

The Circular contains a set of rules regarding the reinvestment of cash provided as collateral in the context of the transactions covered by the Circular.

Regarding the types of reinvestments which the fund may undertake, the Circular sets out that reinvestments may be made in:

- (i) shares or units of certain types of money market UCIs,
- (ii) short term bank deposits,
- (iii) money market instruments as defined in Directive 2007/16/CE,
- (iv) short-term bonds issued or guaranteed by a Member State of the EU, Switzerland, Canada, Japan, the United States or by their local authorities or by supranational institutions and undertakings of a community, regional or worldwide nature,
- (v) bonds issued or guaranteed by first class issuers offering an adequate liquidity, and
- (vi) reverse repurchase transactions.

As a general rule, short term bank deposits, money market instruments and short-term bonds into which the fund reinvests the collateral must constitute eligible assets within the meaning of article 41 (1) of the 2002 Law.

The Circular points out that the reinvestment of cash received as collateral is

not subject to the diversification rules applicable to UCITS, it being however understood that an excessive concentration must be avoided with respect to the issuers and the relevant instruments. However, no diversification rules shall apply regarding the reinvestment in shares or units of money market UCIs and the reinvestment in short-term bonds. The reinvestments are to be taken into account for the calculation of the UCITS' global exposure, in particular if they create a leverage effect.

8. Common rules applicable to the receipt of collateral and the reinvestment of cash provided as collateral

a) With respect to the issuer

The collateral given in a form other than cash or shares/units of funds and the financial assets other than bank assets and shares/units of UCIs purchased through the reinvestment of cash received as collateral must be issued by an entity which is not an affiliate of the counterparty.

b) With respect to the safekeeping

* The collateral in a form other than cash shall not be safekept with the counterparty, except if it is adequately segregated from the counterparty's assets. The same rule applies in case of reinvestment of the collateral in assets other than bank assets.

* The collateral in the form of cash shall not be safekept with the counterparty, except if it is legally protected from the consequences of default by the counterparty. Bank assets acquired through the reinvestment of collateral are subject to the same rule.

Regarding collateral in the form of cash and the reinvestment of collateral in bank assets, the credit risk of a UCITS vis-à-vis the trustee of the collateral shall be taken into account for the limits regarding deposits set out in article 43 (1) of the 2002 Law.

9. Immediate application

The Circular does not contain any transitional provisions, meaning that the funds subject to the Circular will, as a general rule, immediately have to comply with its provisions.

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For your convenience, we have attached the English translation of CSSF Circular 08/356.

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