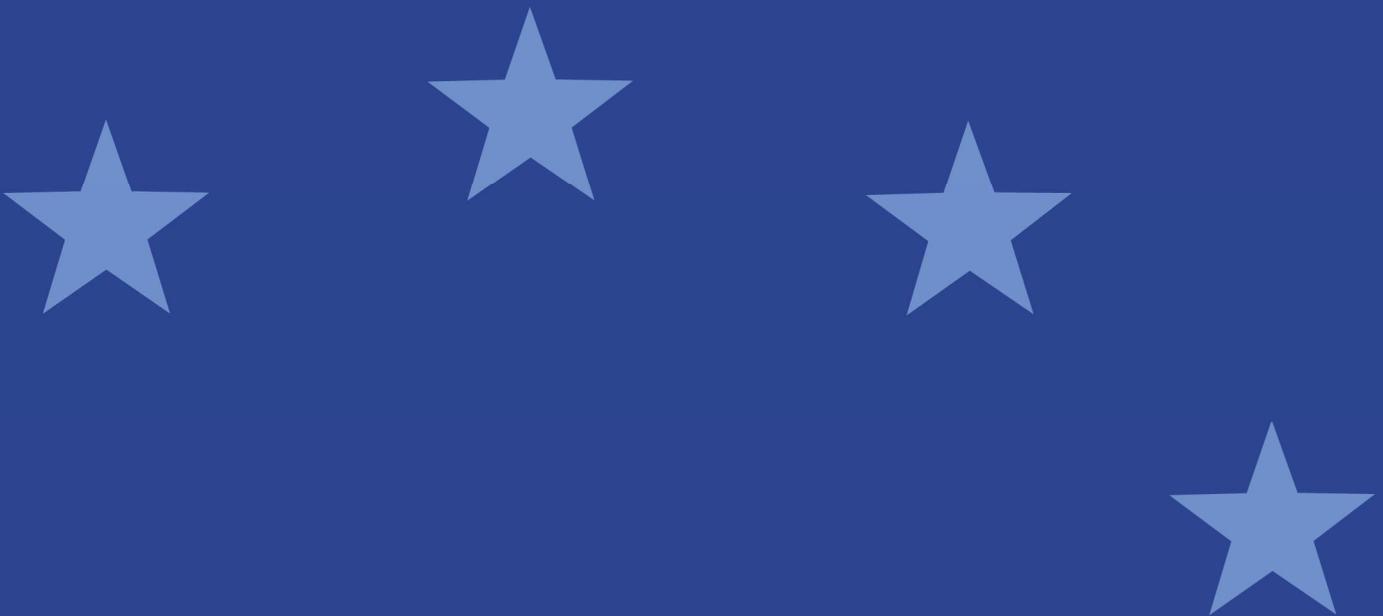




European Securities and  
Markets Authority

## Reply form for the Discussion Paper on Share Classes



## Responding to this paper

The European Securities and Markets Authority (ESMA) invites responses to the specific questions listed in the Discussion Paper on Share Classes (SC), published on the ESMA website.

### *Instructions*

Please note that, in order to facilitate the analysis of the large number of responses expected, you are requested to use this file to send your response to ESMA so as to allow us to process it properly. Therefore, ESMA will only be able to consider responses which follow the instructions described below:

- use this form and send your responses in Word format (pdf documents will not be considered except for annexes);
- do not remove the tags of type < ESMA\_QUESTION\_DP\_SC\_1> - i.e. the response to one question has to be framed by the 2 tags corresponding to the question; and
- if you do not have a response to a question, do not delete it and leave the text “TYPE YOUR TEXT HERE” between the tags.

Responses are most helpful:

- if they respond to the question stated;
- contain a clear rationale, including on any related costs and benefits; and
- describe any alternatives that ESMA should consider

### *Naming protocol*

In order to facilitate the handling of stakeholders responses please save your document using the following format:

ESMA\_DP\_SC\_NAMEOFCOMPANY\_NAMEOFDOCUMENT.

E.g. if the respondent were XXXX, the name of the reply form would be:

ESMA\_DP\_SC\_XXXX\_REPLYFORM or

ESMA\_DP\_SC\_XXXX\_ANNEX1

### *Deadline*

Responses must reach us by **6 June 2016**.

All contributions should be submitted online at [www.esma.europa.eu](http://www.esma.europa.eu) under the heading ‘Your input/Consultations’.



### ***Publication of responses***

All contributions received will be published following the end of the consultation period, unless otherwise requested. **Please clearly indicate by ticking the appropriate checkbox in the website submission form if you do not wish your contribution to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure.** Note also that a confidential response may be requested from us in accordance with ESMA's rules on access to documents. We may consult you if we receive such a request. Any decision we make is reviewable by ESMA's Board of Appeal and the European Ombudsman.

### ***Data protection***

Information on data protection can be found at [www.esma.europa.eu](http://www.esma.europa.eu) under the headings 'Legal notice' and 'Data protection'.



## Introduction

***Please make your introductory comments below, if any:***

<ESMA\_COMMENT\_DP\_SC\_1>

Amundi is the No.1 European Asset Manager and in the Top 10 worldwide with AUM of close to €1,000 billion worldwide.

Located at the heart of the main investment regions in more than 30 countries, Amundi offers a comprehensive range of products covering all asset classes and major currencies.

Amundi has developed savings solutions to meet the needs of more than 100 million retail clients worldwide and designs innovative, high-performing products for institutional clients which are tailored specifically to their requirements and risk profile.

The Group contributes to funding the economy by orienting savings towards company development.

Amundi has a direct interest in the discussion about share classes and frequently uses this mechanism to customise the access to a global portfolio according to the needs of a specific category of investors. Share classes basically offer solutions to client investors with lower costs and more rapid implementation. They have been experimented in the framework of the UCITS directive for many years without any significant trouble.

Answering the second discussion paper published by ESMA on the topic, Amundi stresses the following four key points:

- agreement with the principles-based approach followed by ESMA; we globally share ESMA's first level principles
  - "common pool of interest" is more explicit than "common investment objective" that might be confused with common risk profile as in §19,
  - non-contagion,
  - pre-determination,
  - transparency,and have some reservations on the second level or operational ones;
- need for a grandfathering provision allowing existing holders to continue managing their position in the share class they have selected;
- expansion of the intended scope of share classes with overlay in three different manners: (i) partial hedging should be authorised as well as total hedging, (ii) hedging of one risk or a combination of risks and (iii) not only hedging but exposure overlay should be authorised provided that appropriate risk management is organised;
- preference for a call for harmonisation by all NCAs through an opinion under article 29 of the ESMA regulation.

We now turn to the specific answers to the questions of the discussion paper.

<ESMA\_COMMENT\_DP\_SC\_1>



**Q1: Would you agree with the description of share classes?**

<ESMA\_QUESTION\_DP\_SC\_1>

Amundi agrees with the description of share classes provided by ESMA. Key characteristics are the absence of a legal segregation (contrary to compartments) but the presence of accounting segregation and the existence of different rights or characteristics. We think that a high level typology should be included in the definition: we suggest to differentiate between (i) technical differences with administrative and or accounting impacts and (ii) differences in the assets between classes. In the first category, which we will call “technical share classes”, we find capitalisation /distribution of revenues share classes, shares with different nominal values, different costs and fees as well as specific requirements for compliance with local tax or marketing regulations... On the other side we will find classes, that we will call “overlay share classes”, with an extra layer of assets, typically an overlay of derivatives to manage one or several risk factors.

<ESMA\_QUESTION\_DP\_SC\_1>

**Q2: Do you see any other reasons for setting up share classes?**

<ESMA\_QUESTION\_DP\_SC\_2>

The main reason for setting up new share classes is to respond to a demand of investors. This demand can typically be met through the launch of a new fund (possibly a feeder fund) or a new compartment or a new share class. When possible, the launch of a share class is the preferred solution. It is quicker to launch, it is far less expensive and it helps in terms of holding ratio for large institutional investors. In any case the creation of a new share class is primarily client driven. We would consider the use of share classes for labelling purpose as a real improvement. When the same fund is marketed through different distributors it would make sense to use classes dedicated to each distributor that would be labelled after the name of the distributor without reference to the asset manager.

<ESMA\_QUESTION\_DP\_SC\_2>

**Q3: What is your view on the principle of “common investment objective”?**

<ESMA\_QUESTION\_DP\_SC\_3>

Amundi has a strong view that the existence of a common pool of assets is the essential factor for the existence of different share classes in the same fund or compartment. Investors expect the performance to come from the common “engine” that they share. Nevertheless they may choose to be less exposed to that common engine, or more. Thus, if we agree with §15 we would tend to be more direct and explicitly mention the common pool of assets and the sharing of the risk of this pool as the first principle. We fear that the wording “common investment objective” might be translated by outsiders as meaning a common level of risk or a common risk profile. It would be too restrictive a view. We consider that share classes that belong to the “overlay share classes” may show different SRRIs and have different risk profiles. In particular, it is not true that share classes with different currency exposures have a common risk profile. For the sake of clarification we suggest to directly express the first principle as implying a common pool of assets that does not prevent investors to be offered different levels of exposure to the risk factors of this common pool through different share classes.

<ESMA\_QUESTION\_DP\_SC\_3>

**Q4: Which kinds of hedging arrangements would you consider to be in line with this principle?**

<ESMA\_QUESTION\_DP\_SC\_4>

First, we are not convinced that it is in the best interest of the investors to only allow for hedging, i.e. reduction of risk, in different share classes. It would make sense if we want to offer 3 different levels of exposures to a same risk factor through different share classes to create a common pool of assets that would be in line with the middle level and adjust for a lower exposure through hedging and for the higher level through an overlay that would increase the risk factor. In any case, as will be further discussed below, the concern is to monitor and master risk in order to avoid contagion and that does not imply that hedging is the only possibility.

Second, Amundi does not consider that the definition of hedging for the purpose of defining share classes should refer to box 8 of CESR's *Guidelines on risk measurement*. The guidelines are specific to the metrics of the commitment methodology and present a simplified approach of hedging.

Third, we think that any type of risk factor is manageable and that different share classes should be allowed to offer different exposures to these risk factors. We are aware of clients' interest for a customised exposure to different risk factors and we would expect to meet their needs through share classes that offer different levels of exposure to one or a combination of the following risk factors :

- Interest rate or duration, in order for investors to better adjust the matching between assets and liabilities; interest rate hedging allows as well, when applied to inflation linked bond portfolios, to limit the bet to the expected level of inflation or, when applied on a corporate bond funds, to let investors take a pure credit risk;
- Currency, which is key to attract investors with a different basis currency
- Volatility, that appears as a real performance engine in times of uncertainty
- Equity, where the beta can be adjusted to the risk exposure accepted by the investor and the focus put on alpha performance
- Dividend , that is clearly a major constituent of the long term performance of an equity portfolio and as such a sensitive factor of risk in this asset class.

<ESMA\_QUESTION\_DP\_SC\_4>

**Q5: What is your view on the principle of “non-contagion”?**

<ESMA\_QUESTION\_DP\_SC\_5>

Absence of contagion between classes is paramount when setting up a new share class in a UCITS. Therefore, we understand why a larger number of questions relate to this principle in this discussion paper and agree with ESMA to focus on it. The point is that due to the absence of legal segregation one share class is not protected against the losses incurred by other share classes. That has to be avoided by other means and we think of risk management and limits in the first place. In any case, if it carried a real threat of contagion, the launch of a new share class should not take place.

<ESMA\_QUESTION\_DP\_SC\_5>

**Q6: Are you aware of any material evidence of investors in one share class suffering losses as a result of the crystallisation of risk in another share class?**

<ESMA\_QUESTION\_DP\_SC\_6>

No. This answer is of the utmost importance as it tends to evidence, especially if no regulator has either heard of any occurrence of contagion between classes, that self-regulation by the industry has been efficient. It does not come as a surprise when one realises that creation of share classes is a client driven process where the calibration is determined with a view on what investors ask for. Furthermore UCITS regulation strictly limits risks.

<ESMA\_QUESTION\_DP\_SC\_6>

**Q7: Where do you see a potential for contagion risk arising from the use of derivative hedging arrangements? What are the elements of this contagion risk? (cf. paragraph 23)**

<ESMA\_QUESTION\_DP\_SC\_7>

Except for fraud that can appear anywhere at any time, we identify 3 sources of potential contagion risk between share classes : cash management, counterparty risk, insolvency risk.

The first one is common to all share classes, be they technical or overlay share classes. It results from the fact that cash is common and is not individually split between share classes. It is a key benefit for investors that subscriptions and redemptions are not managed at the level of the share class but belong to the common pool of assets. It offers a smooth process for netting redemptions on one class with subscriptions on others and meeting redemption without selling assets if not necessary. The question with “overlay classes” is that they use cash as deposit and in order to meet margin calls related to their own derivative positions. Margin calls may be positive and bring cash to the common pool as well. Since they represent

the gain or loss at the close of the day, they are accounted for in the specific class that holds the concerned derivative when determining the NAV of this share class. It implies that the fund manager monitors these flows when overviewing and anticipating its global cash position but does not bring any specific risk of contagion, especially due to regular calls or resets to adjust to market value.

The second risk is linked to the counterparty risk existing on derivative products. When traded and centrally cleared, we feel confident that counterparty risk is under control by competent authorities. In case of OTC non centrally cleared transactions, like with FX trades, there is a clear counterparty risk. Regular margin calls or resets, as required by EMIR, reduce it in a very large proportion. The UCITS regulation requires that the asset manager carry and review a thorough assessment of the quality of the counterparties it uses. Other mitigation factors are to be found in the use of platforms to deliver or in the possibility for UCITS to exit at any time from a deal as they benefit from a unilateral cancellation right.

The third risk is a question of size and risk management. Can a UCITS default because of a share class becoming insolvent? This is what contagion risk is about. UCITS regulation aims at preventing this risk. The most prominent provisions in this field are the limitation of the leverage defined as the net commitment of a UCITS, the limits on cash borrowing, the concentration limits, the counterparty selection requirements, the quasi-ban on re-use of collateral received (cash or securities), the risk management process, the disclosure and information required, the frequent, not to say daily in practice, valuation on a mark to market basis... All these requirements are fully applied when managing a UCITS whatever the existence of different classes or not. In the absence of fraud, even the worst case scenario cannot amount to the default of a UCITS. Can the losses on a share class lead to unduly impoverishing holders of other classes? In order to avoid such a dramatic scenario, a daily valuation of the overlay position and a daily margin call is the first way to ensure that there is no "hidden" depreciation. When derivatives are centrally cleared the rules of the CCP provide for a systematic adjustment, without any Minimum Transfer Amount. Intraday call is also a possibility with CCPs in case of high volatility. The second way to ensure solvency of the share class is to properly calibrate the overlay and reverse-stress test in what extreme situations there could be a contagion.

<ESMA\_QUESTION\_DP\_SC\_7>

**Q8: Do you agree with the operational principles set out in paragraphs 28 and 29?**

<ESMA\_QUESTION\_DP\_SC\_8>

Amundi agrees with ESMA's principle based approach when defining what risks share classes could cover as well as when elaborating on the operational aspects of the non-contagion principle.

With regard to §28, we submit the following comments:

- We consider that the way different share classes are separated in the accounting process ensures that a) and b) can be easily monitored and satisfied;
- We think that the asset manager should be given the flexibility to decide on the proper way to conduct the stress test foreseen in c); we believe that the present UCITS regulation is sufficiently demanding to avoid insolvency of a share class; if we consider hedged share classes, they add a specific reduction of risk and we do not feel that there is much to stress test;
- In d), we totally agree that creation of share classes are demand driven;
- Amundi believes that it is redundant to list predefinition and transparency of the overlay management in e) as an operational principle since pre-determination and transparency are the following 2 high level principles (cf 3.3.4 and 3.3.5).

Considering §29, we think that d) should be amended to use the more common wording of "on an ongoing basis" instead of "at any time", to better consider the timely adjustments that are required, knowing that time lag in the circulation of information in different time zones automatically leads to involuntary breaches. Furthermore, we feel that e) is redundant with the introduction of a maximum band for hedging in b) and c) that will impose immediate resets when they are needed.

<ESMA\_QUESTION\_DP\_SC\_8>

**Q9: Do you consider the exposure limits in paragraphs 29.b and 29.c to be appropriate?**

<ESMA\_QUESTION\_DP\_SC\_9>

First, Amundi insists on the possibility to offer to investors either partial or total hedging. In that respect we consider that the wording as it stands is not satisfactory and we suggest to determine the limits as a percentage of the objective level of hedging or exposure announced for the share class. Second, we further believe that it would be more appropriate to slightly enlarge the band from 95/105 % to 90/110% of the objective expressed on the risk exposure of the share class. Otherwise, investors may suffer an excessive cost due to too frequent and non-significant adjustments. Third, we think that ESMA should include some precision on the meaning of this 90/110%. When reaching the limit should the manager reset at 100% or could the policy allow for any figure within the band, for example 95 or 91%?

<ESMA\_QUESTION\_DP\_SC\_9>

**Q10: Which stresses should be analysed as part of the stress tests?**

<ESMA\_QUESTION\_DP\_SC\_10>

We agree that the open counterparty risk ought to be monitored at the level of the share class it belongs to. In terms of stress testing, we have not a clear view of what would be relevant in the case of hedged shares. They reduce risk and the existence of a 90/110 % variation band strictly limits the risk. For share classes with an overlay that increases risk, we agree that stress testing is an efficient instrument to manage risk.

<ESMA\_QUESTION\_DP\_SC\_10>

**Q11: Which hedging arrangements would you consider as compatible with the operational principles outlined above? Insofar as you consider some (or all) of the hedging strategies in paragraph 30(a)-(b) as being compatible with these operational principles, please justify how such strategies are compatible with each one of the principles.**

<ESMA\_QUESTION\_DP\_SC\_11>

We agree that currency risk hedging is compliant with the principles as they are expressed. Based on that evidence, we examined different types of share classes and concluded that share classes hedging other risks should be authorised. We consider that it is not consistent with the principles based approach that ESMA follows to produce an exhaustive list of risks that could be hedged in a compliant manner through share classes. Nevertheless, we will illustrate the case of duration and equity which are the most common examples existing today. But we insist that the predetermined management of other risk factors appeals to investors and is or could soon be offered to them through share classes.

The first 2 principles mentioned under §28 relate to risk management and accounting and point towards standard procedures that can easily be implemented if not yet the case. About stress testing, we have expressed the view that it is difficult to find a relevant unique stress test and that it should be left to the asset management company to decide what to test or reverse test. The fourth operational principle is a need for confirmation of clients' interest in the proposed share class. It can, as mentioned, be evidenced *ex ante* on the basis of the analysis of the customisation the share class offers in the range of exposures to different risk factors. There are significant assets invested in products with a graduation of the level of exposure to maturity risk as well as to equity market beta risk. The fifth principle is implicit in the requirement for predetermination and we totally agree with it, provided the automation on the decision to hedge and to what point does not suppress the ability for the manager to decide on the appropriate instruments to reach the predefined level of hedging. On all of the principles under article 28 we do not see any difficulty for other risk hedging than currency risk to be compliant if we assume that each share class reaches a size sufficient to be active on derivative markets. We are ready to further discuss the point with ESMA if needed.

Under § 29, we agree that the counterparty risk specific to the overlay of a given share class has to be monitored at the level at that share class. We further underscore that the reduction of risk will primarily result from an appropriate exchange of collateral to reduce the open position with a counterparty. We have already commented in our answer to question 8 the other requirements and our suggestions of a practical nature. When referring to them with other risk factors than currency risk, we do not get any hint on what would justify the doubt on their compliance expressed by ESMA in §30. We urge ESMA to be more



specific and open a discussion on this topic. We would find it counterproductive to have various interpretations in different member States of the same ESMA's principles.  
<ESMA\_QUESTION\_DP\_SC\_11>

**Q12: Notwithstanding the fact that ESMA considers the above operational principles as minimum requirements, are there additional operational principles that should apply to address the non-contagion principle?**

<ESMA\_QUESTION\_DP\_SC\_12>  
Amundi considers that the general requirement under UCITS to have a regular review of the procedures and an effective control of their application is sufficient to ensure the efficiency of the proposed framework.  
<ESMA\_QUESTION\_DP\_SC\_12>

**Q13: What effect would these additional measures have on the compatibility of the operational principles with further hedging arrangements?**

<ESMA\_QUESTION\_DP\_SC\_13>  
The introduction of the monitoring of the commitment at the level of the share class where the overlay aims at adding risk is consistent with the need to avoid non-contagion. Such a requirement is only relevant in the case of an increase of the risk level.  
<ESMA\_QUESTION\_DP\_SC\_13>

**Q14: What is your view on the principle of “pre-determination”?**

<ESMA\_QUESTION\_DP\_SC\_14>  
The pre-determination principle is a cornerstone for the implementation of an overlay specific to a share class. It is the only way to avoid confusing management of the common pool of assets and of the overlay. Investors must have confidence in the mechanism of share classes. It allows a common pool of assets to be presented in different wrappers and those must exclude any discretion in the management of the risk exposure resulting from the overlay. We believe, however, that the fund management company should be allowed discretion in the choice of the instruments to use to hedge a risk. Where the manager will act in the best interest of the client investors, we fear that an automated and unique methodology to implement a hedge would lead to non-optimised solutions, especially when using OTC derivatives. We do not like the idea of robot hedging.  
<ESMA\_QUESTION\_DP\_SC\_14>

**Q15: Are there additional requirements necessary to implement this principle?**

<ESMA\_QUESTION\_DP\_SC\_15>  
We have already mentioned under question 9 that ESMA should in our view be more specific on the degree of freedom it intends to allow when resets or quantitative adjustments are necessary. If the hedging band for a full hedging strategy were 90/110%, we suggest that the rule would be to systematically reset at 100% when one of the two sides of the band is reached. We would like to dismiss a strategy whereby the hedging would become a performance engine with a possibility to speculate between 90 and 110%.  
<ESMA\_QUESTION\_DP\_SC\_15>

**Q16: What is your view on the principle of “transparency”?**

<ESMA\_QUESTION\_DP\_SC\_16>  
One of the pillars of UCITS directive is to bring adequate information to units holders. It acted as a real lever and largely contributed to the success of the UCITS label worldwide. The architecture for official documentation includes the prospectus and its KIID summary as well as the annual report which both are updated at least yearly. Incidentally, we are highly surprised that depending on the jurisdiction of a UCITS

it may or may not be required to produce a specific KIID per share class, even if classes do not present the same synthetic risk return indicator (SRRRI). Marketing documentation which is identically subject to format and accuracy requirements is also provided to investors. These documents are made available to the public through the website of the asset management company.

We think that the industry must capitalise on this asset and in the case of share classes use the existing documents, prospectus and annual report, as suggested by ESMA.

We are puzzled with §36 (b) where ESMA introduces the notion of “share classes with a contagion risk”. We believe that all our common efforts aim at preventing share classes to carry a spill over risk. Alternatively we read that ESMA shares our view that we should split share classes in two blocks as we suggest under question 1:

- “technical share classes”, and
- “overlay share classes”.

But in our view both categories carry a potential contagion risk through the centralised cash management of the fund and we do not think that a specific transparency rule should apply to one or the other category. However, we agree that the asset manager should hold an updated list of existing share classes at the disposal of whoever would ask for it.

<ESMA\_QUESTION\_DP\_SC\_16>

**Q17: Do you consider the disclosure requirements to be sufficient?**

<ESMA\_QUESTION\_DP\_SC\_17>

Yes, and very much so when considering the success of the UCITS label worldwide.

<ESMA\_QUESTION\_DP\_SC\_17>

**Q18: Notwithstanding the fact that ESMA considers the above operational principles on transparency as minimum requirements, which modifications would you deem necessary?**

<ESMA\_QUESTION\_DP\_SC\_18>

Please refer to our response to question 16 above and our comment of §36 (b). We reiterate our opinion that the interpretation of the requirement to produce or not a specific KIID for each share class should be clarified and harmonised at the EU level. We consider that it is necessary to separate at least share classes that do not show an identical SRRRI.

<ESMA\_QUESTION\_DP\_SC\_18>

**Q19: Do you see merit in further disclosure vis-à-vis the investor?**

<ESMA\_QUESTION\_DP\_SC\_19>

No. We typically feel that excess of information does not help in the relationship with investors. What is of importance is to convey relevant information in understandable language to help them in their investment decision.

<ESMA\_QUESTION\_DP\_SC\_19>

**Q20: If a framework for share classes, based on the principles as outlined in this paper, was introduced at EU level, what impact on the European fund market could this have?**

<ESMA\_QUESTION\_DP\_SC\_20>

We totally agree with the principles based approach taken by ESMA in order to identify which types of share classes should be authorised under UCITS. It evidences an in depth analysis of the risks involved and helps building a typology that may evolve in the future. Our industry is highly innovative and we do not know how the future will look like: with strong principles we shall have in hands the necessary tools to judge and allow EU asset management to remain at the edge of the international competition.



Based on the principles expressed by ESMA in this discussion paper, we consider that the present framework and internal organisation of UCITS management firms will make it possible for “overlay share classes” to offer different levels of exposure to different risk factors of a fund.

This conclusion, that differs from ESMA’s view, shows that the question of interpretation of the principles will be of foremost importance. Therefore, we urge ESMA to publish an opinion to NCA’s under article 29 of the ESMA regulation and not under article 34. The point would be totally missed if there were not fierce plea for harmonisation of the rules throughout the EU. Article 29 typically calls for the development of a common supervisory culture among NCAs and should be preferred.

<ESMA\_QUESTION\_DP\_SC\_20>

**Q21: Given ESMA’s view that certain hedging arrangements currently in place might not be compliant with the common principles of share classes as outlined above, which kinds of transitional provision would you deem necessary?**

<ESMA\_QUESTION\_DP\_SC\_21>

Amundi does not understand the rationale for ESMA’s general view that some current hedging arrangement should not be confirmed on different share classes. Based on the fact that there is no publicised example of contagion of one share class by another so far, we strongly believe that all existing share classes should be authorised to continue.

We know that some share classes add an exposure to risk on top of the common pool of assets and do not intend to lower risk. They will not comply with ESMA’s present view and language that only considers hedging. We think it is a prejudiced view that does not adequately take stock of the real level of risk for investors (and their appetite for those shares). Principles as expressed by ESMA can easily apply to both hedging and exposure. We think that they should. Should this view not prevail, the introduction of a grand fathering clause would be a necessity to maintain large amounts (billions of €) that have been subscribed by European and Overseas investors on different UCITS share classes.

In order for asset managers to document the compliance of the share classes they run with the new principles, we recommend that a transition period of 2 years be provided for. For those share classes that would not be considered as compliant we recommend a grand fathering provision allowing them to survive without any future marketing towards new clients.

<ESMA\_QUESTION\_DP\_SC\_21>