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ESMA

Discussion paper on share classes of UCITS

Af2i **response to the ESMA's discussion paper on share classes of UCITS**

The Association française des investisseurs institutionnels (Af2i)[1] welcomes the opportunity to answer to ESMA's consultation on UCITS share classes. As we are not asset management companies, we will comment the overall questions about these techniques.

Responses to the questions of the discussion paper

1. What are the drivers for creating different share classes?

Institutional investors are strongly in favor of share classes, because they have many advantages and give many keys to customize basic investments in UCITS.

The many advantages can be summarized as

- Focusing the fund manager on one fund instead of several ones, and reducing the risk of underperformance of one of them;
- Increasing granularity of the investors and helping them to invest more amounts in the same fund and to face concentration risk. Institutional investor usually limit their investment in one fund to 5 10% of the AUM.
- Reduced operating costs, due to the management of pool of assets and to the increased size ;
- Favoring better liquidity risk management;
- Helping to distribute to different investors networks, with different initial investment amounts, different management fees or entry/exit fees;
- Permitting different revenue distribution regimes;
- Permitting to avoid currency risk with hedged share classes;
- Avoiding to create "clones" of the fund for only customized secondary reasons ;
- Giving sources of systematic hedging, partial or total market risk (equity, duration, widening credit spread, inflation.);
- Avoiding transaction costs when investors switch between two share classes.
- Etc.

[1] *Af2i is the French Association of Institutional Investors, created in 2002 to gather and represent the different families of Institutional Investors (insurance companies, pension institutions, foundations, corporate, special institutions (Caisse des Dépôts, FRR), etc., to promote institutional asset management techniques, to organize training and transmission of best practices. Af2i wish also to defend interests of his members in France and in Europe.*

Af2i meet 76 major institutional investors as members representing more than 2 trillion € of assets under management and 66 asset management companies, asset servicers or providers as associate members.

Each year, Af2i publish a global survey on investment and assets.

2. Why do certain UCITS decide to create share classes instead of setting up a new UCITS?

Most of the time, the decision is based on investors' demand. The management company wan to help new investors, interested by a specific UCITS to have a more accurate investment with different or better conditions than the original ones of the selected fund.

3. What are the costs of creating and operating a new share class compared to the cost of creating and operating a separate UCITS?

Asset management companies are more qualified to answer with the appropriate and precise details. We think that the advantage are shared between reduced operating and transaction costs due to the pooling of assets, the decreasing fees based on AUM and fixed fees (as auditors).

4. What are the different types of share class that currently exist?

Shares classes may be created:
- With maximum or minimum investment amounts, or values of holdings allowed to be retained;
- according in terms of the type of investor (e.g. institutional investors vs. retail investors), with "ad hoc" entrée fees or conditions;
- According to the currency in which they are denominated;
- To provide currency hedging when share classes are denominated in different currencies from the base currency;
- to provide a systematic hedging (total or partial) against a market risk (equity market, duration risk increase, risk of widening of credit spread, risk of inflation increase, risk of volatility increase...),
- With different types of charges and fees that may be levied and their amount (on-going charges, subscription and redemption fees, performance-related fee);
- With a different allocation of revenues to investors (by capitalization or distribution, either subject to or exempt from withholding tax);
- With different currency exposure;
- exposed to the same pool of assets but with different level of capital protection/guarantee and/or payoff.

We do not pretend that this list is complete.

5. How would you define a share class?

We consider that shares classes suppose, first of all, a unique pool of assets, which is the base of a unique and common investment strategy.

As the discussion paper says, "shares classes, in contrast with compartments, are not sub-funds but categories of share which belong to the same UCITS and allow subsets of investors in a UCITS to achieve some level of customization which accommodates their specific needs".

We agree with this definition, but "unique pool of assets" or "common pool of assets" should be sufficient and more explicit.

6. Do you agree that share classes of the same UCITS should all share the same investment strategy? If not, please justify your position.

We understand that investment strategy is a concept with a different definitions in others countries. We consider that it is the basic and common criterion to define shares classes.

7. Could you explain how the operational segregation between share classes works in practice?

Asset managers are better qualified to answer to this question.

Their explanation convince that segregation of specific assets, contracts, collaterals and overlays techniques for each share classes can co-exist with a central pool of assets (the same investment strategy).

8. Do you agree that the types of share class set out in paragraph 8 are compatible with the principle of having the same investment strategy? In particular do you agree that currency hedging that is described in paragraph 8 complies with that principle? If not, please justify your position.

Yes, but the list is not exhaustive.

9. Do you believe that other types of share class that comply with the principle of having the same investment strategy exist (or could exist) and should be allowed? If yes, please give examples.

If “same investment strategy” mean “unique common pool of assets”, share classes can be allowed even in hedging one or more market risks.

We should have in mind that some institutional investors, in particular those subjected to the directive Solvency II, may need, by optional strategies, to reduce extreme risks to limit capital charge consequences.

10. Do you agree that the types of share class set out in paragraph 10 above do not comply with the principle of having the same investment strategy? If not, please justify your position.

Share classes offering various levels of protection should be recognized, like shares classes offering a partial or total hedge against a market risk factor existing in the portfolio. The overlay

11. Please provide information about which existing UCITS do not comply with the criteria laid down in paragraph 6 as well as an indication of the assets under management and the number of investors of these UCITS.

In France, all cases described in paragraph 8 are authorized[2].

“Same investment strategy” is respected as long as there is a “unique pool of assets” dedicated for all shares classes and if overlay techniques are systematically reducing the risk of a given risk factor, partially or totally, on a given share class. No contagion risk can affect another shares class.

12. Do you see merit in ESMA clarifying how regulatory ratios such as the counterparty risk limit should be calculated (e.g. at the level of the UCITS or share classes)?

Asset managers are better qualified to describe and confirm the accurate solution, but intuitively, it seems that the counterparty risk as to be calculated at the share class level.

13. Do potential and current investors get adequate information about the characteristics, risks and return of different classes in the same UCITS? If not, what else should be provided to them?

The Position-Recommandation of the AMF (n° 2011-05) explains clearly how investors receive an adequate information and give also the method.

- indicate the risk hedging policy in the summary table of the fund offering (present the entire spectrum of share classes that are offered); the risk heding policy is necessarily a systematic one;
- clearly mention the risk hedging policy related to each share class within the investment strategy;
- ensure consistency between the fund objective, the benchmark, the classification and, if relevant, the threshold of the performance fee with the management put in work for each share, by adapting it to each share class, if needed;

[2] Position recommandation AMF n°2011-05

- to explicitly specify within the profile of risk (except permanent total hedging of the risk for all share classes) the residual risk suitable for each share class – and not the methods of hedging for this risk.

For us, it is sufficient. The Irish UCITS and Luxembourgish UCITS documents we have seen in the past had accurate information for investors.

14. Do you agree that ESMA should develop a common position on this issue? If not, please justify your position.

Yes, as share classes differs from one country to another, it is important to qualify a common definition at the European level.

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Position - recommandation AMF n° 2011-05 –

Guide des documents réglementaires des OPCVM et OPCI – DOC-2011-05

Extrait

1.3.5. Catégories de parts ou d'actions Souscripteurs concernés

Les OPCVM / OPCI dédiés doivent préciser dans cette rubrique :

- soit qu'ils sont « dédiés à 20 porteurs au plus » ;

- soit qu'ils sont « dédiés à [une catégorie d'investisseurs] », en précisant quelle est cette catégorie. Il est rappelé que ces OPCVM / OPCI dédiés ne font pas l'objet de publicité, de démarchage ou autre forme de sollicitation au public.

Les autres OPCVM/OPCI doivent posséder au moins une part accessible à tous les souscripteurs (le cas échéant sous contrainte de montant minimum de souscription). Une distinction sémantique claire doit être faite, le cas échéant, entre :

- les catégories de parts ou d'actions « tous souscripteurs, plus particulièrement destinées à […] », qui sont des parts dont la souscription n'est pas juridiquement interdite à un souscripteur choisissant de respecter les caractéristiques techniques de la part (montant minimum d'investissement initial par exemple). Une simple indication de la cible de commercialisation préférentielle de l'OPCVM / OPCI est dans ce cas présentée ;

- les catégories de parts ou d'actions « réservées à [une catégorie d'investisseur] », auxquelles seuls les investisseurs de cette catégorie peuvent accéder (exemple : part réservée aux OPCVM / OPCI du groupe X).

Différentiation des catégories de parts ou d'actions en fonction du réseau de commercialisation Il est possible de créer des catégories de parts ou d'actions réservées à un réseau de commercialisation. Il n'est pas nécessaire que ces parts diffèrent par une autre caractéristique que leur réseau de commercialisation. Elles peuvent en particulier avoir la même structure de frais.

Mise en place de couverture d'un ou plusieurs risques sur certaines parts ou actions d'un OPCVM ou d'un OPCI

Conformément à l'article 411-22 du règlement général de l'AMF, un OPCVM peut créer des catégories de parts ou d'actions mettant en œuvre une stratégie de couverture systématique de risque, partielle ou totale, définie dans le prospectus. Afin de minimiser le risque opérationnel et d'assurer une bonne information des souscripteurs, les OPCVM mettant en œuvre ce type de méthode doivent :

- s’assurer, le cas échéant et en lien avec leur gestionnaire comptable, de leur capacité à ségréguer les flux financiers et comptables liés à chaque part ou actions, et à tester, avant mise en œuvre, les mécanismes correspondants ;

- indiquer la politique de couverture du risque dans le tableau récapitulatif de l’offre de gestion reprenant l’ensemble des parts proposées, celle-ci étant nécessairement une politique de couverture systématique de ce risque ;

- exprimer clairement la politique de couverture du risque liée à chaque part au sein de la stratégie d’investissement ;

- veiller à l’adéquation de l’objectif de gestion, de l’indicateur de référence, de la classification et si applicable, du seuil de prélèvement de la commission de surperformance avec la gestion mise en œuvre pour chaque catégorie de parts ou d’actions, en l’adaptant au besoin à chaque catégorie de part ou d’action ;

- préciser de façon explicite au sein du profil de risque (sauf couverture totale permanente du risque pour l’ensemble des catégories de parts ou d’actions) le risque résiduel propre à chaque part ou action – et non les modalités de couverture de ce risque.