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| 6 April 2016 |

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| Reply form for the Discussion Paper on Share Classes |
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| Date: 6 April 2016 |

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>

We have provided this response on behalf of Citibank N.A., London Branch (Global Fund Services).

<ESMA\_COMMENT\_ DP\_SC\_1>

1. Would you agree with the description of share classes?

<ESMA\_QUESTION\_DP\_SC\_1>

Yes, we agree the description in paragraph 9.

<ESMA\_QUESTION\_DP\_SC\_1>

1. Do you see any other reasons for setting up share classes?

<ESMA\_QUESTION\_DP\_SC\_2>

Paragraph 12 captures the reasons we have observed for creating share classes. Ultimately creating multiple share classes allow a wider range of investors to get access to the performance of a common pool of investment assets with the efficiencies and cost benefits that a larger pool of assets offers.

<ESMA\_QUESTION\_DP\_SC\_2>

1. What is your view on the principle of “common investment objective”?

<ESMA\_QUESTION\_DP\_SC\_3>

We are broadly in agreement with paragraphs 15 to 18 in respect of the common objectives, in that it is offering access to a common pool of investments with the benefits that larger common pools offer to different investors.

With regard to the statement in paragraph 20 describing the use of currency share classes as being a consequence of not all members being in the Eurozone is too narrow a description. UCITS have been very effectively marketed and “exported” outside of the EU to non-member state citizens. The ability to attract customers from outside the EU has been a significant export success for the industry and we would be concerned if this were lost if the use of currency hedged classes were to be defined in the context of the currencies of member states only.

<ESMA\_QUESTION\_DP\_SC\_3>

1. Which kinds of hedging arrangements would you consider to be in line with this principle?

<ESMA\_QUESTION\_DP\_SC\_4>

We consider hedges that are intended to protect investors from currency fluctuations to be appropriate. These will include hedges between:

* The currency of the share class V’s the fund’s base currency
* The currency of the share class V’s the currencies of the underlying assets

In addition, some UCITS manager offer a share class hedge between the share class and fund base currencies limited to the proportion of the underlying portfolio invested in Fixed Income securities reducing they cost of providing the hedge whilst offering the protection for the asset class whose performance is most susceptible to currency exchange rate changes.

<ESMA\_QUESTION\_DP\_SC\_4>

1. What is your view on the principle of “non-contagion”?

<ESMA\_QUESTION\_DP\_SC\_5>

We support the principle of requiring mitigation of the possible risk of cross contagion.

<ESMA\_QUESTION\_DP\_SC\_5>

1. 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>

We have been supporting clients offering currency hedged classes since 2009 and have not observed any such risk crystallising.

<ESMA\_QUESTION\_DP\_SC\_6>

1. 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>

In respect of currency hedges we agree that the risk of contagion is primarily default by counterparty. This is in part mitigated by the future requirement for margining and processes in place to realise any unrealised gains or losses above an agreed tolerance.

<ESMA\_QUESTION\_DP\_SC\_7>

1. Do you agree with the operational principles set out in paragraphs 28 and 29?

<ESMA\_QUESTION\_DP\_SC\_8>

Yes, we support the principles in paragraphs 28 and 29; however, we believe that controls should be in place to ensure that exposure never exceeds the share class value with triggers to take action be set at a significantly lower level, as is the case in the examples we have observed today.

<ESMA\_QUESTION\_DP\_SC\_8>

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

<ESMA\_QUESTION\_DP\_SC\_9>

Yes we agree these limits and also the ability to set a lower limit where a manager is seeking to reduce the cost of hedging by covering only the parts of a portfolio where the asset value is most sensitive to FX rate movements.

Our experience is that market convention and the regulators in most of the markets that we support permit tolerances between 95% and 105% of the target hedge before an adjustment is needed although many funds in the market have tighter tolerances.

<ESMA\_QUESTION\_DP\_SC\_9>

1. Which stresses should be analysed as part of the stress tests?

<ESMA\_QUESTION\_DP\_SC\_10>

As stated in the response to question 8 we would expect a control process that would require the manager to take action before losses in a class hedge become in anyway material either for their exposure or as a drag on performance.

<ESMA\_QUESTION\_DP\_SC\_10>

1. 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>

For the reason set out in paragraph 30 we agree with the conclusion that it would be difficult to demonstrate that the principles set out above could be met for all except currency hedging where the intention is to protect the investor against currency movements between:

* The currency of the share class V’s the fund’s base currency
* The currency of the share class V’s the currencies of the underlying assets

Again we support the use of partial share class value hedge were linked to asset classes where performance is most sensitive to currency exchange rate variations and the tolerances proposed. These strategies and their potential impact should be clearly stated in fund documentation.

<ESMA\_QUESTION\_DP\_SC\_11>

1. 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>

The key control we apply is to ensure that the extent to which the hedge position is in or out of the money is monitored and when agreed tolerances are breached that action is taken to realise any gain or loss thus bring exposure back within the tolerances agreed.

<ESMA\_QUESTION\_DP\_SC\_12>

1. What effect would these additional measures have on the compatibility of the operational principles with further hedging arrangements?

<ESMA\_QUESTION\_DP\_SC\_13>

We see this proposal as existing current best practice.

<ESMA\_QUESTION\_DP\_SC\_13>

1. What is your view on the principle of “pre-determination”?

<ESMA\_QUESTION\_DP\_SC\_14>

We broadly agree the statements regarding pre-determination with the exception of where a UCITS manager might wish to retain some discretion as to which currencies and asset classes might be deemed to be cost effective to include in the hedging process. The proposed limits of a maximum tolerance of 105% should provide some certainty as to the minimum exposure.

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<ESMA\_QUESTION\_DP\_SC\_14>

1. Are there additional requirements necessary to implement this principle?

<ESMA\_QUESTION\_DP\_SC\_15>

We do not propose any additional requirements

<ESMA\_QUESTION\_DP\_SC\_15>

1. What is your view on the principle of “transparency”?

<ESMA\_QUESTION\_DP\_SC\_16>

Subject to our concerns regarding the nature of the stress test, we agree the proposal for disclosure, and in particular to investors in classes that are not hedged.

<ESMA\_QUESTION\_DP\_SC\_16>

1. Do you consider the disclosure requirements to be sufficient?

<ESMA\_QUESTION\_DP\_SC\_17>

Yes.

<ESMA\_QUESTION\_DP\_SC\_17>

1. 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>

We have no further proposal.

<ESMA\_QUESTION\_DP\_SC\_18>

1. Do you see merit in further disclosure vis-à-vis the investor?

<ESMA\_QUESTION\_DP\_SC\_19>

We agree that all investors whether to the hedge class or other classes are made aware of the presence of the hedged class, its theoretical impact to the other classes and the controls in place to prevent such impact.

<ESMA\_QUESTION\_DP\_SC\_19>

1. 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>

The impact will vary from jurisdiction to jurisdiction with some gaining the ability to offer different share classes with should help with cost associated with sub-optimal sized similar portfolios. Others will lose the ability to offer duration hedges which have been seen as a convenient way to offer investors in Fixed Income funds protection from rising interest rates which will be detrimental to some, more sophisticated, investors. We are not aware of any material disadvantages.

<ESMA\_QUESTION\_DP\_SC\_20>

1. 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>

Any transitional arrangements must allow sufficient times for all investors to be informed and provided with an alternative that would match the investment objective albeit through a less efficient vehicle.

<ESMA\_QUESTION\_DP\_SC\_21>