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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>

The Investment Association represents the UK asset management industry. Our members manage £5.5 trillion (€7 trillion) in the UK of assets on behalf of UK, European and international clients, both retail and institutional. Our aim is to make investment better for clients so they achieve their financial goals, better for companies so they can get the capital they need to grow, and better for the economy so that everyone prospers.

We support ESMA in developing a common position for share classes of UCITS. UCITS is the EU’s flagship investment product for retail investors.

As ESMA recognises, the UCITS Directive does not prescribe what is and is not allowed at share class level. Given that there is no such prescription and given the benefits of pooling, it is in the interests of investors to provide as much flexibility as possible as regards the ability to create share classes within a single UCITS subject to robust management of any residual risks and appropriate disclosure.

As ESMA notes, the driver for creating different share classes is to allow subsets of investors in a UCITS to achieve a level of customisation which accommodates their specific needs in a way which is cost effective for investors. Share classes are significantly more cost effective than sub funds.

We therefore support a principles-based approach to UCITS share classes, with those principles recognising both the importance of robust risk management and appropriate disclosure.

It is equally important that the same range of share classes should be available to investors throughout the EU regardless of the domicile of the UCITS; investors have a legitimate right to expect to be able to access to the same range of share classes in a European product.

Given too that the UCITS of any European domicile can be freely sold throughout the European Union, if any national regulator is unduly restrictive of locally domiciled UCITS, which will hamper the ability of that Member State’s UCITS to meet investor needs.

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

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

<ESMA\_QUESTION\_DP\_SC\_1>

Yes, we agree with the description of share classes although in any setting out of examples (as in paragraph 9), it would also be helpful to give as an example, the hedging of certain risks such as currency risk.

<ESMA\_QUESTION\_DP\_SC\_1>

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

<ESMA\_QUESTION\_DP\_SC\_2>

No. The responses ESMA received in response to its first Discussion Paper highlight the reasons why launching share classes rather than launching new funds is attractive. It is also in keeping with the Commission’s desire to increase the size of UCITS where practicable rather than launch further funds which might be small in scale as they seek to meet the needs of a specific set of investors.

If a UCITS needed to be set up to meet the customised requirements of each group of investor, economies of scale would be lost. There would be a replication of funds with similar underlying portfolios. If, a number of funds had to be set up instead of one, economies of scale are lost to the detriment of all investors.

The ability to have share classes means that each subset of investors has an interest in the same underlying pool of assets but it tailored to meet the needs of the subset.

It is also worth drawing out the specific benefits of having an interest rate hedging share class as opposed to setting up a new fund from a liquidity management perspective - as it brings tangible benefits to investors and the market. As a typical bond fund is susceptible to high levels of redemptions in rising interest rate environments, the availability of an interest rate hedging share class can be a powerful tool in helping to mitigate the potentially detrimental impact on the fund and its investors of significant outflows. A switch between share classes is a more cost effective option for investors than switching funds. If investors had to sell out of one fund with a long duration and into another fund with a short duration, with the consequent need for one fund to sell assets and another one to buy assets, the investors suffer those underlying selling and buying costs. Costs which would not be incurred if the investor could move within share classes within the same fund. The ability to offer share classes with different duration levels would mean that the impact of changes in interest rates on the value of an investor’s capital would be limited and the scale of outflows from bond funds in general correspondingly reduced. Reducing the scale of bond fund outflows minimises the impact on the wider market of investor activity in a rising interest rate environment.

<ESMA\_QUESTION\_DP\_SC\_2>

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

<ESMA\_QUESTION\_DP\_SC\_3>

We support the principle of a fund having a common investment objective.

We do not consider that hedging specific risks at share class level prevents a fund from having a common investment objective.

We certainly agree with ESMA that currency risk hedging is permissible at share class level.

It is important, however, not to be overly narrow in describing the way in which currency hedging is achieved. In last line of paragraph 20, reference is made to ‘exposure to the fund is through a different currency to the base currency’.

In the UK, for example, currency hedging can be achieved in a number of ways. The UK regulator allows

* hedging of units priced in a different currency to the base currency,
* direct hedging between the currency of the currency class and a third currency. When it introduced this ability, the UK regulator provided the following example of this in its consultation - a European Growth fund with Sterling as its base currency might hold some assets in Swiss Francs and issue a Euro currency class. In such a case, a EUR/CHF hedge would be allowed in the Euro class to avoid having to undertake a double hedge (EUR/GBP and GBP/CFH) to achieve the same effect).
* Hedging of units of classes priced in the same base currency, where the UCITS holds assets in a different currency.

The UK regulator introduced this last type of hedging as they wished to allow classes denominated in the base currency of the scheme the same ability to hedge currency exposure for investors in such classes as was available to investors in non-base currency classes. It considered that this facility helps managers tailor their hedging strategies to the needs of a wide range of investors. Again, the regulator provided the following helpful example - a fund investing in a mixture of UK and US assets, with GBP as its base currency. Instead of issuing a currency class, it might wish to offer a second GBP denominated class available to non-UK resident investors, in which the GBP exposure rather than the USD exposure is hedged.

We therefore believe it important to make clear the compatibility of share classes hedging currency risk with the 4 principles.

From a wider EU perspective, we know that our members may make use of other types of hedging currently allowed under specific conditions in other jurisdictions, e.g. duration hedging and equity market hedging, in order to meet EU and non-EU investors’ requests. In these jurisdictions, these types of hedging have been allowed since 2010 at least for duration hedging and since 2011 at least for equity market hedging - without any failure to our knowledge.

In any event, the same range of share classes should be available to investors throughout the Union regardless of the domicile of the UCITS. What is available to meet the needs of investors should not be restricted simply because those investors happen to buy a UCITS domiciled in one jurisdiction rather than another. This would also meet investor expectations as investors would naturally expect the access to the same range of share classes in a European product.

<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>

Currency hedging is certainly permissible. This is currently the only type of hedging permitted as share class level for UK funds.

We also believe it should be possible to hedge, at share class level, other forms of risk arising from the common pool of assets. In particular, duration risk. Whilst some investors might wish to hedge the currency risk to which a UCITS investment strategy gives rise, others might wish to hedge the interest rate risk to which the investment strategy gives rise. Hedged classes enable all investors to have an interest in the same pool of assets that underlie the UCITS investment strategy, whilst addressing specific market risks (such as currency risk and interest rate risk) at the share class level. It provides a level of customisation which accommodates the needs of a wide variety of investors in a cost effective way.

There is nothing in the UCITS Directive which requires the equation of having the same investment strategy with having the same outcome for all investors. What the UCITS Directive does require is that a UCITS should have an investment strategy (or using the terminology in the Directive ’investment objectives and investment policy’). A share class which hedges a particular risk can still be viewed as having the same investment strategy as other classes. It is simply hedging a particular risk to which the UCITS’ investment strategy gives rise. There is nothing in the Directive which bases allowable share classes on the same outcomes for all investors in the fund.

<ESMA\_QUESTION\_DP\_SC\_4>

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

<ESMA\_QUESTION\_DP\_SC\_5>

Answer 5: We agree with the principle of non-contagion, in so far as while it recognises the risk of contagion cannot be entirely eliminated, risks associated with the use of a derivative overlay at the level of a share class should be monitored and mitigated in order to minimise the risk of contagion to other share classes. Costs associated with providing a derivative overlay for one particular share class should be borne by the holders of that share class only.

<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 are not aware of any such evidence.

<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 most EU jurisdictions, there is no segregation of assets between share classes. The value of each share class is an apportionment of the NAV of the overall fund. The impact of any derivative overlay is then applied at class level. This gives rise to a theoretical risk of contagion to other share classes should any claim arising on instruments used at share class level exceed the value of assets in that share class.

However, in practice, robust risk and operational controls can manage that risk - as noted in our response to Q6, and in paragraph 25, there have been no known cases where a loss arising from the use of a hedging instrument at the level of a share classes has resulted in losses being attributed to other share classes. The use of a hedging instrument at share class level is solely to reduce a risk attributed to a single risk variable, these are not used to increase the risk exposure of a share class. As such, the use of a derivative instrument at share class level will be limited to that necessary to hedge the identified risk, allowing for a suitable tolerance range.

A further challenge for UCITS Management Companies is that they are effectively unable to use repos as a tool to transform assets into cash for the purposes of posting margin on derivatives transactions due to the restrictions imposed in the ESMA Guidelines on ETFs and Other UCITS Issues (ESMA/2014/987). Paragraphs 42 and 43j of the ESMA Guidelines prohibits cash received through repos being used to post margin for derivatives transactions. These guidelines are proving increasingly problematic for UCITS Management Companies facing margin calls, who in addition to providing initial and variation margin for exchange traded derivative transactions, increasingly have to provide margin on OTC derivative transactions in cash. This problem will worsen as EMIR and Dodd Frank bring more OTC derivatives within the scope of mandatory clearing, thus increasing cash demands on UCITS.

This means that in order to meet margin requirements, UCITS Management Companies are therefore left with the options of holding additional cash in the portfolio, selling assets in order to raise collateral (although settlement timing can be an issue) or not to execute a hedging transaction. None of these options are attractive – these may all impact investment performance, which is not in the interests of investors. In the case of a derivative overlay program for a hedged share class, the last of these options will not be possible since the UCITS Management Company will not have discretion over whether or not to apply the hedge.

Repos allow a UCITS to transform assets to cash in order to be able to post margin while retaining ultimate ownership of the assets, thus avoiding issues associated with performance drag which can result from the other options mentioned above. We therefore believe it is in the interests of investors that UCITS be allowed to use repos to transform assets to cash for the purposes of meeting margin requirements, provided a suitably robust risk management program is followed when entering into repo transactions for this purpose. As part of its work on share classes of UCITS, ESMA should also consider revising the Guidelines on UCITS and Other Issues to allow repos to be used to transform securities to cash in order to meet margin calls.

<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>

We agree that a robust risk management and operational framework is necessary to manage the contagion risks outlined above. A core principle is that any hedging framework at share class level should be functionally separated from the portfolio management of the fund, except where such a requirement would be disproportionate to the size of the UCITS Management Company. In all cases, a process entirely separate to the management of the portfolio should be used when managing the hedging overlay at share class level. This should follow a prescribed risk objective, and should not be subject to the discretion of the portfolio manager.

Although we support their overall intention, we do have some concerns about some of the principles outlined in paragraphs 28 and 29, which we highlight below:

28a - as outlined above, there is no segregation between share classes, and therefore a share class does not have an eligible pool of collateral. The share class has a proportion of the value of a fund, not of a proportion of the assets of the fund. We would agree that the amount of collateral that could potentially be called on any hedging instruments used in a derivative overlay at share class level, as prudently assessed, should not exceed the value of that share class. We suggest this principle is redrafted on these lines.

28b – we agree that a level operational segregation should be in place to clearly apportion the value of each share class and where a share class has a derivative hedge overlay, ensure the costs of the overlay, where they are identifiable and attributable, and the profit or losses arising from these, are apportioned to the applicable share class only on an ongoing basis and at least at the same valuation frequency as the fund. As noted above in respect to principle 28a, there is no segregation of assets between share classes and this should be considered when drafting this principle.

28c – since the purpose of a derivative overlay at share class level would be to hedge an identifiable risk variable, in practice the market risk and counterparty risk exposure will be limited to a small portion of the net asset value apportioned to the share class in all but the most extreme market conditions (eg. the collapse of the hedged currency relative to the base currency or vice versa). Absent human error or operational failure, it is unlikely that a loss significant enough to cause losses to other shareholders would materialise. It is questionable as to the value which would be added by conducting stress tests against such extreme market conditions. We therefore believe the focus is better placed on ensuring there are robust operational procedures and risk controls to avoid such operational risks being crystallised.

28d – we largely agree with this principle – derivative overlays at share class level should only be used to hedge an identified risk in line with the hedging criteria of the share class. However, the UCITS Management Company should have flexibility in the choice of instruments to use to execute a pre-defined hedging strategy.

28e – we agree that the derivative overlay should be implemented according to a pre-defined hedging strategy, but the terms “detailed” and “transparent” relating to the hedging strategy are vague and could therefore become far-reaching if detailed further either at EU or national level. The hedging strategy should be clear on the risk exposure to be hedged, however it should allow the UCITS Management Company sufficient flexibility to select from a range of hedging instruments in order to execute the hedge in the most efficient manner.

29a – we believe counterparty limits should be applied at fund level. The exposure to a counterparty at the level of a share class should be considered by the fund and included when assessing the overall counterparty exposure at the level of the fund.

29b – we agree with principle of applying buffers, however these should be set by the UCITS Management Company as part of a pre-defined and pre-disclosed process, with regard to the volatility of the assets/currencies being hedged. While the limits suggested by ESMA are in line with market practice and likely to be sufficient for most funds, eg. currency hedging instruments involving most common currency pairs, these may not be sufficient for more volatile pairs, eg. frontier market currencies. There should therefore be a level of flexibility permitted for the management company to set a buffer, ex-ante, which is appropriate to the hedging instruments in question.

29c - as with our comment on the principle in 29b, we do not believe an absolute level for a buffer should be set by ESMA, rather a level of flexibility should be permitted for the UCITS Management Company to set a buffer, ex-ante, which is appropriate to the hedging instruments in question.

29d – the requirement to review hedging positions to ensure over- and under-hedged positions do not exceed/fall short of the permitted levels "at any time" would operationally be almost impossible to achieve, particularly in the case of currency hedging positions which would require 24 hour continuous monitoring. The principle should instead require hedging to be reviewed at least at each valuation point and/or dealing point, to ensure any excess or shortfall is addressed when the fund/share class are valued.

29e – provided the hedged positon stays within the levels permitted in 29b and 29c, up to 3 months should be allowed between resets to align with typical contract lengths for instruments commonly used in hedging overlays, eg. Forward FX contracts.

<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>

As mentioned in our response to question 8, we do not believe an absolute level for a buffer should be set by ESMA, rather a level of flexibility should be permitted for the UCITS Management Company to set a buffer, ex-ante, which is appropriate to the hedging instruments in question – in the own interests of investors.

<ESMA\_QUESTION\_DP\_SC\_9>

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

<ESMA\_QUESTION\_DP\_SC\_10>

As mentioned in our response to Q8, we believe the market conditions which would be required to cause a loss on a hedging derivative overlay at share class level sufficient to cause a loss to other shareholders would be so extreme that it is questionable as to what value stress tests would add. A stress test could be undertaken to identify the market conditions which would be necessary to cause losses to be realised by other share classes, however in practice such a test is unlikely to provide useful information on a regular basis for UCITS Management Companies or regulators. Instead, we would suggest focus is better placed on ensuring there are robust operational procedures and risk controls in place to ensure the hedging overlay is properly managed.

<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>

We believe ESMA is right to apply a principles based approach to the consideration on the differentiation that should be allowed at share class level, and as mentioned in our response to question 3, we do not consider that hedging specific risks at share class level prevents a fund from having a common investment objective. We agree with ESMA’s view in paragraph 30a that share classes that hedge currency risks are compatible with the core aims of the operational principles (although we note some amendments are needed to these, as outlined in our response to question 8). We also note in our response to question 3 that currency hedging at share class level could take more than one form. We believe that all of these forms would be compatible with the operating principles.

We believe, however, that share classes with other types of overlays, such as duration risk hedging, equity market hedging or volatility risk hedging, could also be structured to be compatible with the operating principles. We therefore do not believe ESMA should exclude the possibility of share classes that hedge risks other than currency risk at share class level being compatible with the principles.

<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>

We believe the operation principles are largely sufficient, subject to the issues and amendments suggested in our response to question 8 being addressed. We suggest the management of the hedging overlay strategy of a share class should be performed separately to the portfolio management of the fund (which may itself utilise hedging strategies). Where the same management teams perform both functions, operational procedures, systems and controls should ensure the processes are performed separately and in particular that the portfolio management of the fund does not influence the management of the share class hedging strategy and vice versa.

<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 do not believe the additional measure suggested above would have any effect on the compatibility of the operational principles with further hedging arrangements.

<ESMA\_QUESTION\_DP\_SC\_13>

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

<ESMA\_QUESTION\_DP\_SC\_14>

We answer this in the context of our experience in the UK.

The UK FCA regulation of currency hedging share classes (as mentioned earlier in our response, this is only type of hedging UK Authorised Funds can currently do at share class level) has worked well.  This ability to launch hedged share classes into existing funds was only introduced in 2006 after a detailed regulatory consultation and careful consideration of the issues such as the potential, however theoretical, of contagion risk.  Detailed guidance is contained in the FCA’s sourcebook.  As hedging of share classes came in with the rule changes in 2006, it meant that, where hedged currency classes were to be introduced to existing funds, changes needed to be made to fund Instruments of Incorporation and prospectuses. This included, amongst other things, a requirement to ensure that the prospectus explains the risks that hedging transactions may pose to all investors and also a requirement to notify unitholders of the introduction of the hedged currency class.  The potential contagion risk is mitigated through robust risk management.

As mentioned above, this FCA regulatory approach has worked very well.  It balances bringing in hedged currency classes –which benefit investors wishing to hedge that risk with the needs of investors in other classes (through robust risk management and meeting the information needs of investors in other classes).

A literal reading of the ESMA DP paragraphs on pre-determination suggests that this approach would not be permitted –ie a fund which doesn’t currently have the hedged share currency could not introduce one. Paragraph 33 – *‘ If a share class is created after the fund in which the share class is included has been authorised, the new share class should not affect the features and characteristics of the fund for investors already in other share classes’.*  Given the existence of the contagion risk, this would suggest hedged share classes can’t be created for existing funds.

Another concern is that paragraph 33 appears to have in mind that all features of a share class should be pre-determined before a share class is set up.  This is very wide and is this necessary where, for example, a change in the features of a share class does not impact holders of units in other share classes and any regulatory notification requirements as regards investors in the share class concerned have been met?

Paragraph 34 appears to suggest a prohibition on *‘any form’* of discretion with regard to hedging mechanisms. A degree of discretion may be in the interests of investors in the hedged share class. Provided that the risk of contagion is mitigated, a degree of discretion should be allowed.

We do not think pre-determination is necessary. As mentioned above, the current UK regulator approach to introducing the ability to hedge currency classes for existing funds has worked well – a combination of disclosures that meet the information needs of all unitholders and the mitigation of contagion risk is a ‘fit for purpose’ approach.

<ESMA\_QUESTION\_DP\_SC\_14>

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

<ESMA\_QUESTION\_DP\_SC\_15>

Please see answer to Q 14.

<ESMA\_QUESTION\_DP\_SC\_15>

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

<ESMA\_QUESTION\_DP\_SC\_16>

We agree with this principle. With regard to whether further information is required over and above what is already required by the UCITS Directive and the KIID Regulation, please see our response to Q17.

The above response applies in respect of transparency to retail investors. We agree that transparency should also apply in respect of the UCITS Management Company making information available to national competent authorities, although we believe some modifications are required to the operating principle in paragraph 36c – please see our response to Q18.

<ESMA\_QUESTION\_DP\_SC\_16>

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

<ESMA\_QUESTION\_DP\_SC\_17>

We believe that existing disclosure requirements are sufficient. It is important that investors receive appropriate, meaningful and relevant information in order to make investment decisions, as well as ensuring the information they receive is accurate, clear, fair and not misleading. Over disclosure can be as unhelpful to investors as under disclosure, as this can mean investors being unable to easily identify the information that is relevant to them.

In this regard, we believe the current disclosures in the Key Investor Information Document (KIID), as required by the KII Regulation, strikes an appropriate balance in ensuring that all investors receive key information in relation to the share class of the UCITS they have chosen to invest in, including any characteristics applicable to that share class, the ongoing charges of the share class, the performance of the share class and material risks that may be associated with that share class. While in theory a risk of contagion exists for UCITS with hedged share classes, in practice this risk should be immaterial for non-hedged share classes provided a robust risk management framework is in place in respect of the hedging strategy applied to the hedged share class. Therefore, we would not ordinarily expect contagion risk to be a material risk to be disclosed to investors in the KIIDs for the non-hedged share classes of the UCITS. There may be limited cases where a management company considers the contagion risk arising from a hedged share class to be a material risk for the UCITS (eg. due to the size of the hedged share class relative to the other share classes of the UCITS), and in these limited examples the contagion risk should be disclosed as a material risk in the KIIDs for the non-hedged share classes of the UCITS.

The Practical Information section of the KIID already requires a disclosure that other share classes exist for the UCITS, and where more information on these share classes can be found. We believe this is sufficient for the majority of investors, for whom many of the other share classes offered are unlikely to be relevant to their financial circumstances or their investment needs. Investors who require information on all available share classes, including the differences between these, are directed in the KIID to the prospectus for the UCITS, the KIIDs for other share classes of the UCITS or other resources provided by the management company (as applicable). Maintaining a separate list (as suggested by principle in paragraph 36b) is therefore superfluous.

For the majority of investors, further disclosure requirements on other share classes available in the same UCITS and the differences between the share classes are not likely to be helpful and could prove counterproductive. Therefore we would urge that ESMA not recommend additional disclosure requirements be imposed. The KII Regulation already requires disclosure key information on share classes to investors in plain language, and where there are examples of failure in this regard these should rightly be addressed by NCAs, but through appropriate enforcement of the existing KII Regulation.

<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>

Please see response to Q 17 above.

Regarding transparency for national competent authorities, in respect of the operating principle in 36c, this could be read that the UCITS Management Company is required to provide stress test results to its national competent authority on a regular basis. We believe this operating principle goes beyond what is necessary. Firstly, as noted in our response to questions 8 and 10, we do not believe stress testing will provide useful information in all circumstances. Secondly, we do not believe it will be necessary for a UCITS Management Company to provide these to its national competent authority on a regular basis. Instead, we suggest the operating principle in paragraph 36c could be amended as follows:

“The results of any risk analysis or stress testing undertaken (where applicable) on hedging arrangements at the level of a share class should be made available to national competent authorities at their request.”

<ESMA\_QUESTION\_DP\_SC\_18>

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

<ESMA\_QUESTION\_DP\_SC\_19>

Please see response to Q 17 above.

<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>

Provided that the wording in relation to currency hedging is flexible enough to cater for the variety of ways in which this is delivered to investors (please see response to Q 3) then, from a UK UCITS perspective, then the framework should not have much of an impact as, in terms of share classes, the UK has currently only hedged share classes. However, it will have an impact on UCITS in a number of other fund domiciles and, of course, investors in such share classes which are currently hedged against duration risk and equity market risk for instance.

We would prefer that any principles recognise an ability, at share class level, to hedge other risks than narrowly currency risk. This is not prohibited within the UCITS Directive. Such share classes exist in other jurisdictions and these are designed to meet investor needs whilst still respecting the principle of having a common investment objective. A harmonised understanding and the ability in all jurisdictions to allow hedged share classes, subject to robust risk management, is our preferred outcome. It ensures that investors have the ability to access a similar range of share classes regardless of the domicile of the UCITS.

As mentioned in our response to ESMA’s first DP, creation of share classes permits a level of customisation in a way which is cost efficient for investors and avoids the situation of having a plethora of small UCITS each having the same underlying portfolio of investments and investment strategy but of interest only to a particular set of investors.

As ESMA has previously noted, the UCITS Directive does not prescribe what is and is not allowed at share class level. Given that there is no such prescription and given the benefits of pooling, it is in the interests of investors to provide as much flexibility as possible as regards the ability to create share classes within a single UCITS subject to robust management of any residual risks and appropriate disclosure.

<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>

Transitional provisions are likely to be necessary, although the provisions required will depend on the final outcome of the ESMA work on share classes of UCITS. If ESMA proceeds along the lines of the approach outlined in this discussion paper (with the modifications we have suggested), a transitional period will be required to allow sufficient time for UCITS Management Companies to determine what share classes may be non-compliant, what action it should take regarding those share classes, to review disclosure requirements and operational procedures and to make any necessary changes to these. Taking action regarding a share class may necessitate closing or merging that share class, and in some cases possibly require a separate UCITS or compartment to be established to accommodate an arrangement previously within a particular share class. Making these changes could take considerable time, particularly for UCITS Management Companies which have a large number of UCITS and share classes under management, and this should therefore be taken into account when setting the transitional provisions.

Taking the above into consideration, we believe the transitional period would need to be at least two years to allow UCITS Management Companies sufficient time to make the required changes.

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