# Alternative Investment Management Association

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European Securities and Markets Authority (ESMA)
103 Rue de Grenelle
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Submitted via the ESMA website

26 March 2015

Dear Sirs,

**AIMA's response to ESMA's Discussion Paper - Share classes of UCITS**

The Alternative Investment Management Association Limited[1] (AIMA) is grateful to ESMA for the opportunity to comment on its Discussion Paper regarding share classes of UCITS (the 'Discussion Paper'). AIMA welcomes ESMA's consideration of the merits of developing a common understanding of what constitutes a share class of a UCITS. However, we have some concerns in relation to the categorisation of interest rate and duration hedging share classes as not being permissible.

In order to assess the legality of different share classes, ESMA has suggested that the following principles should be used:

- Share classes of the same UCITS should have the same investment strategy.
- Features that are specific to one share class should not have a potential (or actual) adverse impact on other share classes of the same UCITS.
- Differences between share classes of the same UCITS should be disclosed to investors when they have a choice between two or more classes.

In paragraph 8 of the Discussion Paper ESMA sets out a non-exhaustive list of types of share class that would be compatible with the principles above. This list includes "share classes that provide currency hedging when share classes are denominated in different currencies from the base currency". We strongly agree that currency hedging should be a permissible type of share class. However, we do not agree with ESMA's statement in paragraph 11 of the Discussion Paper that:

"Unlike currency hedging referred to in paragraph 9 above, ESMA believes that interest rate hedging performed at the level of share classes does not comply with the principle of having the same investment strategy, because it modifies the investment strategy of the share class. For example, a share class that reduces the duration of the portfolio should not be considered as compatible with the principle of a unique investment strategy because investors in that class are not exposed to the same interest rate risk as investors in the other classes of the fund."

[1] As the global hedge fund association, the Alternative Investment Management Association (AIMA) has over 1,500 corporate members (with over 8,000 individual contacts) worldwide, based in over 50 countries. Members include hedge fund managers, fund of hedge funds managers, prime brokers, legal and accounting firms, investors, fund administrators and independent fund directors. AIMA's manager members collectively manage more than $1.5 trillion in assets.

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Employing interest rate hedging or duration hedging does not alter the investment strategy of the share class any more than employing a currency hedge would. From a structural and operations perspective, interest rate-hedged share classes are similar to currency-hedged share classes; both hedges are created by using highly liquid, low-cost derivatives available from counterparties with little counterparty risk. Allowing interest rate-hedged share classes within UCITS permits firms to offer hedges against these risks to investors at a lower cost.

Furthermore, the UCITS will still employ the same strategy for both the share class that does not have the interest rate/duration hedge and the share class that does. Both a hedge and an unhedged class would be exposed to the same portfolio of investments with the exception of the interest rate or duration hedge itself. Exposure to and the costs of interest-rate hedging are primarily limited to the investors in the applicable share class, just as it is for currency hedging. This is the same as what occurs for currency classes. Conceptually, there is not a fundamental difference between a currency class which removes currency risk and an interest rate or duration hedged class that removes the interest rate or duration risk.

Interest rate-hedged share classes may reduce the risk of the share class and the fund that they are attached to in terms of reducing the average value-at-risk indicator for the class and fund under normal market conditions. Even in stressed conditions, the loss to investors of interest-rate hedged classes would be limited. Allowing interest rate-hedged share classes in UCITS will give investors greater choice and the characteristics of the interest rate hedge are appropriately disclosed to investors in the offering documents. For certain investors who wish to lower their exposure to interest-rate risk, these types of share classes can offer an attractive investment.

In terms of operational risk, interest rate-hedged share classes do not jeopardise any investors in any other classes assuming proper risk management and segregation of liabilities is in place as it is for funds that have currency hedged share classes. All hedges put in place can be non-recourse so that the assets of any other classes are protected which is similar to the protections applicable to a currency-hedged share class.

We hope you find our comments useful and would be more than happy to answer any questions you may have in relation to this letter.

Yours faithfully,

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Head of Government & Regulatory Affairs