Reply form

**On the review of the UCITS Eligible Assets Directive**

Responding to this paper

ESMA invites comments on all matters in this paper and in particular on the specific questions summarised in Annex 1. Comments are most helpful if they:

* respond to the question stated;
* indicate the specific question to which the comment relates;
* contain a clear rationale; and
* describe any alternatives ESMA should consider.

ESMA will consider all comments received by **Wednesday 7 August 2024.**

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

Instructions

In order to facilitate analysis of responses to the Call for Evidence, respondents are requested to follow the below steps when preparing and submitting their response:

• Insert your responses to the questions in the Call for Evidence in this reply form.

• Please do not remove tags of the type < ESMA\_QUESTION\_EADC\_0>. Your response to each question has to be framed by the two tags corresponding to the question.

• If you do not wish to respond to a given question, please do not delete it but simply leave the text “TYPE YOUR TEXT HERE” between the tags.

• When you have drafted your responses, save the reply form according to the following convention: ESMA\_CP1\_EADC\_nameofrespondent.

For example, for a respondent named ABCD, the reply form would be saved with the following name: ESMA\_CP1\_EADC \_ABCD.

• Upload the Word reply form containing your responses to ESMA’s website (**pdf**  **documents will not be considered except for annexes**). All contributions should be submitted online at <https://www.esma.europa.eu/press-news/consultations/call-evidence-review-ucits-eligible-assets-directive> under the heading *‘Your input -*  *Consultations’.*

**Publication of responses**

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. 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 not to disclose the response 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 heading ‘[Data protection](https://www.esma.europa.eu/about-esma/data-protection)’.

**Who should read this paper?**

This Call for Evidence is of particular interest for investors and consumer groups interested in retail investment products, management companies of Undertakings for Collective Investment in Transferable Securities (UCITS), self-managed UCITS investment companies, depositaries of UCITS and trade associations.

# General information about respondent

|  |  |
| --- | --- |
| Name of the company / organisation | France Post Marché |
| Activity | Associations, professional bodies, industry representatives, Depositaries of UCITS) |
| Country / Region | France |

# Questions

1. In your view, what is the most pressing issue to address in the UCITS EAD with a view to improving investor protection, clarity and supervisory convergence across the EU?

<ESMA\_QUESTION\_EADC\_1>

FRANCE POST-MARCHE (previously named AFTI) was created in 1990, with the goal of gathering members of organizations in the Banking and Financial Services industry involved in activities with financial instruments and specifically post trade activities.

FRANCE POST-MARCHE is an integral part of the French, European and international financial ecosystem, supporting the increasingly interdependent players in the French financial marketplace.

FRANCE POST-MARCHE (FPM) is the leading association representing the post-trade business in France and Europe.

FPM represents through its 82 members a wide range of activities: market infrastructures, custodians, account-keepers and depositaries, issuer services, reporting, and data management services, with a total staff of 28,000 in Europe of which 16,000 in France*.*

Our members acting as financial intermediaries account for 26% of the European market.

Without prejudice to the detailed comments in this contribution France Post Marché is of the view that any future amendments to the UCITS Directive derived from this call for evidence must be guided by the following overarching principles: 1) preservation and integrity of the UCITS brand, 2) clarity and EU-wide harmonization of regulation, 3) investor protection and financial stability.

FPM, the French post-market association, brings together UCITS depositories in France. FPM thanks ESMA for the opportunity to participate in the Call for Evidence on the revision of the UCITS Eligible Assets Directive (EAD).

As part of the analysis which should lead ESMA to issue a technical advice on the revision of the EAD to the European Commission, FPM wishes to share the following general messages and comments:

UCITS funds benefits from a marketing passport allowing them to be sold to retail investors within the European Union. The format is also popular with foreign investors, particularly Asian or South American investors. It is a franchise that is therefore a structuring pillar of the Capital Markets Union.

This success is due in particular to the liquidity of the assets held by UCITS, given the application of strict asset eligibility criteria and the risk dispersion rules that apply and thus provide strong protection for retail investors.

Since 2007, new types of financial instruments/assets have appeared on the markets, questioning their eligibility in relation to the criteria defined in the 2007 delegated directive which complements the UCITS Directive and still refers to the UCITS Directive 85/611/EEC as amended in 2004 (UCITS III).

* References to the revised Directive 2007 should therefore now refer to Directive 2009/65/EC which repealed Directive 85/611/EC.

Depositaries see an interest in having clear and precise definitions in order to limit any interpretation of asset eligibility (e.g., the concept of presumption of liquidity) in order to carry out their controls on the regularity of management decisions taken by management companies for the UCITS they manage.

In addition, the NCAs have been able to develop local doctrines on the eligibility of certain assets. For example, the AMF in France has developed a doctrine on holding Catastrophe Bonds (“Cat bonds”) or Contingent Convertible Bonds (“CoCos bonds”). Asset managers wishing to go to these assets’ classes must complete their work program by expressly describing the means put in place for investing in these assets, which requires additional due diligence to justify the eligibility of the asset in relation to the liquidity, reliable valuation and negotiability criteria.

* These local doctrines must be reviewed at EU level so that the rules are harmonized and allow for a same level playing field at EU level.

More generally, in relation to the text and spirit of the UCITS Directive, depositaries consider that a UCITS must remain exposed to simple risks whose assets remain high in liquidity to have the ability to settle investors' redemptions in accordance with the conditions set out in the prospectus.

From this point of view, depositaries are interested in discussing ESMA’s position ‘building more effective and attractive capital markets in the EU’ issued on 22 May 2024 and in particular on Recommendation 1, which refers to the creation at European level of a voluntary label for ‘basic’ products applicable to certain UCITS.

* Depositaries are wondering about the criteria that would be used to define the basic products concerned and whether this would ultimately lead to a distinction between “basic UCITS” on the one hand and “non-basic UCITS” on the other, the latter being able to use a wider range of assets, including assets that do not meet the same liquidity criteria as those of “basic UCITS”.
* If the criteria were not precise enough, it could again introduce local interpretations.
* Moreover, as the label is ‘voluntary’, some basic funds could display this label, others could not, which would not allow the investor to compare ‘basic’ UCITS among themselves.

The depositaries also point out that another vehicle, the ELTIF, now allows retail investors to have access to the private asset class (in particular, private equity, debts, loans, simple transparent and standardized (STS) securitizations and real assets). This AIF is approved by the NCAs and benefits from the marketing passport in the EU.

It has a robust European regulatory framework to ensure the protection of retail investors (information in regulatory documents and specific liquidity conditions defined in the level 2 measures (RTS) currently being finalized). The minimum share of 55% of illiquid assets held by an ELTIF is also supplemented by a pocket of assets eligible for UCITS, presumed as such to be liquid (listed equities, listed bonds, MMI, units of UCITS).

* Private assets should therefore not be offered as part of a UCITS but only as part of the ELTIF.

Furthermore, and at least at the origin of the UCITS Directive, the financial instruments eligible for UCITS (in particular transferable securities and MMI) were subject to the custody regime, which implies a restitution of assets in the event of the loss of assets or the bankruptcy of the depositary and therefore increased protection of UCITS and ultimately those of investors.

Since then, many financial instruments that are subject to record-keeping regime have been admitted to UCITS (derivative instruments for hedging or in exposures purposes provided for in the Directive, more complex financial instruments according to an approach that may be applied locally in the absence of details at the level of the Directive).

* Depositaries point out that the record-keeping regime involves control of the ownership of the assets held by the fund. The terms and conditions of ownership verification performed by the Depositary may be complex. The more complex record-keeping assets there are in a UCITS portfolio, the more complex the ownership insurance criteria are likely to become. In addition, as these assets are not subject to restitution in the event of loss of assets, this ultimately leads to less protection for investors.
* Depositaries are therefore not in favor of extending the eligibility of the asset classes presented in question 20 that are not subject to the custody regime, such as loans, emission allowances or crypto assets.

While considering market practices, the various elements outsourced by ESMA (guidelines, Q&A, CSA analysis) and local doctrines that may have been developed by regulators since 2007, UCITS depositories in France call for the maintenance of a label that remains consistent, readable and understandable by retail investors, thus allowing the UCITS franchise to continue to develop and contribute to the Capital Markets Union.

* It seems to us that the creation of a two-speed label (‘basic’ and ‘non-basic’) could harm the readability and understanding of the UCITS model currently in place, which, if it needs to be reviewed and improved, has been perfectly recognized for several decades by European and foreign investors.

Depositaries are calling for the clarification of certain key criteria such as liquidity, negotiability to determine the eligibility of an asset for a UCITS. This clarification should lead to limiting any interpretation by the players and allow the Depositary to carry out reliable second-level ex-post controls in the interest of end investors.

For example, in our opinion, the liquidity criteria have to be supplemented by providing indications on the minimum transaction volumes allowing an asset manager to complete the assessment of the presumption of liquidity of a security and thus its eligibility for the fund.

This clarification would allow asset management companies to have clear and homogeneous rules within the European Union on key concepts, avoiding the emergence of local doctrines that can be a source of divergent interpretations and that ultimately do not allow for a level playing field between players within the European Union.

Beyond the concept of asset liquidity to determine the eligibility of a financial instrument, the EAD must also provide guidance on the types of assets which, although not expressly prohibited by the Directive (developed since 2007), do not meet the UCITS spirit. This is the case, for example, with certain complex derivative contracts that also push the fund to adopt a VaR model with sometimes significant indicative gross leverage effects (examples of 2000% are reported) and not in the method of calculating the commitment usually used for UCITS, which is limited to one time the fund's net assets. The VaR method described in the prospectus remains complex to understand for the retail investor and does not allow comparability with UCITS products which use the commitment method.

In France, the AMF has defined in its 2012-19 doctrine a classification of financial contracts and securities containing a financial contract as a "simple" or "complex" instrument, considering the nature of the underlying, its valuation method and its risk profile. Without being exhaustive, the list nevertheless guides the players in this classification exercise to validate the eligibility or not of the asset within a UCITS fund, the assets must also be described in the asset manager's activity program.

<ESMA\_QUESTION\_EADC\_1>

1. Have you experienced any recurring or significant issues with the interpretation or consistent application of UCITS EAD rules with respect to financial indices? If so, please describe any recurring or significant issues that you have experienced and how you would propose to amend the UCITS EAD to improve investor protection, clarity and supervisory convergence. Where relevant, please specify what indices this relates to and what were the specific characteristics of those indices that raised doubts or concerns. Where possible, please provide data to substantiate the materiality of the issue.

<ESMA\_QUESTION\_EADC\_2>

Problem of interpretation of the application of the index funds derogatory ratio: The regulation should clarify whether the index fund derogatory ratio applies only to the constituent securities of the index or may also apply in the case of synthetic index replication across the portfolio (including non-index securities).

Example of a UCITS consisting of a basket of assets and a swap that will cancel the performance of the basket of assets and serve the performance of the index. This is synthetic index replication. On reading the regulation (Articles 53 of Directive 2009/65/EC and Article R214-22 of the French Monetary and financial code), the asset manager considers that the basket of securities in the assets side is not subject to the UCITS risk diversification limit of 10% per entity (translated into 10% by issuer in COMOFI Article R214-22 in France).This interpretation is justified by the fact that the investor does not bear any market risk on the securities held on the asset side since their performance is cancelled by the swap. There is only counterparty risk on the swap. This arrangement is structuring and would be in the investors' interest, as the conditions offered by the counterparty for the swap depend on the possibility of going up to 20% if necessary.

The texts speak of the “reproduction” of the index, which means that a basket of assets held directly by the UCITS, and which does not reproduce an index should not benefit from this derogation. UCITS should perform a double calculation on the risk division constraints, one in investment (with or without derogation if the assets are not those making up the index) and another in exposure via the swap.

Clarification on the application of the derogatory ratios applicable to index funds would be desirable.

<ESMA\_QUESTION\_EADC\_2>

1. Have you experienced any recurring or significant issues with the interpretation or consistent application of UCITS EAD rules with respect to money market instruments? If so, please describe the issues you have experienced and how you would propose to amend the UCITS EAD to improve investor protection, clarity and supervisory convergence. Where relevant, please describe the specific characteristics of the money market instruments that raised doubts or concerns.

<ESMA\_QUESTION\_EADC\_3>

Money market instruments are defined under the Article 3 point 2 of the Asset Eligibility Directive. They must respect one of three criteria:

1. Maturity of the instrument lower than 397 days, or
2. Residual maturity of less than 397 days, or
3. Interest adjustment date less than 397 days.

The difficulty currently encountered by depositaries lies in the criteria where the same product, during its lifespan, ranks first (i.e., residual maturity greater than 397 days) as an eligible financial security (article 2 of the directive) then, approaching final maturity (i.e., residual maturity less than 397 days), is classified in the criteria for money market instruments.

This change in classification poses difficulties in the asset trees of the depositary's automated control systems: the product has not legally changed during its life but is reanalyzed when its residual maturity passes to 397 days.

In addition, the classification of products with an interest adjustment date lower than 397 days raises the question: should we consider a product with a legal maturity of 10 years (and with, to date, a residual maturity of 7 years) with a variable rate indexed to the €ster as a money market instrument?

More precise wording of the text could avoid confusion in the classification of money market instruments and better consideration of products in depositary’ information systems.

<ESMA\_QUESTION\_EADC\_3>

1. Have you experienced any recurring or significant issues with the interpretation or consistent application of UCITS EAD provisions using the notions of « liquidity » or « liquid financial assets »? If so, please describe the issues you have experienced and how you would propose to amend the UCITS EAD to better specify these notions with a view to improving investor protection, clarity and supervisory convergence. Where relevant, please explain any differences to be made between the liquidity of different asset.

<ESMA\_QUESTION\_EADC\_4>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_EADC\_4>

1. The 2020 ESMA CSA on UCITS liquidity risk management identified issues with respect to the presumption of liquidity and negotiability set out in UCITS EAD. In light of the changed market conditions since 2007, do you consider such a presumption of liquidity and negotiability still appropriate? Where possible, please provide views, data or estimates on the possible impact of removing the presumption of liquidity and negotiability set out in the UCITS EAD.

<ESMA\_QUESTION\_EADC\_5>

We do not have any statistical elements to share in order to assess the impact of the removal of the presumption of liquidity or negotiability, but we believe that the disappearance of these criteria would create uncertainty as to whether or not a financial instrument is eligible.

The reference to the concepts of liquidity and negotiability therefore still makes sense and should be complemented by other criteria such as market depth in order to refine eligibility checks.

The observation made by ESMA in public statement 34/43/880 relating to the CSA on monitoring the liquidity risk of UCITS issued in 2021 is in line with maintaining the presumption of liquidity by adding the consideration of transaction volumes, in particular to complete the assessment of the presumption of liquidity of a security and thus its eligibility for the fund.

The AMF has also taken up this point in its doctrine (Doc 2012-19) by focusing on securities traded on markets with reduced liquidity (e.g., Euronext Growth).

In this case, in order to cope with redemptions, the asset manager must take into account the volumes traded on Euronext Growth, an organised market, which are not comparable to the volumes traded on Euronext's large caps companies.

Liquidity must be assessed by taking into account the volume of securities traded, the volume of free float, the volume of securities held by the fund, and the ability of the fund to sell its securities without influencing the price of the security.

The proportion of securities with reduced liquidity or that can be significantly and rapidly reduced must be determined taking into account the need to be able to quickly realise a more or less significant proportion of the fund's assets in order to honor redemption requests.

The AMF also adds that the asset manager must be able to value the securities traded on Euronext Growth.

<ESMA\_QUESTION\_EADC\_5>

1. Please explain your understanding of the notion of ancillary liquid assets and any recurring or significant issues that you might have experienced in this context. Please clarify if these are held as bank deposits at sight and what else is used as ancillary liquid assets. Where relevant, please distinguish between ancillary liquid assets denominated in (1) the base currency of the fund and (2) foreign currencies.

<ESMA\_QUESTION\_EADC\_6>

This question calls for several comments.

First of all, as the term ‘ancillary’ is not defined, it may have been interpreted differently by the Member States. The AMF (DOC 2011-25) doctrine has defined the term “ancillary” as being limited to 10% of the fund’s net assets (this limit may be extended up to 20% but only on an ad hoc basis and only under exceptional market conditions that must be duly justified by the asset manager) whereas other countries authorize in principle up to 20% of the assets (e.g., Luxembourg).

Generally speaking, to avoid any risk of interpretation and local adaptation, the use of adverbs should be avoided or translated by a threshold, which would be applicable by all.

Thus, for example, Article 83 of the UCITS Directive provides that a UCITS can borrow up to 10% of net assets temporarily. The term “temporary” is assessed differently within the Union and even differently within the same state. Depending on the actors, the temporary term can range from a few days to several months. Temporary should be defined as a time frame that corresponds to the settlement cycle of orders on the liabilities side.

Secondly, the terms used in the UCITS Directive are not identical depending on whether we refer to the English or French version. In the English version of the UCITS Directive, the last paragraph of Article 50(2) specifies “UCITS may hold ancillary liquid assets”, while the French version of the Directive specifies that a UCITS may hold ancillary “liquidities”, which France has therefore interpreted as only sight deposits recorded in the UCITS cash account.

The English version thus allows, at least in theory, the use of a broader base of liquid assets such as shares in short-term MMFs, government bonds (more generally transferable securities or MMI that can be settled/delivered within a very short period).

Moreover, cross-border managers have different rules to comply with depending on the country in which they manage or market their funds, which does not allow a satisfactory level playing field and a homogeneous level of protection for final investors.

It seems to us that the AMF’s interpretation is in line with the spirit of the UCITS Directive: the fund must be invested at a minimum of 90% of the assets in accordance with its investment objective, with ancillary liquidity up to 10% of the net assets to enable the UCITS to meet current or exceptional payments or, in the event of sales to the fund’s assets, the time needed to reinvest in other financial instruments.

In addition, the concepts of liquidity and deposits are not necessarily understood and translated in the same way by the actors or the member states. It would be necessary to define strictly what liquidity is (sight deposit, falling under the ratio of cash held on an ancillary basis) and what is a deposit made with the same entity (term deposit as opposed to sight deposit, falling under the deposit ratio, defined at 20% of net assets by the UCITS Directive, Article 52, 1, b). This would avoid any potential interpretation, for example as to whether cash received as collateral by the UCITS (in the face of lending or OTC transactions) constitutes liquidity or deposits before any possible reinvestment of that cash collateral in accordance with paragraph 43 j of the ESMA/2014/937 guidelines.

<ESMA\_QUESTION\_EADC\_6>

1. Beyond holding currency for liquidity purposes, do you think UCITS should be permitted to acquire or hold foreign currency also for investment purposes, taking into account the high volatility and devaluation/depreciation of some currencies? Where relevant, please distinguish between direct and indirect investments.

<ESMA\_QUESTION\_EADC\_7>

In investment, the UCITS Directive indicates a limit of 20% in deposits per entity, which therefore increases the limit of foreign currency investments in theory up to 100% of the assets. A UCITS could be 100% invested only in foreign currency deposits if provided for in the prospectus.

While the UCITS Directive sets limits on counterparty credit risk for OTC trades (5% or 10% depending on the quality of the counterparty), no overall limit on exposure to currencies or currency risk is indicated. The only limit is that of the calculation of the commitment at 100%.

As this commitment limit does not apply to VaR funds, there is no maximum limit on currency exposure or currency risk for UCITS in the regulation.

UCITS should be limited by regulation in terms of exposure to currency risk.

<ESMA\_QUESTION\_EADC\_7>

1. Have you observed any recurring or significant issues with the interpretation or consistent application of the 10% limit set out in the UCITS Directive for investments in transferable securities and money market instruments other than those referred to in Article 50(1) of the UCITS Directive? If so, please explain the issues and how you would propose to address them in the UCITS EAD with a view to improving investor protection, clarity and supervisory convergence.

<ESMA\_QUESTION\_EADC\_8>

The application of the ratio of “other eligible assets” limited to 10% does not seem to us to be uniform across the European Union.

France has literally transposed Article 50(2)(a) of the UCITS Directive into national law.

As a result, in theory, only eligible MMI and financial securities not traded on a regulated market can be held in the assets of the UCITS up to a limit of 10%.

Any other value would not be allowed, as it would not be eligible for the asset in the first place (e.g., unlisted shares or bonds). However, discussions have already taken place between the management companies and the depositories on the securities held in this ratio, particularly with regard to securities admitted to a traded/negotiated market but with low transaction volumes.

This is also the observation made by ESMA in public statement 34/43/880 concerning the CSA on monitoring the liquidity risk of UCITS published in 2021.

Taking into account the volumes of transactions would make it possible to complete the assessment of the presumed liquidity of a security and thus its eligibility for the fund (see answer to question 5).

Other countries seem to have chosen a different approach by removing the concept of the “other eligible assets” ratio in order to avoid any circumvention of the eligibility of assets under this limit of 10%. This is particularly the case for the CBI in Ireland or the AFM in the Netherlands.

It would therefore be appropriate (i) to supplement the liquidity criteria and (ii) to specify whether, in the context of market practices or developments, securities other than those referred to exhaustively in Article 50(2)(a) could be held in the context of the “other eligible assets ratio” (e.g., “solidarity securities”).

This would make it possible to define clear rules for all EU actors, facilitate controls and ensure a level playing field within the EU.

<ESMA\_QUESTION\_EADC\_8>

1. Are the ‘transferable security’ criteria set out in the UCITS EAD adequate and clear enough? If not, please describe any recurring or significant issues that you have observed and how you would propose to amend the UCITS EAD to improve investor protection, clarity and supervisory convergence.

<ESMA\_QUESTION\_EADC\_9>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_EADC\_9>

1. How are the valuation and risk management-related criteria set out in the UCITS EAD interpreted and applied in practice, in particular the need for (1) risks to be “adequately captured” by the risk management process and (2) having “reliable” valuation/prices. Please describe any recurring or significant issues that you have observed with the interpretation or consistent application of these criteria and how you would propose to amend the UCITS EAD to improve investor protection, clarity and supervisory convergence.

<ESMA\_QUESTION\_EADC\_10>

The UCITS EAD requires that reliable valuation processes of UCITS must be available (i) for listed securities, through ‘*accurate, reliable, and regular prices which are either market prices or prices made available by valuation systems*’, and (ii) for other securities, through ‘*a valuation on a periodic basis which is derived from information from the issuer of the security or from competent investment research’*. From a fund administrator (FA) perspective, we carry out robust valuation processes, as a task delegated by our clients/UCITS funds. With regard to the interpretation and application of the criteria set out in the UCITS EAD, we face the following issues:

* As the interpretation and application of the **‘reliability’ of the valuation/prices is left to Member States**, there are large differences in the local requirements (and market practices) applicable to Fund Administrators/Management Companies as to the design and the risk management framework of the valuation, which could lead to **unlevel playing field** (depending on the Member State, and on the contract negotiated between Management Companies and FAs) **and potential legal uncertainties**;

* In **specific events** (major and sudden geopolitical or market/credit events impacting listed and OTC financial instruments), **the valuation of some assets is particularly challenging** as market data vendors do not take into account those events sufficiently quickly, making necessary for market actors (Management Companies, FA) to adapt their BAU valuation/pricing processes. As the UCITS EAD does not specifically refers to those situations, it is up to those actors to agree on specific procedures, leading **to differences in investor protection**.

* The **absence of reference to the delegation of valuation/pricing** (to a FA) in the UCITS EAD may lead to a confusion of roles between the Management Company and the FA with regard to the design and the responsibility of the risk management framework and the valuation process.

On the basis of those identified issues, we propose the following amendments to the UCITS EAD to improve investor protection, clarity and supervisory convergence:

 - **defining more granularly the concept of ‘reliability’**: introducing in the UCITS EAD (or through technical standards/ ESMA guidelines) a minimal and harmonised set of oversight/requirements on valuation processes (including with references to cases when those valuation processes are delegated to FAs) to make them fully reliable. Those requirements may include:

            > a framework and a minimal frequency of oversight controls exercised by the Management Company on its FA at least once a year,

            > a granular description of the valuation/pricing process in BAU period and in specific events, relying on multiple market sources, when possible (for listed financial instruments),

            > a granular description of the pricing process of OTC financial instruments, including a reference to the market price to be taken into account for valuation.

 - **clarifying that Management Companies are responsible for managing the risk** in relation of valuation/pricing, and that, when the Management Company choses to delegate the valuation to a FA, the contractual commitment between the Management Company and the FA is without prejudice to the fact the responsibility for the quality of the valuation process lies with the Management Company. The more responsibility and tools for controlling its FA the Management Companies would have, the less margin for interpretation (and thus, the less risk of legal uncertainty) there would be.

<ESMA\_QUESTION\_EADC\_10>

1. Are the UCITS EAD provisions on investments in financial instruments backed by, or linked to the performance of assets other than those listed in Article 50(1) of the UCITS Directive adequate and clear enough? Please describe any recurring or significant issues that you have observed in this respect and how you would propose to amend the UCITS EAD to improve investor protection, clarity and supervisory convergence.

<ESMA\_QUESTION\_EADC\_11>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_EADC\_11>

1. Is the concept of « embedded » derivatives set out in the UCITS EAD adequate and clear enough? Please describe any recurring or significant issues that you have observed with the interpretation or consistent application of this concept and how you would propose to amend UCITS EAD to improve investor protection, clarity and supervisory convergence.

<ESMA\_QUESTION\_EADC\_12>

The European texts are not complete and should be enriched like local regulations (see AMF doctrine 2012-19 - appendix 1).

The historical nature of UCITS should not lead to risks being taken via complex “embedded” derivatives that are difficult to understand by the holder.

One particular case regularly comes up: the classification of subscription rights. As a reminder, these instruments are generally freely obtained because ordinary shares are held in the fund portfolio. Quotes and/or transactions on the secondary market are usually low or unavailable. According to the definition of embedding derivatives securities in the UCITS directive, it is not clear whether subscription rights should be classified (a) as embedded derivatives securities (such as warrants) or (b) as equity-related securities (common stock). It would be helpful to clarify in which group they belong to.

<ESMA\_QUESTION\_EADC\_12>

1. Linked to Q11 and Q12, ESMA is aware of diverging interpretations on the treatment of delta-one instruments under the EAD, taking into account that they might provide UCITS with exposures to asset classes that are not eligible for direct investment (see also Section 3.2). How would you propose to amend the UCITS EAD to improve investor protection, clarity and supervisory convergence? Please provide details on the assessment of the eligibility of different types of delta-one instruments, identify the issues per product and provide data to support the reasoning.

<ESMA\_QUESTION\_EADC\_13>

Financial instruments considered as 'delta one instruments' are not defined in the regulations. Instruments incorporating simple derivatives and considered as delta one remains a source of interpretation. For example, 'make whole call' bonds should be considered as securities integrating simple but delta one type derivatives, without leverage.

It would be desirable to have a definition and/or classification criteria for these instruments (eligibility/associated risks).

<ESMA\_QUESTION\_EADC\_13>

1. Have you observed any recurring or significant issues with the interpretation or consistent application of the rules on UCITS investments in other UCITS and alternative investment funds (AIFs)? In this context, have you observed any issues in terms of the clarity, interaction and logical consistency between (1) the rules on investments in UCITS and other open-ended funds set out in the UCITS Directive and (2) the provisions on UCITS investments in closed ended funds set out in the UCITS EAD? Please describe any recurring or significant issues that you have observed in this respect and how you would propose to amend the relevant rules to improve investor protection, clarity and supervisory convergence. Where relevant, please distinguish between different types of AIFs (e.g. closed-ended, open-ended), investment strategies (real estate, hedge fund, private equity, venture capital etc.) and location (e.g. EU, non-EU, specific countries). In this context, please also share views on whether there is a need to update the legal wording used in the UCITS EAD and UCITS Directive given the fact that e.g. they refer to ‘open-ended’ and ‘closed ended funds’, whereas it might seem preferable to use the notion of ‘AIFs’ by now given the subsequent introduction of the AIFMD in 2011.

<ESMA\_QUESTION\_EADC\_14>

Depositaries are in favor of updating the 'open ended' and 'closed ended' terminologies following regulatory developments since 2007, notably AIFMD.

<ESMA\_QUESTION\_EADC\_14>

1. More specifically, have you observed any recurring or significant issues with the interpretation or consistent application of the rules on UCITS investments in (1) EU ETFs and (2) non-EU ETFs? Please describe any issues that you have observed in this respect and how you would propose to amend the relevant rules to improve investor protection, clarity and supervisory convergence.

<ESMA\_QUESTION\_EADC\_15>

Non-EU ETFs or ETCs must meet the criteria applied to UCITS to be eligible. However, we note a different application of the criteria used for eligibility depending on the member countries. Ex: Mono underlying ETC on gold, iShares ETF US... prohibited in France and authorized in Luxembourg. The same would apply to US bitcoin ETFs (or other crypto assets).

Homogenization on the application of this point would be useful.

<ESMA\_QUESTION\_EADC\_15>

1. How would you propose to amend the UCITS EAD to improve investor protection, clarity and supervisory convergence with respect to the Efficient Portfolio Management (EPM)-related issues identified in the following ESMA reports: (1) Peer Review on the ESMA Guidelines on ETFs and other UCITS issues; (2) Follow-up Peer Review on the ETF Guidelines; and (3) CSA on costs and fees. In this context, ESMA is interested in also gathering evidence and views on how to best address the uneven market practices with respect to securities lending fees described in the aforementioned ESMA reports with a view to better protect investors from being overcharged.

<ESMA\_QUESTION\_EADC\_16>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_EADC\_16>

1. Would you see merit in linking or replacing the notion of EPM techniques set out in the UCITS Directive and UCITS EAD with the notion of securities financing transaction (SFT) set out in the SFTR? Beyond the notions of EPM and SFT, are there any other notions or issues raising concerns in terms of transversal consistency between the UCITS and SFTR frameworks?

<ESMA\_QUESTION\_EADC\_17>

The EPM techniques defined by the EAD are broader than the operations defined by SFTR. We understand that the purpose of the EAD is to establish a general framework without limiting the transactions that enable efficient portfolio management. Thus, reference could be made to the operations referred to by SFTR in Article 11 of the EAD, but without limitation to other potential EPM techniques.

<ESMA\_QUESTION\_EADC\_17>

1. Apart from the definitions and concepts covered above, are there any other definitions, notions or concepts used in the UCITS EAD that may require updates, further clarification or better consistency with definitions and concepts used in other pieces of EU financial legislation, e.g. MiFID II, EMIR, Benchmark Regulation and MMFR? If so, please provide details on the issues you have observed and how you would propose to clarify or link the relevant definitions or concepts.

<ESMA\_QUESTION\_EADC\_18>

The EAD should clarify the notion of Entity or Issuer, because in absence of clear definition, it can lead to different interpretation and no consistency between UCITS directive and other texts such as MMFR. It would be useful to have a clear definition with examples.

For example, we note drafting differences between the Directive 2009/65/EC and the French Monetary and Financial Code on risk division ratios (5-10/40):

\*Art 52 Directive 2009/65/EC: the limits of 5% and 10% must be checked ‘**by entity’**. However, the accumulation between 5% and 10% limited to 40% must be controlled **by issuer**.

\*Art R214-21 French Monetary and Financial Code: All limits of 5-10-40 must be controlled **by issuer.** There is no specific reference made to entity.

Other clarification to be made on the notion of Issuer / Entity in MMFR: Article 56 of the UCITS Directive introduces the notion of "issuer” concentration, referring to the company that issued the security. Subsequently, article 18 of the MMF regulation seems to reuse the concentration notion, but this time we find the term "entity" which differs from "issuer". The fund industry usually defines the term "entity" as a combination of issuers belonging to the same group. Therefore, Money market funds that are UCITS could have to comply with two concentration ratios: the first coming from the UCITS Directive, and the second from the MMF regulation. Will the two concentration notions converge in the next UCITS or MMF review?

Another difference identified: the division of risks on guaranteed issuers for MMFs. The 35% limit per issuer does not exist, the 30% limit systematically applies provided there is a minimum of 6 emissions (of the same country in France). Issuers guaranteed for MMFs therefore follow the same constraints as corporate bonds and do not benefit from the intermediate limit of 35% for UCITS.

<ESMA\_QUESTION\_EADC\_18>

1. Are there any national rules, guidance, definitions or concepts in national regulatory frameworks that go beyond (‘gold-plating’), diverge or are more detailed than what is set out in the UCITS EAD? If so, please elaborate whether these are causing any recurring or significant practical issues or challenges.

<ESMA\_QUESTION\_EADC\_19>

NCAs have been able to define national doctrines, on various subjects, to answer stakeholders' questions and to guide them. This in itself does not constitute a desire to make gold-plating but the need to clarify a rule that is insufficiently defined at the level of the directive.

For example, the AMF 2012-19 doctrine provides elements to take into account for:

- Justify the presumption of the liquidity of an asset concerning securities traded on markets with reduced liquidity, Euronext Growth for example

- Determine the additional due diligence or points of attention to be taken into account when an asset manager wishes to invest in Cat bonds, Cocos or even certain securitization vehicles presenting high levels of sophistication such as Collateralized Debt Obligations)

While this makes it possible to clarify certain key notions, it also means that each regulator interprets the text according to its risk-based approach to protect investors, which can lead to an inconsistent application of the rules (holding of ETCs indexed to gold possible in certain member states, for example in Luxembourg and not in France) and ultimately lead to divergences in terms of supervision.

As part of its assessment, ESMA should retain the most favorable approaches to investor protection (e.g., AMF doctrine on Cat bonds, Cocos) in order to make them a European standard. Generally speaking, a reminder should be made to require that the assets used by asset managers be exhaustively listed in the UCITS prospectus with the systematically associated risks. The AMF 2011-19 doctrine proposes a standard prospectus framework to be followed to describe the assets and associated risks. Otherwise, assets not specified in the prospectus should be ineligible for UCITS.

Moreover, in reading articles 50, 52 and 54 of Directive 2009/65/EC, we understand that "third countries" correspond to non-EU countries. However, equivalent texts from the French Monetary and Financial Code refer to a list of different countries. For example, third countries correspond to non-EU and EEA countries for the eligibility of deposits (Art R214-14) and for the extended risk division ratios for guaranteed securities (Art R214-21). In addition, for 10% counterparty risk, article R214-21 (with reference to R214-19) does not mention third countries, but if compared to Article 52, third countries could agree outside the EU, EEA, and OECD with a prohibition on outside the OECD.

A list of "third countries subject to equivalent rules" should be specified and published on an official website to avoid any interpretation of local regulations on various subjects (Deposit, OTC, counterparty risk, risk division ratios, etc.)

In summary, there are three levels of divergence:

- The geographical areas to be considered

- The applicable ratios using this concept

- Unitary analysis of a third country outside the zones (EU, EEA, OECD)

There are different interpretations between European jurisdictions.

<ESMA\_QUESTION\_EADC\_19>

1. Please fill in the table in the Annex to this document on the merits of allowing direct or indirect UCITS exposures to the asset classes listed therein, taking into account the instructions provided in the same Annex. Please assess and provide evidence on the merits of such exposures in light of their risks and benefits taking into account the characteristics of the underlying markets (e.g. availability of reliable valuation information, liquidity, safekeeping). To substantiate your position, please fill the table with any available data and evidence (e.g. on liquidity or valuation of the relevant asset classes and underlying markets). ESMA acknowledges that the availability of data on direct/indirect exposures to some of the asset classes listed in this table is limited and would welcome receiving any available data (whether on individual market participants and products or market-wide) and even rough estimates that help to understand the practical relevance of the relevant asset class for UCITS and the possible impact of any future policy measures.

<ESMA\_QUESTION\_EADC\_20>

See the table in the Annex to this document. The Depositaries did not provide statistical information but completed the comments column to give their analysis of eligibility for UCITS for each type of asset in the table.

<ESMA\_QUESTION\_EADC\_20>

1. Please elaborate and provide evidence on how indirect exposures to the aforementioned asset classes (e.g. through delta-one instruments, ETNs, derivatives) increase or decrease costs and/or risks borne by UCITS and their investors compared to direct investments.

<ESMA\_QUESTION\_EADC\_21>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_EADC\_21>

1. Under the EAD, should a look-through approach be required to determine the eligibility of assets? Please explain your position taking into account the aforementioned risks and benefits of UCITS gaining exposures to asset classes that are not directly investible as well as the increased/decreased costs associated with such indirect investments. A look-through approach would aim to ensure that the list of eligible asset classes set out in the UCITS Level 1 Directive would be deemed exhaustive and reduce risk of circumvention by gaining indirect exposures to ineligible asset classes via instruments such as delta-one instruments, exchange-traded products or derivatives. Where possible, please provide views, data or estimates on the possible impact of such a possible policy measure.

<ESMA\_QUESTION\_EADC\_22>

France Post-Marché considers that a look-through approach to control the asset eligibility is a practice to keep, guaranteeing the best level of investor protection.

The current directive provides three possibilities (excluding UCIs including ETFs) to be exposed to a given risk:

- Direct investment, mentioned in Article 2 to 6 of the directive

- Derivative instruments, mentioned in Article 8

- Embedded derivatives, mentioned in Article 10

The current directive is broader on eligible underlying assets through embedded derivatives than through derivative instruments. The Article 8 1.a) specifies the types of eligible risks for derivative instruments (i.e., (i) assets as listed in Article 19(1) of Directive 85/611/EEC including financial instruments having one or several characteristics of those assets; (ii) interest rates; (iii) foreign exchange rates or currencies; (iv) financial indices)

There is no equivalence for embedded derivative mentioned in the Article 10: this absence of limit is a source of different interpretations between jurisdictions and allows the acquisition of embedded derivatives that can be considered as complex risks.

The eligibility criteria for embedded derivatives should be specified in the directive.

Concerning UCIs, it should be noted that the AMF 2011-19 doctrine in France requires that the exposure for fund of funds is computed on a look-through basis with several calculation methods, depending on the level of information available on the underlying fund. It seems that this look-through methodology does not exist in other jurisdictions. The approach for fund of funds should be clarified in the directive to homogenize across the UE.

<ESMA\_QUESTION\_EADC\_22>

1. What are the risks and benefits of UCITS investments in securities issued by securitisation vehicles? Please share evidence and experiences on current market practices and views on a possible need for legislative clarifications or amendments.

<ESMA\_QUESTION\_EADC\_23>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_EADC\_23>

1. What are the risks and benefits of permitting UCITS to build up short positions through the use of (embedded) derivatives, delta-one instruments or other instruments/tools? Please share evidence and experiences on current market practice and views on a possible need for legislative clarifications or amendments.

<ESMA\_QUESTION\_EADC\_24>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_EADC\_24>

1. Apart from the topics covered in the above sections, have you observed any other issues with respect to the interpretation or consistent application of the UCITS EAD? If so, please describe the issues and how you would propose to revise the UCITS EAD or UCITS Directive with a view to improve investor protection, clarity and supervisory convergence.

<ESMA\_QUESTION\_EADC\_25>

Specify the exclusion of derivative products in exposure to the 100% limit in the UCITs Directive:

According to our analysis of Articles 51, 52 and 54 of Directive 2009/65/EC on risk sharing rules (division rules) for transferable securities and money market instruments issued or guaranteed by a Member State, its local authorities, a third country or by an international public body of which one or more Member States are part, derivatives should only be considered for the 35% limit and not the 100% limit. However, the answer given to Question 3 - Concentration Rules - Q&A 1199 of ESMA 34-43392 Q&A UCITS, indicates that derivatives must be taken into account for the calculation of the 100% limit, but this is not the market practice.

The texts should be clarified (or the Question 3 - Concentration Rules - Q&A 1199 deleted).

<ESMA\_QUESTION\_EADC\_25>