



European Securities and Markets Authority
201-203 Rue de Bercy
CS 80910
75589 Paris

6th August 2024

Dear Sir/ Madam

Re: ESMA's call for evidence on the review of the UCITS Eligible Assets Directive

We refer to ESMA's call for evidence on the review of the UCITS Eligible Assets Directive ("**ESMA CFE**") dated 7 May 2024 [Ref: ESMA 34-1270380148-1032].

We set out hereunder our feedback on a selected number of questions included in the ESMA CFE:

Q1: 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?

The review of list of financial instruments that are eligible investments under the UCITS framework is long overdue. We are of the view that there are divergent positions across EEA Member States on the ability of UCITS Funds to invest in a number of financial instruments that are generally widely available to retail clients in the EEA. These include – structured products linked to various asset classes like precious metals, commodities, and crypto assets – to mention a few.

Whilst Article 2(2)(c) of Commission Directive 2007/16/EC ("**EA Directive**") clearly states that: *"Transferable securities as referred to in Article 1(8) of Directive 85/611/EEC shall be taken to include the following (c) financial instruments which fulfil the following criteria: (i) they fulfil the criteria set out in paragraph 1; (ii) they are backed by, or linked to the performance of, other assets, which may differ from those referred to in Article 19(1) of Directive 85/611/EEC."* various Member States have expressed divergent views on whether structured products linked to various asset classes like precious metals, commodities, and crypto assets which otherwise fulfil all the requirements of Article 2(1) of the EA Directive are eligible.

Generally speaking, any revisions to the list of eligible assets should ensure that the list is broadened to cater for all financial instruments that are already available to retail investors within the EEA in terms of the Prospectus Regulations¹. This should include any type of financial instruments that may be offered to the public in accordance with the Prospectus Regulation ("**PR Registered Products**"). Once the EU Regulatory framework already recognises that PR Registered Products may be offered to the retail public in the EEA, it is nonsensical to restrict UCITS Funds from investing in those same products. Likewise, MIFID Firms are permitted (subject to where applicable appropriateness or suitability assessment obligations) to market PR Registered Products to their retail clients so again it is nonsensical to exclude UCITS Funds from investing in those products. Indeed, not only is there no real justifiable reason from an investor protection point of view to restrict UCITS Funds from accessing PR Registered Products but retail investors are generally better off being exposed to PR Registered Products through an investment in a UCITS Fund rather than acquiring them directly on a non-advised or even on an advised basis with potentially no ongoing oversight of the performance of these products by

a relevant MIFID Firm. This particularly in view of the extensive investor protection mechanisms that are already in-built in the UCITS Framework such as onerous investment, diversification, borrowing, risk management, and global / total exposure limits as well as the role of the UCITS Management Company and the Depositary. Further, the UCITS Fund route offers investors the peace of mind that a fully regulated UCITS Management Company is overseeing the performance of PR Registered Products on an ongoing basis as opposed for example a MIFID Firm that can sell such assets on a non-advised basis or even potentially on an execution-only basis.

In summary, retail investors wishing to be exposed to PR Registered Products that are linked to assets (such as crypto currencies) that are generally volatile and considered high risk are better off investing in a UCITS Fund that is exposed to these PR Registered Products rather than invest in these PR Registered Products directly.

Q9: 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.

We have experienced divergent interpretations on the application of Article 2(1)(g) on the extent to which the risks associated with certain transferable securities are “...adequately captured by the risk management process of the UCITS”. Please refer to our reply to Q10 below.

Q10: How are the valuation and risk management-related criteria set out in the UCITS EAD22 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.

There are evidently divergent interpretations on the extent to which the risks associated with certain transferable securities are “...adequately captured by the risk management process of the UCITS”. To the extent that there is sufficient historical data in respect of the target transferable security in question or a proxy that may be identified by the relevant UCITS Management Company, then the target financial instrument should be considered as fulfilling this requirement. Risk management, in the main, revolves around the analysis of historic data that relates to the transferable security in question (or a proxy in the case of a newly issued transferable security or a transferable security with limited historic data). To the extent that meaningful historic data is available and can be modelled, there should not be any uncertainty on the eligibility of the target transferable security.

Similarly, to the extent that the target transferable security is listed and actively traded then no valuation concerns should arise. In the event that the target transferable security is not actively traded but can nonetheless be valued in accordance with the UCITS Management Company’s valuation policy through the use of a proxy or another suitable valuation methodology set out in the policy, the target transferable security should be deemed to satisfy the requirements of Article 2(1)(c).

Q11: 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.

In our view, the provisions of Article 2(2)(c) of the EA Directive are very clear but may well require further revisions to ensure the consistent application of this article across Member States.

To illustrate, we have noticed that certain Member States have outrightly rejected the eligibility of listed (on EEA Regulated Markets) transferable securities backed by crypto currencies which have been issued in terms of the Prospectus Regulation and are widely available to the retail public within the EEA and which fulfil fully the requirements of Article 2(1) of the EA Directive. This refusal was based exclusively on the fact that the transferable securities in question were backed by crypto currencies.

To illustrate, we take Fidelity Physical Bitcoin ETP issued by Fidelity Exchange Traded Products GmbH as an example. This product is issued in terms of the Base Prospectus (see link below) issued by Fidelity Exchange Traded Products GmbH. The documentation listed below clearly provides that the Fidelity Physical Bitcoin ETP is a transferable security that is backed by assets (in this case Bitcoin) – in line with Article 2(2)(c) of the EA Directive. At no point in the extensive documentation relating to this product does it hint to the fact the Fidelity Physical Bitcoin ETP is an AIF/ collective investment scheme and there should be no doubt about the fact that the Fidelity Physical Bitcoin ETP **does not** qualify as an AIF/ collective investment scheme. The Fidelity Physical Bitcoin ETP falls within the definition of a transferable security in terms of Article 2 of the EA Directive as it:

- i. is a financial instrument – debt securities;
- ii. fulfils the criteria set out in Article 2(1) of the EA Directive;
- iii. is backed by, or linked to the performance of, other assets, which may differ from those referred to in Article 50(1) of the UCITS Directive² – the ETP is backed by crypto currencies as set out in the Final Terms (see link below); and
- iv. the transferable security does not embed a derivative.

Naturally the transferable security in question would fall under either of Articles 50(1)(a), (b) or (c) of the UCITS Directive.

The Base Prospectus provides in the cover page that the Fidelity Physical Bitcoin ETP qualifies as a debt security. Furthermore, the Base Prospectus has been notified to various competent authorities of EEA Member States in accordance with the Prospectus Regulation as set out in the enclosed Fact Sheet [see link: [https://www.consob.it/web/consob-and-its-activities/ue-passports?_it_consob_ProspecttiSiPassUE_INSTANCE_YZtSpz2AARy7_formDate=1711014325406&p_p_id=it_consob_ProspecttiSiPassUE_INSTANCE_YZtSpz2AARy7&p_p_lifecycle=0&p_p_state=normal&p_p_mode=view&_it_consob_ProspecttiSiPassUE_INSTANCE_YZtSpz2AARy7_curPage=1&_it_consob_ProspecttiSiPassUE_INSTANCE_YZtSpz2AARy7_idNationalAuthority=0&_it_consob_ProspecttiSiPassUE_INSTANCE_YZtSpz2AARy7_emittenteText=FIDELITY+EXCHANGE+TRADED+PRODUCTS+GMBH&_it_consob_ProspecttiSiPassUE_INSTANCE_YZtSpz2AARy7_emittente=294&_it_consob_ProspecttiSiPassUE_INSTANCE_YZtSpz2AARy7_tipoDocumento=0&_it_consob_ProspecttiSiPassUE_INSTANCE_YZtSpz2AARy7_dataInizioNotifica=&_it_consob_ProspecttiSiPassUE_INSTANCE_YZtSpz2AARy7_dataFineNotifica=&_it_consob_ProspecttiSiPassUE_INSTANCE_YZtSpz2AARy7_dataInizioApprovazione=&_it_consob_ProspecttiSiPassUE_INSTANCE_YZtSpz2AARy7_dataFineApprovazione=">](https://www.consob.it/web/consob-and-its-activities/ue-passports?_it_consob_ProspecttiSiPassUE_INSTANCE_YZtSpz2AARy7_formDate=1711014325406&p_p_id=it_consob_ProspecttiSiPassUE_INSTANCE_YZtSpz2AARy7&p_p_lifecycle=0&p_p_state=normal&p_p_mode=view&_it_consob_ProspecttiSiPassUE_INSTANCE_YZtSpz2AARy7_curPage=1&_it_consob_ProspecttiSiPassUE_INSTANCE_YZtSpz2AARy7_idNationalAuthority=0&_it_consob_ProspecttiSiPassUE_INSTANCE_YZtSpz2AARy7_emittenteText=FIDELITY+EXCHANGE+TRADED+PRODUCTS+GMBH&_it_consob_ProspecttiSiPassUE_INSTANCE_YZtSpz2AARy7_emittente=294&_it_consob_ProspecttiSiPassUE_INSTANCE_YZtSpz2AARy7_tipoDocumento=0&_it_consob_ProspecttiSiPassUE_INSTANCE_YZtSpz2AARy7_dataInizioNotifica=&_it_consob_ProspecttiSiPassUE_INSTANCE_YZtSpz2AARy7_dataFineNotifica=&_it_consob_ProspecttiSiPassUE_INSTANCE_YZtSpz2AARy7_dataInizioApprovazione=&_it_consob_ProspecttiSiPassUE_INSTANCE_YZtSpz2AARy7_dataFineApprovazione=)].

The Confirmation issued by Bafin in respect of the issuer clearly provides that the prospectus relates to the “...issuance of **Bonds** secured by Cryptocurrencies..” and makes no reference to the Fidelity

Physical Bitcoin ETP qualifying as a closed ended AIF/ collective investment scheme [see link: <https://www.consob.it/ProspettiSiPassUE/DownloadProspetto?name=592489/9/COA>].

Furthermore, the Frankfurt Stock Exchange also classifies the Fidelity Physical Bitcoin ETP as an Exchange Traded Note (“ETN” and not as “ETF”). See link to the website of the Frankfurt Stock Exchange below.

Please see the relevant documentation relating to the Fidelity Physical Bitcoin ETP for ease of reference:

- a. Fidelity Exchange Traded Products GmbH: Base Prospectus
https://www.fidelity.lu/static/master/media/pdf/download-material/Fidelity-Exchange-Traded-Products-GmbH-Base-Prospectus-2024_01_25.pdf
- b. Fidelity Physical Bitcoin ETP: Final Terms
<https://www.fidelity.lu/static/master/media/pdf/download-material/fidelity-exchange-traded-products-gmbh-final-terms.pdf>
- c. Fidelity Physical Bitcoin ETP: Issue Specific Summary
<https://www.fidelity.lu/static/master/media/pdf/download-material/fil-bitcoin-etp-summary.pdf>
- d. Fidelity Physical Bitcoin ETP: KID
https://www.fidelity.lu/static/master/media/pdf/download-material/Final-EU_PRIIP_KID_Fidelity-Physical-Bitcoin-ETP_STRD_en-gb_XS2434891219.pdf
- e. Fidelity Physical Bitcoin ETP: Frankfurt Stock Exchange Classification as an ETN (not an ETF):
<https://www.boerse-frankfurt.de/en/etf/fidelity-physical-bitcoin-etp>

It is still unclear to us, notwithstanding the above, why the Fidelity Physical Bitcoin ETP was considered by a number of Member States as not being UCITS eligible.

Evidently the reference in Article 2(2)(c) to **any asset** not covered under Article 50(1) of the UCITS Directive needs to be expanded in such a way that it clearly refers to any asset class, from precious metals, to commodities, and crypto currencies.

We find it rather odd that certain Member States accept as eligible, listed (on EEA Regulated Markets) transferable securities backed by precious metals which have been issued in terms of the Prospectus Regulation and are widely available to the retail public within the EEA and which fulfil fully the requirements of Article 2(1) of the EA Directive but then reject identical transferable securities that are backed by crypto currencies (rather than precious metals). This in our view is a clear misapplication of Article 2 of the EA Directive – which should thus be amended to ensure both certainty and convergence. It is anathema to the UCITS Framework and the European Union Single Market generally to have divergent views on matters such as UCITS Funds eligible assets, where potentially a UCITS Fund authorised in one Member State may face issues with enjoying its freedom of services under the UCITS Directive and the Treaty.

The coming into force of the Markets in Crypto Assets Regulation is also reflective of the direction that the EU Commission, Council and Parliament are taking in so far as retail distribution of crypto assets is concerned and supports even further the thesis that crypto assets backed transferable securities that are widely available to the retail public in the EEA should not be excluded from the list of eligible assets.

Q12: 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.

The principal matter that ought to be clarified is the extent to which an embedded derivative needs to be an eligible derivative in accordance with Article 50(1) of the UCITS Directive. The existing text does not appear to mandate that an embedded derivative needs to be an eligible derivative in accordance with Article 50(1) of the UCITS Directive. This position is supported by Article 2(2)(c) which refers to financial instruments that are “...linked to the performance of, other assets, which may differ from those referred to in Article 19(1) of Directive 85/611/EEC.”. The “link” to other assets is generally achieved through the use of embedded derivatives.

Q13: 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.

Please refer to our comments under Q11 above which are equally relevant to delta one instruments.

Delta one instruments – to the extent that they do not embed a derivative – that qualify as transferable securities fulfil the requirements of Article 2 of the EA Directive should be considered eligible, irrespective of the nature of the underlying asset.

Q21: 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.

Please refer to our comments under Q1 above. To the extent that these products qualify as PR Registered Products in that they are available to the retail public in the EEA in terms of the Prospectus Regulation, they should automatically be eligible subject to the applicable investment, borrowing and global/ total exposure limits. It is difficult to argue that these products should be excluded based on considerations of **costs or risk**, when:

- i. they are already widely available as direct investments in the EEA under another EU framework. The exclusion of these products is rather counterintuitive as it would effectively mean that a retail investor can take direct exposure to them generally on a non-advised basis (possibly subject to appropriateness assessment and related risk warnings in the case of failure of the appropriateness assessment) but the same retail investor cannot gain exposure to them through a highly regulated UCITS Fund (as they are deemed to be non-eligible investments); and
- ii. the UCITS Directive already caters for the establishment of UCITS Fund of Funds, subject to, among other things, the disclosure of the combined management fees – so concerns about multiple layers of costs are addressed through disclosure rather than exclusion of the asset class from the eligibility pool.

Q22: 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.

Please refer to our comments above. The use of a “look through approach” would limit extensively the universe of eligible assets and the strategies that can be deployed under the UCITS brand. Overall such an approach would certainly be detrimental from an investor protection point of view as it would simply push retail investors to investing directly in, among other things, PR Registered Products (possibly without the safeguards provided by the UCITS framework – as summarised above) with no one (such as a regulated UCITS Management Company or MIFID Firm) overseeing on an ongoing basis the performance and risk profile of these investments.

To the contrary the list of eligible assets should be broadened (as outlined above subject to compliance with strict investment, borrowing and global/ total exposure limits) so that investors can gain exposure to asset classes (which they can in any case access through direct investments) through professionally managed UCITS Funds (with all the safeguards that the UCITS regulatory framework has to offer).

Yours faithfully

Daniele Bernardi
