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 | Union Asset Management Holding AG |
| Activity | Asset Management |
| Country / Region | Germany |

# 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>

In our opinion, the “most pressing issue” in this context is to preserve the legal basis for the success of UCITS to date for the benefit of retail investors. Subsequently, please find a selection of material corner points which we would like to mention in this context.

* Preservation and contemporary further development of the legal basis for diversity in UCITS product design

UCITS are an universal investment vehicle for retail investors. It provides access to a broad investment universe and thus the opportunity to participate in its performance (various types of securities, asset classes, sectors, countries, regions). Access to assets can be direct (explicitly referred to as permissible assets or “other” within the scope of the cap). UCITS can also provide indirect access to assets that are not explicitly permitted, if they meet the criteria for financial instruments or securities within the EAD.

The future UCITS-EAD should - as before - have immanent principles as its leading idea which allows for a breathing regulatory application and, if necessary, further development of the rules to changing environmental conditions and not have regulation that is precise down to the last detail as its objective. A (too) small-scale and detailed regulatory framework leads to massive challenges in practical application due to its rigidity (as we currently see, for example, in ESG regulation with the challenge of accompanying the transformation process of the economy through the financial industry).

A review of UCITS L1-regulation has just taken place, which further developed, specified and EU-wide harmonized some existing and functioning principles, among other things:

* New Art. 18 a UCITS Directive: new requirements for liquidity management,
* New Art. 20a UCITS Directive: new requirements for regular reporting obligations to the national supervisory authority about the markets and instruments in which a UCITS invests, and
* New Article 84 UCITS Directive: for UCITS, national supervisory authorities are authorized to require an asset manager to suspend the issue or redemption of shares. The supervisory authority of a Member State in which a UCITS is marketed may in future require the supervisory authority of the Member State in which the UCITS was authorized to exercise its right to require the asset manager to suspend the issue or redemption of units, if it sees risks to the stability of the financial system.
* Risk diversification inherent in UCITS reduces the risk of cluster risk investments

A broad investment spectrum enables better risk diversification and a reduction in individual asset risk for the retail investor. Diversification at product and investor level avoids risks from direct acquisition (cluster risk). The broader and more diverse the investment universe, the greater the opportunity to combine different assets and reduce overall risk in a retail product. It is crucial that UCITS's ability to meet investors' redemption requests at any time is not impaired.

* Maintaining opportunities for cost efficiencies via indirect investment exposures

Standardizing the requirements in an investment vehicle like UCITS investment funds can reduce the costs of managing and trading the assets. This can lead to lower fees for providers and investors in UCITS funds in comparison to direct acquisition, e.g. precious metals, oil and other natural resources.

<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>

No.

<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>

No.

<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>

#### No. Additionally, a review of UCITS L1-regulation has just taken place, which further developed, specified and EU-wide harmonized some existing and functioning provisions, among other things:

* New Art. 18 a UCITS Directive: new requirements for liquidity management,
* New: Art. 20a UCITS Directive: new requirements for regular reporting obligations to the national supervisory authority about the markets and instruments in which a UCITS invests, and
* New: Article 84 UCITS Directive: for UCITS, national supervisory authorities are authorized to require an asset manager to suspend the issue or redemption of shares. The supervisory authority of a Member State in which a UCITS is marketed may in future require the supervisory authority of the Member State in which the UCITS was authorized to exercise its right to require the asset manager to suspend the issue or redemption of units, if it sees risks to the stability of the financial system.

<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>

Yes, we believe, the general assumption that listed securities are liquid is still true.

The current provision in Article 2(1) of the EAD is a differentiating regulation because it states that the presumption applies only when the UCITS has no information suggesting a different determination. So, asset managers are not allowed to rely universally on this presumption, as admission to a regulated market does not inherently guarantee liquidity for all instruments. However, this presumption is true for many scenarios and reflects the practical, risk-based approach that asset managers take. Since 2007, the presumption has been reinforced by additional rules that enhance the manager's role in managing investment risks. Recent amendments to the UCITS Directive recognize and provide managers with liquidity management tools to better manage liquidity risk. Removing the presumption could necessitate routine analysis although it adds no value.

Thus, it is crucial to maintain this presumption, as it supports the practical considerations and risk management strategies employed by managers.

<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>

TYPE YOUR TEXT HERE

<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>

Yes, UCITS should be allowed to hold foreign currencies also for investment purposes. Investors accept the risks and chances by investing into foreign currencies already by choosing fixed income, money market and equity funds that invest into foreign currency denominated assets. The currency exposure is not different from a direct investment into foreign currencies. The same is true for indirect investments, e.g. German equities with an international business model that includes associated foreign exchange risks according to the relevant business model. Whether these risks are hedged or not depends on the strategy of the relevant company.

Very often the currencies are more liquid than e.g. floating rate notes in the relevant currencies with more or less the same exposure. Therefore, holding foreign currencies could even improve the liquidity status of an UCITs.

<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>

No. We did not face any recurring or significant issues with the interpretation or consistent application of the 10% limit.

<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>

We are not aware of any recurring or significant issues regarding the ‘transferable security’ criteria set out in the UCITS EAD.

[CESR’s Advice](https://www.esma.europa.eu/sites/default/files/library/2015/11/06_005_0.pdf) to the European Commission on Clarification of Definitions concerning Eligible Assets for Investments of UCITS clarities the criteria in a sufficient manner, see p.8 No 30

“CESR has reflected on this and has deleted the reference to ‘freely and to ‘in the capital markets’, concluding that a UCITS may invest in ‘not freely negotiable’ transferable securities, provided that it is aware of the existence of limitations to their transferability and that notwithstanding that it will be able to redeem units at the request of the unit holders. In addition, it has been clarified that where a security is listed, a presumption of negotiability applies, but as with the presumption of liquidity, it is not guaranteed, for example in the case there are specific restrictions on the transferability of the security (i.e. the presence of a lock-in clause or of a clause submitting the transfer of a share to the agreement of the other shareholders).”

These criteria are still valid.

<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>

TYPE YOUR TEXT HERE

<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>

Yes.

<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>

Yes.

<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>

The provisions allowing exposures to asset classes that are not eligible for direct investment are not new. They support management companies to develop investment funds that are attractive for investors. In all these years, management companies have issued many UCITS with investments into delta-one instruments. Those instruments must in particular fulfil certain requirements of Art. 2 of the UCITS EAD including the consideration of its risks within the risk management of the UCITS. We believe that there is no need to narrow the investment pos­sibili­ties of UCITS.

We believe, that adding the most popular asset classes as eligible direct investment or as eligible underlying for derivatives, along with necessary regulatory require­ments could improve investor protection, clarity and supervisory convergence.

One example regarding commodities. There are many UCITS that have exposure to commodities and that are attracting many investors. If the UCITS EAD would make com­modities an eligible underlying for derivatives, by adding them in Art. 8(1)(a), this could reduce costs for investors and would open the possibility to set-out regulatory details like a ban of derivatives on agriculture commodities (e.g. wheat or soya beans) or a mandatory cash settlement. Adding popular asset classes as eligible for direct investments would make UCITS more attractive, would come along with necessary requirements and would make investments via delta-one instruments less attractive.

Finally, investors are deciding about their investments. If UCITS are not able to address the interests and demands of investors, investors may decide on direct investments instead of investing via fully diversified and highly regulated UCITS. We believe that investors are protected most if they have the option to undertake their aimed investments via UCITS rather than investing directly, without any diversification, risk management systems and professional knowledge.

<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>

In our opinion, in general the existing rules on UCITS investments in other UCITS and AIFs have been proven suitable. However, given the greater level of standardization for AIF, for example through the AIFMD and the introduction of the ELTIF, it might be worth to establish more clarity regarding the equivalence of the level of protection pursuant to Article 50 Para. 1 e) (i) UCITS Directive. Furthermore, we suggest to reconsider the relationship between Article 50 Para. 1 e) UCITS Directive and Article 2 Para. 2 a) and b) UCITS EAD.

We note that the UCITS EAD allows a UCITS to invest in closed ended-funds, e.g. venture capital vehicles from non-EU jurisdictions (subject to certain requirements), while investments in some open-ended funds are currently not possible.

We agree that the reference in the EAD to ‘closed-ended funds’ is outdated, not only taking into account Article 1 of Delegated Regulation (EU) No. 694/2014 which uses the term ‘closed-ended AIF‘, but also from a regulatory perspective.

From our point of view, if a collective investment undertaking does not meet the criteria of Article 50 Para. 1 e) UCITS Directive, an UCITS should still be able to invest in a collective investment undertaking provided this collective investment undertaking, whether open- or closed-ended, meets the criteria of a transferable security pursuant to Article 2 Para. 2 a) and b) UCITS EAD.

Therefore, these collective investment undertaking should be explicitly classified as an eligible investment within the 10% limit in Article 50 para. 2 a) UCITS.

Consequently, Article 2 Para. 2 UCITS EAD should be revised by replacing the term ‘closed-ended funds’ with ‘collective investment undertakings which do not fulfil the criteria of Article 50 Para. 1 e) Directive 2009/65/EC‘.

<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>

No, we did not observe any such issues.

<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>

We would like to comment on Repurchase Agreements and the Securities Lending Fees:

1. Repurchase Agreements

Article 11 of the UCITS EAD allows for the usage of efficient portfolio management techniques (EPM), if they are in compliance with the criterions determined in that article. EPM do also include repurchase agreements.

The introduction of EMIR created liquidity requirements which have not been there before. Cleared OTC derivatives require the provision of VM (cash collateral). Besides, market practise shows that uncleared OTC derivatives are also collateralised with cash collateral. In case of troubled times at the financial markets, investors may redeem their fund units more often as they would do under normal circumstances. In those circumstances making usage of liquidity gained via repurchase agreement would be for the benefit of both, remaining investors and redeeming investors: Without that additional access to liquidity, the management company might be forced to undertake fire sales in order to remain able making collateral contributions and effecting the redemption of fund units. Those fire sales are likely to fortify the downward movement of markets and would impede the stabilisation of markets. On the other hand side, using the liquidity temporarily gained via repurchase agreements would provide the manage-ment company with an additional liquidity tool for that type of crisis.

According to para. 42 of ESMAs Guidelines on ETFs and other UCITS issues (ESMA/2014/937EN) the liquidity gained via repurchase agreements should be considered as collateral, subject to the limitations laid down in para. 43 of the Guidelines. In other words: According to these Guidelines, gaining liquidity via repurchase agreements is allowed but it cannot be used where required. Instead, UCITS shall use that liquidity only for providing liquidity to others (reverse repos), putting it on an account or investing it into high-quality government bonds.

We understand that initial thoughts behind that restriction to hamper an extra leverage of investments. However, we believe that leverage is already limited for UCITS and the source of liquidity does not have any impact on the fact that a UCITS must comply with the statutory limitation of leverage. Against that background it should not be necessary to artificially deem the liquidity gained via repurchase agreements “collateral” for achieving compliance with leverage limits. “Artificially” because any such liquidity is not considered collateral under any of the master agreements for repurchase agreements worldwide. It is only deemed “collateral” in said guidelines.

In particular, we see that those restrictions mean a potential risk for investors of UCITS in times of a crisis of financial markets, because these restrictions may trigger fire sales bridging the temporary liquidity gaps in many UCITS funds at the same time.

For the reasons provided above, we would highly recommend to amend Art. 11 para. 1 (b) by adding sub-paragraph “(iv) generation of temporary liquidity.”

2. Securities Lending Fees

Based on the key points mentioned in the reports, ESMA is concerned about exemptions from collateralization, hidden fees, and unfair market rates. In order to address these concerns, we propose to distinguish between two cases:

1. when a management company conducts securities lending transactions with its own lending desk, and
2. when the management company outsources these transactions to an agent lender.

In case (i), the management company incurs costs associated with securities lending, such as wages, systems maintenance and development, membership fees, etc. In case (ii), the management company faces third-party costs, particularly the fees charged by the agent lender for its services.

Both cases involve costs that are subject to change, such as increasing wages or fees. However, there are differences between the two. In case (i), management companies have the flexibility to adjust and expand their systems, such as onboarding multiple tri-party agents, connecting to clearing platforms, or renegotiating agreements. On the other hand, in case (ii), management companies have limited control over the infrastructure of securities lending and heavily rely on the services provided by the agent lender. Switching to a different agent lender may pose challenges, as it requires establishing new connections, negotiating agreements, and potentially interrupting securities lending operations.

It is important to note that the lending fee obtained from securities lending transactions depends on the infrastructure built by the lender or agent lender and their trading experience. Lower infrastructure costs often result in lower lending fees and vice versa. ESMA acknowledges this correlation in its discussion on costs and fees. However, ESMA is concerned that management companies may not consider competitors offering similar quality services at better rates due to a lack of review and adjustment of fees.

We understand these concerns but believe that it would be difficult for management companies to conduct a comprehensive review due to the following reasons:

* Lack of Information: Management companies do not have access to the internal securities lending infrastructure and trading experience of other companies or agent lenders. This information is considered proprietary and there is no way to determine which companies or lenders offer similar quality services.
* Difficulty in Comparisons: Even if a comparison were possible, it would have to be highly granular, considering various factors such as asset class, region, rating, maturity, liquidity, and volume. Data on lending fees of competitors or agent lenders is not available to management companies.
* Volume Dependency: Lending fees also depend on the volume of securities lent. If borrowers need to conduct multiple transactions with different lenders to obtain the necessary securities, it increases their operational efforts and costs. Higher volume concentration with a single lender reduces operational efforts and costs for borrowers, leading to a willingness to pay higher lending fees. Management companies cannot determine the quality level achieved by other companies or lenders if they do not know whether higher lending fees are the result of higher volume or other factors.
* Borrower Quality: Lending fees also vary depending on the quality of the borrower.

Considering these challenges, it is not feasible to conduct a review as mentioned in ESMA's discussion on costs and fees.

Focusing solely on fees without considering the quality of service may lead to management companies replacing higher-fee agent lenders with lower-fee ones, potentially reducing the gains from securities lending for investors. Example: it does not make sense to compare solely the fee, billed to the UCITS by the rate (e.g. 15% of the lending fee versus 30% of the lending fee) because, if lending agent “A” offers its services for 15% of the lending fee but only achieves 4 bps for lending a bond while the management company “B” charges 30% of the lending fee but achieves 16 bps for lending a bond, the investors do benefit more, where the fee is higher. In the given example, A would be much “cheaper” but investors would only receive 3.4 bps compared to 11,2 bps achieved by involving B. We do not see that investors are overcharged in that case.

Therefore, we believe that the approach taken by BaFin, and potentially a model across the EU, offers a viable solution. Management companies can choose between a fixed fee rate (with self-borne costs of securities lending infrastructure) or reimbursement of costs incurred when an agent lender is involved.

We believe that the fixed fee rate proposed by BaFin provides an incentive for management companies to improve their securities lending infrastructure. This improvement would result in higher lending fees, benefiting both the companies and investors. If management companies do not see any additional income from improving their services, they would not consider making the necessary investments. Undertaking securities lending is always beneficial for investors, but it requires investments in trading infrastructure to increase lending fee rates and volumes.

When referring to the approach supported by BaFin, we avoid using the term “fee-split” because we believe that its meaning could be misunderstood:

ESMA’s final Report on the 2021 CSA on costs and fees (ESMA34-45-1673) from May 21, 2022 refers to “fee splits” (page 13). According to Art. 22(3)(d) of the UCITS Directive (respectively Art. 32(3)(b), a depository shall ensure that in transactions involving a common fund’s assets any consideration is remitted to it within the usual time limits. Against that background it is our understanding that 100% of the lending fee forms part of the UCITS (no split). The management company would claim its (fix) fees afterwards and it is within the responsibility of the depository to effect the payment of these fees from the UCITS assets. However it might be the case that an interpretation of ESMA’s guidelines on ETFs and other UCITS issues (ESMA/2014/937) and in particular para. 29 have opened the possibility to deduct fees from EPM income before any such income has been received by the depository (“All the revenues arising from efficient portfolio management techniques, net of direct and indirect operational costs, should be returned to the UCITS.”), which would be a split of fees before they are received by the investors. The term “fee split”, used by ESMA would support the latter. We believe that any hidden costs could be avoided when it is ensured that lending fees must be paid in full onto an account maintained at the depository before effecting the payment of any costs or (fix) fees claimed by the management company or the agent lender from that resource.

Regarding the exemption from collateralization mentioned in the peer review, we propose supplementing the UCITS EAD with a regulatory basis for voluntary central clearing of efficient portfolio management (EPM) activities.

The German approach, referred to by ESMA (§ 202 of the German Investment Code), may not be sufficient as clearing is typically offered by exchanges through a central counterparty, not by central securities depositories. In order to enable voluntary clearing of EPM, UCITS should have the flexibility to deviate from regulatory restrictions, such as the way collateral is to be provided (pledge/full title) or limitations on securities lending transactions with the same counterparty. UCITS EAD should provide a general framework for such deviations to facilitate access to clearing via an exchange.

<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>

We do not see a merit in linking or replacing the notion of EPM techniques. Repos, reverse-repos and securities lending transactions are EPM techniques and SFTs. However, any link to SFTR may result in unintended effects in case of an amendment of SFTR. It is our understanding that EPM include a wider range of instruments compared to SFTs; see [CESR/06-005](https://www.esma.europa.eu/sites/default/files/library/2015/11/06_005_0.pdf), Advice, p. 38, Box 10, No. 3):

“Based on the above-mentioned criteria, techniques and instruments relating to transferable securities and money market instruments include, but are not limited to, collateral under the provisions of Directive 2002/47/EC on financial collateral arrangements, repurchase agreements, guarantees received, and securities lending and securities borrowing.”

Hence, replacing the notion of EPM by SFT could create misinterpretations in case of alignments through a linkage between EPM and SFT. Therefore, a link between the UCITS EAD and SFTR should be avoided.

TYPE YOUR TEXT HERE

<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>

No. We do not see 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.

<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>

1. Collateralisation requirements

According to German law (§ 200 para 3 German Investment Code), securities lending transactions must be fully collateralised at any time. On top, over-collateralisation is required. The security value is determined from the market value of the securities to be transferred as a securities loan and the associated income. The German legislation is consistent with the international applied concept of collateralisation which is also basis of the GMSLA (Global Master Securities Lending Agreement), an international standard master agreement governing securities lending transactions, see ISLA, [GMSLA](https://www.islaemea.org/wp-content/uploads/2019/03/GMSLA_2010_amendments_July_2012-1.pdf), 5.4 (a), p. 11).

“(a) the aggregate Market Value of the Collateral delivered to or deposited with Lender (excluding any Equivalent Collateral repaid or delivered under paragraphs 5.4(b) or 5.5(b) (as the case may be)) (Posted Collateral) in respect of all Loans outstanding under this Agreement shall equal the aggregate of the Market Value of Securities equivalent to the Loaned Securities and the applicable Margin (the Required Collateral Value) in respect of such Loans;”

On top, any decrease of collateral below the real value of the securities lent is to be reported immediately to the German NCA, including the reasons for that decrease (§ 200 para 4 German Investment Code).

This system has proven to be robust in practice and corresponds to international market practice. However, ESMA has created requirements laid down in ESMA’s guidelines on ETFs and other UCITS issues (ESMA/2014/937), under which the over-collateralisation of securities loan transactions is achieved via a haircut on the collateral received (a concept which is common for derivatives, but not so much for securities lending transactions). That means, collateral received is deemed to have a lower value. This has been “ratified” into German law in parallel to the German regulatory requirements by amending the German Derivative Regulation which is also applicable on securities lending transactions, see § 27 para 6 Derivative Regulation.

Since that time, German UCITS have to comply simultaneously with two different methods of calculating the collateral required. Whenever master agreements for securities lending transactions are negotiated, counterparties (borrowers) wonder about the complexity created by that overlapping approach.

As the approach of the German Regulation is based on the GMSLA and hence, reflecting the international market standard, and on top of the compulsory framework by ESMA, we propose to align the ESMA / UCITS EAD approach accordingly with the GMSLA to reduce regulatory complexity and support the effectiveness and competitiveness of EU-Asset Management Industry or alternatively to allow market participants to choose between the two approaches.

2. Clearing burden

§ 200 para 1 German Investment Act includes a prohibition to conclude securities lending transactions of more than 10 percent of NAV of the respective UCITS with the identical counterparty. The scope of this requirement is wide and captures both the clearing member and the CCP of an exchange. This limits the ability to access the full advantage of clearing.

In order to improve the effectiveness and efficiency of clearing infrastructure we propose to clarify that access to clearing of EPM should not be hampered by national regulation.

<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>

TYPE YOUR TEXT HERE

<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>

We observe different cases:

1. For asset classes like commodities that can only be invested via certain indirect delta-1-instruments like ETN or derivatives on financial indices, it’s necessary to invest indirectly. Physical delivery is not allowed in any case and would cause huge costs. Consequently, physical investments are not allowed because no investor wants to handle physical delivery processes. Therefore, comparison of costs between direct and indirect exposure is in favour of indirect investments.
2. In other cases, e. g. stock or fixed income indices, it’s cheaper and less risky to invest in indirect vehicles. These investments are necessary for an efficient management of UCITS. Example: to get exposure to developed stock market it’s cheaper and more liquid to buy a future or an ETN based on the MSCI World Index than to invest simultaneously into around 1,600 single stocks. For that reason, a single stock investment would cause 1,600 trading tickets instead of just 1 trading ticket. Furthermore, it’s an easy way to invest into a well-diversified structure or market.
3. Investments like crypto currencies are another case. As long as volumes are low, indirect investments are more efficient and cheaper than direct investment because no physical infrastructure to the crypto market is needed. With rising volume, there will be a break-even-barrier that makes direct investments cheaper than indirect investments. Currently, direct investments are not allowed but it could be helpful for the future. It would save costs with rising volumes.

<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>

No, for financial indices that fulfil the requirements of “Guidelines on ETFs and other UCITS issues” a look-through approach is not necessary because there is already a regulatory well-working framework for such indices. With that framework, all qualified indices satisfy index criteria in Article 53 of UCITS Directive and Article 9 of the Eligible Assets Directive, including that of being a benchmark for the market to which it refers. An introduction of a look-through approach would cause huge costs for necessary data and IT infrastructure and therefore, it will be negative for investors.

For an underlying that doesn’t fulfil these requirements a look-through approach is appropriate and already part of existing investment regulations and consequently part of an existing investment process.

<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>

* Regulatory Support

There is a high regulatory protection standard: AIFMD-Level 2 and Regulation (EU) 2017/2402) contains e.g. a 5% risk retention requirement and risk transparency requirements.

* Diversification

ABS invest in a broad range of assets (for ABS/RMBS: >1,000, for CLO: 100-400) across various industries and geographies. Adding ABSs to a fund's investment universe expands its exposure to non-traditional credits, sectors, and regions, helping to reduce concentration risk and potentially enhance risk-adjusted returns.

* Tranching

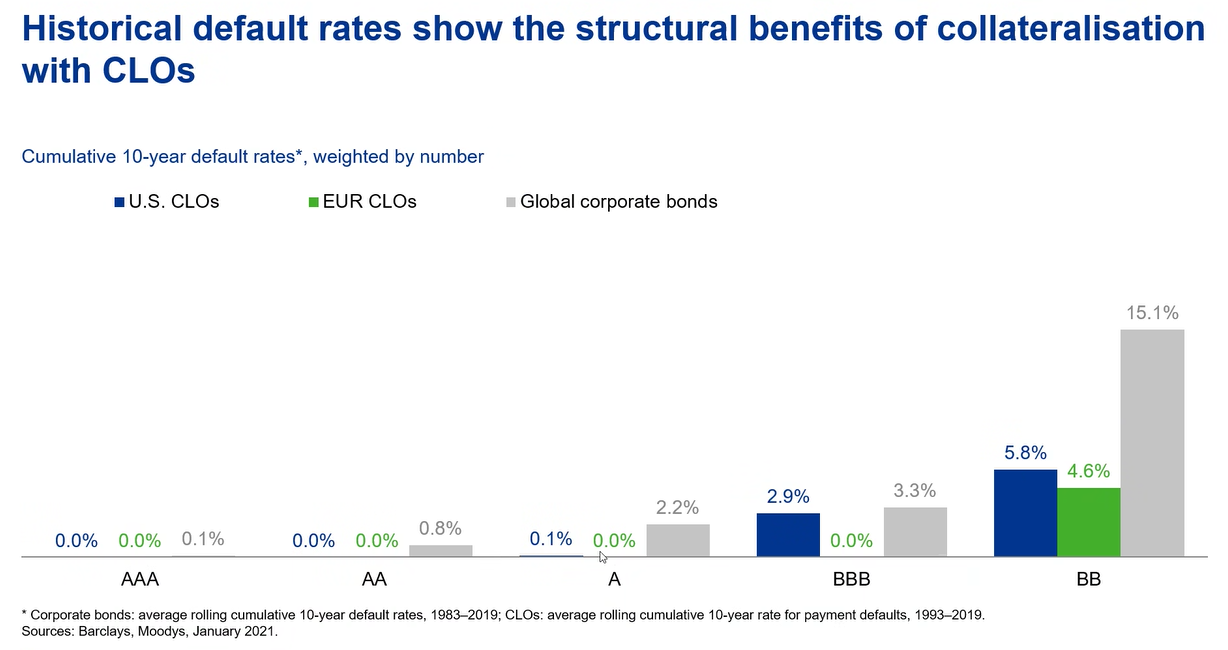
ABS are structured with different tranches of varying risk profiles. These tranches allow investors to choose their preferred level of risk exposure. UCITS can invest in tranches that align with their risk appetite, allowing for better risk management and the potential to optimize the risk-reward tradeoff within the portfolio.

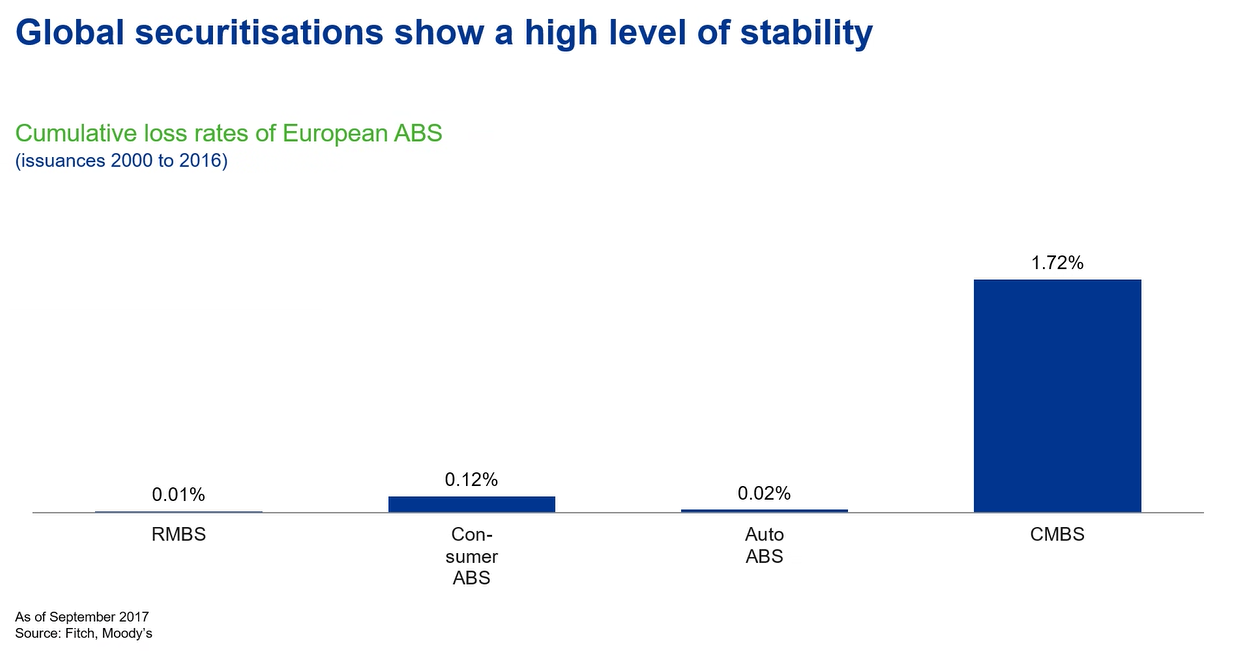
* Enhanced Liquidity

ABS can offer a degree of liquidity comparable to corporate bonds with corresponding rating

* Past Performance

Securitizations like ABS and CLO have a much lower default rates than corporate bonds with comparable ratings over the last 25 years. Reasons are additional credit support through tranching and secured nature of loans.





<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>

The crucial point of short positions is that this practice requires careful risk management. It's important to carefully consider the short positions and have a thorough understanding of the market dynamics before engaging in short selling for UCITS.

By employing short positions, fund managers can also generate positive returns during market phases characterized by declining or volatile markets. Compared to long-only strategies where fund managers bet only on rising prices, the ability to bet both on rising and falling prices offers greater flexibility and can hedge against portfolio losses.

The additional advantages include risk neutralization and improved risk-return profile. Short positions can help neutralize specific risks and achieve market direction neutrality, reducing portfolio volatility and potential risks. Moreover, through selectively building short positions, the risk-return profile of the fund can be improved. The ability to profit from both rising and falling prices provides more opportunities for positive returns, while short positions can also limit loss potential and enhance the resilience of the portfolio against market disruptions.

<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>

TYPE YOUR TEXT HERE

<ESMA\_QUESTION\_EADC\_25>