**Annex – Question 20. Table on eligible assets UCITS EAD.**

For the purposes of Question 20, please complete the table below with the requested information, taking into account the instructions provided in the footnotes. After having completed the form, please save the document (according to the following convention: “ESMA\_Q20\_nameofrespondent”) and upload it online at <https://www.esma.europa.eu/press-news/consultations/call-evidence-review-ucits-eligible-assets-directive>under the heading *‘Your input - Consultations’*, as an Annex to the Reply Form. In case you upload a pdf file, please choose an editable form.

**We comment on a selected number of asset types highlighted by our investment teams.**

|  |  |  |  |  |
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| **Asset class[[1]](#footnote-2)** | **Merits of allowing direct UCITS exposures** | **Merits of allowing *indirect* UCITS exposures[[2]](#footnote-3)** | **Extent/amount of existing UCITS exposures[[3]](#footnote-4)** | **Additional comments[[4]](#footnote-5)** |
| 1. Loans[[5]](#footnote-6) | * **Higher yields and diversification**: Loans, especially loan participations and CLOs, can provide higher returns than other corporate debt categories, as well as diversification benefits due to their low correlation with other fixed income sectors. * **Low interest-rate sensitivity and inflation hedge:** Collateralized Loan Obligations (CLOs) in particular are typically structured as floating-rate instruments. The loans tend to adjust their yields according to a designated benchmark rate. This means that they have lower interest-rate sensitivity and can protect investors from rising rates and inflation. * **Loans have an attractive risk profile and credit quality**: Loans have lower default rates, higher recovery rates, and stronger credit quality than most corporate bonds, as they are secured by first-lien collateral and backed by covenants. CLOs also have a robust structure that mitigates the risks of the underlying loans. * **Market with deep liquidity**: Loans are part of a large and still growing market. They have well-established liquidity, with high average daily trading volumes both for investment grade and non-investment grade CLO debt. CLOs also have observable secondary transactions and full transparency into the underlying collateral.   **Supporting real economy:** Provides capital to enterprises that may be looking to expand, make acquisitions or undergo other growth initiatives, which can contribute to economic growth. | * Could gain access to even higher liquidity if loans are invested in through exchange traded products rather than directly. |  |  |
| 2. Catastrophe bonds (‘Cat bonds’) |  |  |  |  |
| 3. Contingent Convertible bonds (‘CoCo bonds’) | * **Higher yields with diversification benefits:** These hybrid securities can convert into equity or be written off when the issuer's capital ratio falls below a certain threshold. In the UCITS context, we would recommend that only those with terms which specify the CoCo bond converts into equity be permitted as UCITS-eligible. CoCo bonds typically offer higher yields than traditional bonds and can help improve asset diversification within a portfolio. * **Reliable liquidity and valuations:** CoCo bonds have similarly comparable liquidity to other corporate bonds, and are priced in the same way as traditional bonds. * **Issued by regulated entities with transparent reporting**: CoCo bonds are predominantly issued by banks and insurers, who are subject to robust regulatory regimes and stress testing. The reporting of capital ratios has become more transparent and standardised over the years, and the terms and conditions of each issuance are clearly specified and widely available. * **Can reduce credit risk and offer capital appreciation potential**: CoCo bonds can reduce credit risk for investors by strengthening the resilience of the issuer in instances of stress, as the conversion to equity can improve the issuer's capital position. Moreover, the conversion to equity can offer a potential for capital appreciation if the issuer's situation improves and the equity value increases. |  |  | * **CoCo bonds can be volatile and subject to extension risk**: CoCo bonds are subject to volatility and uncertainty, as the conversion or write-off trigger depends on the issuer's capital ratio, which can fluctuate due to market conditions or regulatory changes. CoCo bonds are also subject to extension risk, as the issuer may decide not to call the bond at the expected date, which can affect the bond's price and yield. |
| 4. Unrated bonds |  |  |  |  |
| 5. Distressed securities |  |  |  |  |
| 6. Unlisted equities[[6]](#footnote-7) | Access to private markets for UCITS investors, selectively, can help to deliver stronger, less correlated returns in the long term, an attractive consideration for investors using UCITS to save for the future. In detail:   * **Higher return potential:** Unlisted equities can be purchased pre-IPO, providing investors the opportunity to build up starting positions in these promising companies at lower costs, which may then grow and potentially list at an attractive valuation. * **Exposure to innovation:** Investors can gain access to innovative and disruptive businesses, supporting growth in new sectors, and gaining insight into potential future economic drivers.   **Risk diversification:** Unlisted equities are not subject to the same market fluctuations as listed companies, which can sometimes provide a more stable investment environment. |  |  | Reliable liquidity and valuation can be more challenging for unlisted equities than their listed counterparts, and we support limiting holdings in alignment with the 10% rule. |
| 7. Crypto assets[[7]](#footnote-8) | The issue of direct eligibility of crypto-assets, as an instrument so distinctive to those originally considered in the UCITS Directive, raises issues around the extent to which the rigorous UCITS framework could or should adapt to such innovations.  Given the multi-faceted considerations around custody, valuation, liquidity, and diversity of this ecosystem, we believe this will require further detailed analysis on whether the UCITS framework is the most appropriate setting for facilitating retail access to these assets, or, whether another framework such as MICA would be more appropriate.  Noting though, that not all digital assets are alike, we support the general principle in the MiCA regulation not to change the regulatory treatment of financial instruments which already qualify as transferable securities, just because they have been tokenised. Such tokenised assets can enhance liquidity for a particular asset class, reduce costs and enable smoother and faster settlement, increasing efficiency and value for UCITS investors. |  |  |  |
| 8. Commodities and precious metals[[8]](#footnote-9) |  | See below. |  |  |
| 9. Exchange-traded commodities (‘ETCs’) | * **Enables simplification and cost reduction:** There are currently many ways that investors can gain direct exposure to commodities, but these impose unnecessary costs on investors, can lack transparency and often tend to have higher counterparty risk. However, accessing commodities through exchange traded products increases liquidity, enables more transparent price discovery and more frequent trading – ultimately providing investors with more cost-effective exposure to commodities. * **Increased protections and higher returns:** ETCs have historically displayed low correlation to stocks, providing increased return potential and diversification. The exchange-traded structure also provides the benefit of protecting the assets through a custodian, and provide the investor the ability to receive cash settlement on an early redemption, rather than physical settlement. |  |  | We have observed divergent approaches across NCAs, with many, but not all, NCAs recognising ETCs as UCITS-eligible, and for the reasons mentioned above, we see this as an opportunity for harmonisation across Member States. |
| 10. Real estate |  |  |  |  |
| 11. Real Estate Investment Trusts (‘REITs’) | * **Traded on regulated markets:** As publicly traded assets, REITs can provide liquidity and transparency for investors. The valuations of REITs are based on the market prices of their shares, which reflect the underlying value of their real estate assets. * **More efficient than real estate, but with access to the associated benefits:** REITs are tax transparent vehicles that invest in real estate and distribute most of their income as dividends to investors. They allow investors to access different sectors and locations of real estate without requiring direct ownership or high capital. They are also easier to buy and sell than physical real estate, which can take a long time and incur high costs. REITs also provide economies of scale, as they can manage large portfolios of properties with lower expenses and leverage. As noted in our response to Q14 we note some interpretative issues regarding the status of UCITS in some jurisdictions and how to resolve these. |  |  |  |
| 12. Special Purpose Acquisition Companies (‘SPACs’) |  |  |  |  |
| 13. EU AIFs[[9]](#footnote-10) | The range of alternative investment funds (AIFs) has expanded significantly since the publication of the EAD. We encourage ESMA to reassess the eligibility of those AIFs which do not comply with Article 50(1)(e) (i)-(iv) of the UCITS Directive within the 10% ratio.  Appropriate guardrails could include an assessment of the AIF’s impact on the UCITS’ overall liquidity profile, the liquidity profile of the AIF itself and whether those AIFs are constituted in a regulated fund format, such as a European Long-term Investment Fund (ELTIF), or whether they are set up in a fund of funds format. |  |  |  |
| 14. Non-EU AIFs | Permitting access to non-EU ETFs, which would currently classify as non-EU AIFs for the purpose of UCITS, can provide investors exposure to a variety of industries that may be performing well in their respective regions, in a highly liquid, diversified and cost-efficient way. Markets can differ in the stages they are in with regards to economic cycles, regulatory regimes, and sectoral balances and such exposure provides UCITS investors the opportunity to take advantage of growth opportunities across regions.  While we agree that the eligibility of these funds should consider how equivalent the investment universe is to that of a UCITS, we note challenges with the eligibility test due to operational differences in other jurisdictions, such as the way cash collateral is accounted and treated for, which appear to be an unintended barrier. See our answer to Q15 for further detail on the obstacles to investing in non-EU AIFs. |  |  |  |
| 15. Emission allowances |  |  |  |  |
| 16. Delta-one instruments |  |  |  |  |
| 17. Exchange-traded notes (‘ETNs’) |  |  |  |  |
| 18. Asset-backed securities (‘ABS’) including mortgage-backed securities (‘MBS’) | * **ABS / MBS offer yield and diversification through securitized loans**: ABS / MBS are securities that are backed by pools of loans, such as mortgages, consumer credit, or corporate debt. They offer investors a steady stream of income from the interest and principal payments of the underlying loans, and a diversification benefit from exposure to different types of borrowers and sectors. * **ABS / MBS are liquid and transparent assets with reliable valuations**: ABS / MBS are traded in large and active markets, especially in the US, where they have standardised features and high credit ratings. The information on the underlying loans and collateral is readily available from market data providers, and the liquidity and pricing of the securities can be tracked from the TRACE database and other sources. * **Offers lower duration risk**: ABS / MBS are usually floating rate and have shorter maturities than other fixed-income securities, which reduces the duration risk and the sensitivity to interest rate changes. As long as they meet certain criteria of credit quality, diversification, and liquidity, ABS / MBS should be able to be included in UCITS funds. |  |  | Some sectors of Asset-Backed Securities trade daily but require a lead time to gather quotes so mangers may require more preparation when trading these securities. The inclusion of notice periods, for example prior day notice rather than same day notice, can give time to do so. |
| 19. Other relevant asset classes (please specify) |  |  |  |  |

1. ESMA acknowledges that most of the asset classes listed below have not been clearly defined in EU legislation and this might be a source of divergent interpretations and misunderstandings. Where possible, ESMA invites stakeholders to specify their understanding or definition of the relevant asset classes under the “additional comments” box. [↑](#footnote-ref-2)
2. Where relevant, please distinguish between indirect exposures via instruments such as delta-one instruments, exchange-traded products, derivatives, or AIFs (EU or non-EU). [↑](#footnote-ref-3)
3. Please share any available data or estimates that help to assess the amount or extent to which there are existing UCITS exposures (distinguishing between direct and indirect, where possible) to these asset classes. Where no reliable data is available, ESMA would appreciate receiving estimates in terms of numbers and/or percentages of UCITS exposed to these asset classes and what is the average proportion in the relevant portfolios. Any additional data and insights on strategies, techniques and instruments used to gain exposure to these asset classes would be also highly appreciated. [↑](#footnote-ref-4)
4. Please include under this column any other evidence or views that you would like to share. [↑](#footnote-ref-5)
5. Where relevant, please distinguish between leveraged/structured loans, collateralised loan obligations (CLOs) and other types of loans or loan participations (please specify). [↑](#footnote-ref-6)
6. Where relevant, please distinguish between equity instruments issued by (1) private companies and (2) shares in public companies that that are not listed. [↑](#footnote-ref-7)
7. Where relevant, please specify what type of crypto assets and whether the implementation of MICA will change anything in terms of your assessment. With respect to indirect exposures, ESMA is particularly interested in stakeholder input on exchange-traded products including ETFs with crypto assets as an underlying. [↑](#footnote-ref-8)
8. With respect to indirect exposures, ESMA is particularly interested in stakeholder input on ETFs with commodities/precious metals as underlying. Please note that under the current UCITS rules, precious metals and certificates representing them are not eligible (Article 50(2)(b) of the UCITS Directive). [↑](#footnote-ref-9)
9. Where relevant, please distinguish between different types of AIFs (e.g. open-ended, closed-ended) and investment strategies (e.g. real estate, private equity, hedge funds). [↑](#footnote-ref-10)