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 | Alternative Investment Management Association (AIMA) |
| Activity | Trade Association |
| Country / Region | International |

# 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>

AIMA welcomes the work that ESMA is undertaking in this Call for Evidence to review and develop the UCITS framework in line with market developments. The Directive 2007/16/EC on UCITS eligible assets (‘UCITS EAD’), in combination with robust diversification and concentration rules, has generally worked well for investors, allowing them to benefit from expert investment management techniques and enhanced risk management within a diversified and well-regulated structure. AIMA believes that the policy decision made in UCITS III to expand the scope of eligible assets for UCITS investment to keep it in line with market developments remains the right choice.

With regard to investor protection, AIMA acknowledges that some portfolio management techniques may be challenging for some non-professional investors to understand. However, the use of more complex portfolio management techniques does not necessarily make the investment strategy difficult to understand if properly disclosed and we believe all investors should have access to such advanced portfolio management techniques, where aligned with their investment objectives and risk tolerance.

We acknowledge that it is crucial for retail investors to understand the potential risks and rewards of an investment and that this information is clearly communicated and understandable as set out in the prospectus and by the obligation to prepare a key information document in accordance with Regulation (EU) No 1286/2014. Importantly, the fiduciary treatment by the investment managers and distributors allows investors to trust and rely on the investment as a suitable component of their savings and investment strategy. It is why structures exist today in legislation to enable greater participation in capital markets and wealth creation opportunities, through enhanced returns, additional income generation and diversification of risk.

It should also be noted that many of the asset classes identified in this Call for Evidence are available for retail investors to invest in directly without the protection afforded by investing via a highly regulated product such as a UCITS fund managed by suitably qualified professionals.

In addition, managers frequently add to the discourse on the asset classes that they invest in by publishing high-quality research, insights, and other updates provided to investors on a regular basis that enable retail investors to increase their understanding of the risks and rewards available. If UCITS funds cannot invest in a particular asset class then investment managers are unlikely to publish this information and retail investors could be more reliant on information made available by potentially unregulated and less qualified entities or individuals.

Given the above, we would urge ESMA to recommend that the European Commission address market developments by amending the UCITS EAD positively in certain areas, rather than restricting the investment strategies that can be used by disallowing investments in certain assets perceived to be overly complex. We note that investor protection is already being strengthened in other areas for UCITS. Recent changes to the UCITS Directive, for example, on the availability and use of liquidity management tools will further enhance the investor protection provisions for UCITS.[[1]](#footnote-2) UCITS management companies will also become subject to more stringent supervisory reporting obligations in respect of each UCITS they manage, with the final details of these obligations still being developed at Level 2.

We would therefore advocate for ESMA to recommend for the UCITS EAD to be amended with the introduction of further diversified return streams that assets such as commodities, for example, can bring. Moreover, this will help to ensure that a broader spectrum of investors participate in the deepening and strengthening of Europe’s capital markets.

*Commodity derivatives*

AIMA considers that if the scope of eligible assets is to be reviewed in connection with the Call for Evidence, instead of further restricting the list of eligible assets in which a UCITS can invest, this should instead be expanded to more clearly include cash settled commodity derivatives as eligible financial derivative instruments (FDI). The current difficulty with the treatment of commodities does not just affect investors access to an alternative return stream it also restricts their access to investment techniques and strategies like commodity trading advisors (CTAs) and managed futures funds for the simple reason it is hard to run these strategies without commodities. By extension, and to ensure that the UCITS brand remains current, we would also suggest that digital assets derivatives (e.g., Bitcoin futures) should be permitted underliers for UCITS (noting, e.g., the U.S. CFTC’s treatment of these as commodity derivatives).

In this regard, AIMA once again urges ESMA to recommend to the Commission to focus on the outcomes to be achieved by the UCITS and their investors rather than on the perceived complexity of the underlying assets which, as we have already noted, are subject to relevant regulations. As noted above, the important issue for investors is that they can understand the overall risk-reward profile of the fund as a whole. To this end, it is important that Member State regulators ensure UCITS managers provide clear disclosure of the risks and rewards associated with the fund. Once investors have clear information about the fund as a whole it should not be necessary to ensure that the investor understands the risk-reward profile of each underlying asset in which the fund may invest in line with relevant regulations – that is the role of the professional investment manager and it is this skill and expertise which the investor is seeking to benefit from by investing in the UCITS.

The risk management process requires significant amounts of disclosure to the home Member State regulator before a fund is approved and subsequently offered to investors. These disclosure requirements and the fiduciary duty to act in the best interests of investors apply regardless of the underlying investments being made by a fund. Managers have a duty to achieve the most economic exposure to the investment strategies and risks described in the fund’s offering document. Not allowing certain types of instruments to be held, such as direct investments in commodity derivatives, makes achieving these outcomes more expensive, without benefiting UCITS investors.

We note that the risk-return profile of many derivatives can be essentially reproduced by using simple building blocks such as future options, forwards or swaps and a combination of different underlying assets. Prohibiting the use of complex derivatives by UCITS would therefore not necessarily lead to any changes of risk exposure for the end investor. Indeed one could say that such changes would potentially result in greater complexity as the UCITS would end up having a more complex set of counterparty exposures and potentially less favourable collateral treatment, leading to a potential reduction of returns for investors.

The list of eligible assets in Article 50 of the UCITS Directive currently includes transferable securities, money market instruments, units of collective investment schemes, bank deposits and FDI. Derivatives on commodities were excluded from the references to liquid financial assets in Articles 1(2) and 19(1)(g) of Directive 85/611/EEC and by Article 8(5) of Directive 2007/16/EC. This treatment of commodity derivatives appears to be outdated and misaligned with market developments as single commodity futures and options are now among the most liquid instruments traded in financial markets. They are much more liquid than a great majority of transferable securities such as corporate bonds or small cap shares.

In an era of volatile macro-economics and turbulent geopolitics, Europe’s investors need to have the flexibility of added exposure to commodity prices. If food and energy prices continue to fluctuate, the UCITS investor may not have adequate means to shelter his or her savings and investment against such shocks.

In the ESMA Market Report, EU Derivatives Markets 2023, it was noted that *“Commodity derivative notional amounts grew 65% in the reporting period, to EUR 3.3tn in 4Q22 from about EUR 2tn in 4Q20. Growth was steady, peaking at 3Q22 at EUR 3.6tn, and was across the largest instruments: swaps, futures, and options. This was fuelled by the Russian invasion of Ukraine in February 2022 increasing commodity prices in 2022, particularly natural gas, and correspondingly increasing notional amounts of new contracts.”* If UCITS investors had exposure to commodity derivatives then they could have benefited and been protected against the steep rise in prices.

Investment strategies pursued by CTAs and managed futures funds have proved to be popular when employed within the UCITS framework by using such tools as strategy indexes. However, it would be more transparent and cost effective for the end investor if the CTAs were able to invest in the commodity derivatives directly as opposed to using a swap route based on a strategy index. Restricting UCITS to only diversified commodities indices does not offer investors the benefits of experienced active management of commodities. Indirect exposure to commodities through wrapped delta one products or financial indices, as at present, are more costly to UCITS (and therefore investors) than a more straightforward swap product. CTAs saw significant benefits in 2008, 2021 and 2022 because of their commodity exposure and were some of the best performing strategies in those years.

A UCITS should be permitted to invest in single commodity derivatives as part of its portfolio so long as the UCITS diversification requirements are met. Where a UCITS offers appropriate risk diversification, active management of a UCITS should permit the use of single commodity derivatives. Commodity indices would not need to be diversified with respect to the 20/35% limit, so long as the exposure of the UCITS to the individual indices complies with the 5/10/40% ratios and satisfy the other criteria in respect of the construction methodology, regular rebalancing and publication of the index, subject to some appropriate method of classifying commodities to better track concentration limits.

In the event there are concerns about the liquidity and transparency of commodity derivatives, we would note that there are mandatory clearing requirements for derivatives and clearing, even where not mandatory, will be encouraged.[[2]](#footnote-3) It is a central characteristic of clearing that the instruments subject to it are sufficiently standardised, liquid and transparent. For example, Article 4 of the European Markets Infrastructure Regulation (‘EMIR’) when dealing with the criteria for central clearing refers to: (i) the degree of standardisation of the contractual terms and the operational process of the OTC derivative, (ii) the volume and liquidity of the relevant OTC derivative, and (iii) the availability of fair, reliable and generally accepted pricing information in relation to the relevant OTC derivative. Such requirements result in a reduction of risk posed by centrally cleared commodity derivative contracts which supports their inclusion within a UCITS portfolio. A number of exchanges also impose position limits on commodity derivatives. These limits are applied for spot months and also overall exposure across all months.

In respect of derivatives, we urge ESMA to recommend to the Commission to consider the benefits that funds run by CTAs and Global Macro managers can offer, such as creating well-balanced, diversified investment portfolios that have the potential to deliver returns and limit risks in any market environment. CTAs and Global Macro are also among the most transparent and liquid investment options, providing investors with a valuable tool for diversifying the risk of their own portfolios. Eliminating or severely limiting the ability of UCITS to pursue the types of strategies pursued by these types of funds would deprive investors of an important tool for creating a well-diversified portfolio capable of withstanding a variety of macro-economic events.

AIMA believes that appropriate fiduciary standards, enforcement and sanctions within the UCITS framework can address product diversity without stifling access to investment management products. UCITS is an important product for institutional and professional investors due to its standardised risk management requirements, liquidity, internal investment guidelines and the ability to make large investments without significantly affecting the total assets of a UCITS fund. Depriving UCITS of the potential to deliver more diversified products could be detrimental to investors.

<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>

The requirement for UCITS funds to list in the investment objective all financial indices they are exposed to through investment in derivatives is overly cumbersome. Instead, UCITS funds should be permitted to take exposures to diversified indices as allowed by regulations.

The requirement to ensure that financial indices are sufficiently diversified, and to notify the home regulator of the UCITS fund if they meet certain criteria is a burdensome, manual and inefficient process. It would be appreciated if ESMA could consider how this process could be made more streamlined and efficient. For example, it may be helpful to update the rules on financial indices to reflect the developments that have taken place under the EU Benchmark Regulation (BMR), including in terms of representativeness of the market, appropriate publication and rebalancing. Certain aspects of the existing requirements might be able to be assumed where the administrator is subject to the BMR (or, e.g., where a third country administrator is recognised).

The diversification and concentration requirements can also impact the eligibility of investing in certain indices, particularly where a single issuer has a weighting above 10% in said index. This impacts the ability of index funds to optimise large indices but also continue to track their benchmarks. To reflect the evolution of concentration over the past 10 years, ESMA could consider further assessment of these rules, including potential exemptions for such optimising funds, to strike the right balance between avoiding excessive concentration and ensuring appropriate levels of diversification.

<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>

For many funds, the limitation of 10% investment in money market instruments has been a big issue and resulted in diminished yields for unutilised cash. Cash in custody accounts have been earning close to zero even in this higher rate environment where US and Gilt money funds have been earning around 5%. Money market funds with T+0 liquidity are a useful tool for managing investor flows in and out of funds. With the 10% restriction it has meant that the main alternative is US T-bills which arguably increases concentration (e.g., US fiscal cliff concerns) but also given a fund is only allowed 100% exposure to any sovereign it can restrict the trading strategy because one cannot trade as many US bonds in a portfolio. For instance, a fund trading on derivatives may have 80-90% cash excess and so if they invest that cash in T-bills they may not be able to trade the longer bonds in their portfolio that they trade in their similar offshore product.

<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>

The notion of liquidity is difficult to define precisely, such that AIMA believes that further development of rules on the liquidity of eligible assets is impracticable. While market liquidity can be measured, an asset's liquidity is not absolute and can vary over time. We believe the requirements set out in the UCITS Directive provide sufficient clarity. Designating a universe of inherently liquid assets through qualitative criteria or legal definitions is unfeasible and could have unintended systemic risk consequences.

<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 consider that the rebuttable presumptions of liquidity and negotiability remain appropriate. This is especially the case for new primary issuance of bonds as there is no history of reliable trading data available directly for that bond for several days or weeks after it has been issued. In most cases it is possible to substantiate the presumption of liquidity and negotiability by using data from bonds already issued from the same issuer or bonds from different issuers with similar characteristics, however this is not always possible depending on the circumstances. Hence the presumption should remain. Limiting the ability for UCITS to take part in new primary issues by removing the rebuttable presumptions of liquidity and negotiability would limit the returns provided to investors.

Furthermore, ESMA has conducted much work on the liquidity risk management framework in recent years, which have sufficiently bolstered the presumptions of liquidity and negotiability. This includes the liquidity stress testing requirements UCITS have been subject to since 2020, which ensure that all liquidity risks are adequately assessed and captured on at least an annual basis, but typically more frequently; as well as the recently published changes to the UCITS Directive to broaden the availability of Liquidity Management Tools (LMTs) used in UCITS funds.

<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>

There has been some divergence of what ‘ancillary liquid assets’ are across Europe. It would be beneficial for a common approach to be used for all jurisdictions.

We also note differences in the concentration thresholds applied to ancillary liquid assets across jurisdictions. In light of the move to shorter settlement cycles in the US raising the likelihood of settlement mismatches between fund dealing cycles and the standard settlement cycle in Europe, there is a higher risk of potential breach of the varying limits. We recommend ESMA continue to coordinate with member NCAs on this issue, to drive regulatory convergence.

<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>

We believe that UCITS should be permitted to acquire or hold foreign currency for investment purposes, provided the associated risks are adequately disclosed and effectively managed in accordance with the same principles as for other assets. Holding foreign currencies opens opportunities for potential gains from favourable exchange rate movements, contributing to enhanced returns. Investment managers can leverage currency movements as part of their active management strategies, optimising performance through tactical positioning. In the main, currency volatility is much lower than equity volatility. Currently, equity volatility of most global indices is 3 times higher than most G10 and EM currencies. NASDAQ is 15% which is higher than both the Brazilian Real and the Chilean Peso. We believe that permitting access to foreign currencies supports a more robust and versatile investment strategy, thereby enabling investment managers to respond effectively to changing global market conditions and taking advantage of diverse investment opportunities.

<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>

We believe that there should be an increase to the limit for money market instruments and allowance for multiple allocations to different providers. As an example, 30% per provider up to a maximum of 80-90%.

<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 believe the criteria are sufficiently clear.

However, we believe that the definition of ’transferable securities‘ could be broadened to allow for the investment by UCITS in all forms of tradeable financial assets. This should encompass financial assets that are both legally transferable and have some liquidity due to the existence of some form of regular market, even if it is not a ‘regulated market’ as defined in MiFID. We also think it would be helpful for an alignment of interpretation around what a ‘regulated market’ is.

Regarding the requirement for a transferable security to be traded on a ‘regulated market’ as defined in MiFID, we consider that digital trading exchanges also satisfy these criteria, given they play a crucial role in the price discovery process, and provide a mechanism for trading and liquidity, similar to existing regulated markets. These exchanges are also subject to regulatory oversight and control under the Markets in Crypto-assets Regulation (MiCA).

In addition, the definition of a ‘financial instrument’ in MiFID, which includes ‘transferable securities’, has been expanded to include any traditional ‘financial instrument’ listed in Section C of Annex I of MiFID II which is issued via distributed ledger technology – thus, for the purposes of legal certainty, guidance would be welcome clarifying that this revised definition should be extended to the UCITS EAD. This clarification would be helpful given the increasing utilisation and purported benefits of tokenised assets.

<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>

We believe the criteria set out in the UCITS EAD are sufficiently clear. In our view the introduction of more detailed criteria is not possible given the range of eligible assets.

<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, we consider these are sufficiently clear.

<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>

A recurring issue is the ambiguity surrounding what constitutes an ‘embedded’ derivative, particularly in the context of structured products where the returns of the host contract are linked to the performance of one or more underlying assets. The definition itself is difficult to apply where there is not a specific derivative instrument (e.g., an option) which when exercised materially changes the performance trajectory of the security and therefore can be measured separately. It is important to note that transferable securities should always be limited recourse instruments, so the amount at risk is necessarily limited in a way which is not the case with a stand-alone derivative. The blending of treatment of embedded derivatives and actual derivatives makes less sense in any event post the introduction of EMIR and the changes introduced through that regime.

We would suggest a simplification of the embedded derivative rules here, e.g., so that it applies to convertible bonds, callable/puttable bonds and similar instruments where the embedded derivative is in the hands of the investor/issuer, or where there is a derivative element which, on the occurrence of a relevant event (e.g., as in the context of a CLN) changes the economics materially. This should not, however, capture where the transferable security by its terms agrees to pay the return on an underlying asset(s), also taking into account the limited liability nature of such instruments.

<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>

UCITS in a number of jurisdictions have used delta-one instruments without any significant risks having been introduced as a consequence. UCITS should continue to be able to invest in delta-one instruments, which can provide useful diversification, and it should be ensured that this is applied across all Member States. Subject to our response in question 12, we do not specifically consider that further changes are needed and that it is for the manager and relevant Member State regulator to ensure that clear disclosures are made regarding the types of investments that a UCITS can hold.

<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>

We acknowledge that investment in AIFs requires greater consideration and due diligence which practically restricts investment in AIFs. The current rules regarding the eligibility for investment in a collective investment scheme (CIS) could be clarified (e.g., the meaning of the term “constitutional documents” of a CIS should be clear and applied consistently to both UCITS and non-UCITS). The current approach from ESMA and the national regulators with regards to the eligibility of a non-EU or non-UCITS CIS does not benefit investors as it makes UCITS less attractive as investments by limiting the universe of available CIS.

<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>

EU ETFs tend to be EU UCITS, meaning investment in EU ETFs does not cause any issues. Additional guidance regarding the treatment of investments in ETFs established outside of the EU, and in particular US ETFs, would be helpful.

UCITS are unable to invest in a collective investment scheme that does not include an explicit statement in its fund rules or instruments of incorporation that it will not invest more than 10% of its assets in other collective investment schemes. This has restricted the ability for UCITS to invest in certain US ETFs as their fund rules omit this statement, as US ETFs which are enrolled in securities lending programmes where cash collateral is mandated to be invested in US 2-a7 MMFs. This has resulted in a limitation of the potential investment universe available to UCITS as an equivalent EU ETF must be available. This is not always the case and as a result UCITS have lost efficient access to a particular asset class, market or theme. It is relevant to note here that, while the US Securities and Exchange Commission similarly restricts investments in other collective investment schemes to 10% for open-ended funds registered under the US Investment Company Act of 1940. However, in these instances, the US Securities and Exchange Commission does not treat those US MMFs as collective investment schemes for this purpose. Where the investment universe is consistent with UCITS investment restrictions, we believe these funds should be considered eligible. In cases where an equivalent is available, this may have led to increased costs to investors as the ongoing charge figure (OCF) on the EU ETF has been higher. Making available US ETFs that do not include the explicit statement but allowing UCITS managers to confirm by other means could lead to enhanced returns for investors with no reduction in investor protection.

<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 do not consider that changes at the level of the EAD are required in this respect.

<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>

There is an inconsistency generally in what instruments are covered by EPM techniques. In the UCITS rules, derivatives can be used for EPM, but for example, in the ESMA Guidelines on ETFs and other UCITS issues, EPM is used separately to FDI and more specifically with regard to rules on repo and stock lending. The lack of clear meaning makes prospectus drafting more complicated. It would not be possible to replace the notion of EPM technique in UCITS with that in SFTR without losing the derivatives piece entirely, which may not be problematic, although it is clearly useful in terms of letting investors know whether a particular UCITS can use derivatives for investment purposes or EPM only. However, there is less definitional clarity on what EPM means in the context of derivatives than is helpful.

To the extent that the concept of EPM were narrowed to exclude derivatives, it might then be possible to link to the SFTR, although this definition goes beyond repo and stock loans on securities, but includes commodities (this may be helpful – see above), guaranteed rights and also margin lending transactions.

We can see that there may be a benefit (that of simplicity) in removing the reference to EPM techniques in the context of UCITS eligible SFTs and simply using the relevant terms from the SFTR, taking into account the prospectus and ongoing disclosures required to Investors as a result of that Regulation. We would then suggest maintaining the distinction of EPM versus Investment purposes for derivatives only, with more detail on what comprises the former.

<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>

*Investment limits rules*

The current rules regarding investment limits, especially the “100% of NAV” rule for investments in transferable securities and money market instruments issued by governments or public authorities, could benefit from simplification and clarification. Specifically, if a UCITS invests through futures contracts, it should be clear that the 100% limit applies per member state.

*FDI exposures*

Another area needing clarification is the treatment of FDI exposures that are centrally cleared. The rules should explicitly state that such exposures should not count against the exposure limits of a counterparty, as the UCITS is effectively facing the central clearer, which presents minimal risk, and not the counterparty. We note that this is anticipated in the EMIR 3.0 package, and is something that we fully support. We also consider that the requirement for daily valuation and verifiable valuation should be removed from the Directive as these are now largely covered by the valuation requirements under EMIR.

*Bank Holding Company Licences*

Furthermore, there should be a definitive rule regarding entities holding a Bank Holding Company License from the Federal Reserve, including subsidiaries thereof. These entities should also be subject to a 10% counterparty exposure limit.

*5%/10%/20% counterparty exposure limits*

The 5%/10%/20% counterparty exposure limits, depending on the location and type of licence of the entity, need clearer definitions.

*Collateral held on exchanges*

There is ambiguity around whether collateral held on some exchanges is included in the exposure calculations. We would welcome further clarification here.

<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>

It would be helpful that the guidance be clearer that indirect exposure to non-eligible assets for UCITS can be achieved via delta-one instruments within the updated guidance so there is uniformity across the EU.

<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>

We have provided our responses in the Annex which we have uploaded separately.

<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>

Indirect exposures to asset classes through instruments like delta-one instruments, exchange-traded notes (ETNs), and derivatives can significantly impact the costs and risks borne by UCITS and their investors. Managing indirect exposures often requires more sophisticated strategies and expertise, leading to higher management fees. ETNs may also require dedicated offshore vehicles to be set up and more service providers in the chain. There is more operational overhead to publish the unique prices and to rebalance the ETN. Depending on the size of the fund it can add 20-200bps to the cost of running the equivalent strategy in direct futures. Instruments through which indirect exposure can be obtained differ and it is the responsibility of the manager to select the most effective solution to the benefit of investors.

<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>

We do not consider that a look-through approach should be adopted.

By focusing on clear risk assessment and communication rather than exhaustive look-through requirements, robust investor protection can be achieved without unnecessary complexity. This approach leverages the transparency improvements introduced since the initial UCITS EAD by regulations such as EMIR, SFTR and PRIIPs, which provide investors and regulators with a better understanding of portfolio risks. Consequently, ESMA should consider relaxing some of the more restrictive eligibility rules, as the enhanced transparency and reporting requirements already offer substantial insights into the risks associated with UCITS investments.

<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>

The current ability for UCITS to invest in securitisations is hampered by several burdensome administrative requirements.

Securitisation allows UCITS to gain exposure to a wide range of asset classes, enhancing portfolio diversification and potentially reducing overall risk. Also, it provides access to asset classes that might otherwise be difficult to invest in directly, such as mortgage-backed securities or asset-backed securities. Securitisation structures often include different tranches with varying risk levels, allowing UCITS to choose the tranche that best fits their risk tolerance and investment strategy.

At present, there are many disincentives for both issuers and investors in this market, in part due to onerous due diligence requirements. While conducting due diligence is indeed a crucial part of the risk assessment process for securitisations, we see opportunities for potential efficiencies in the process, such as simplifying the report process across Europe with a single template and considering limiting the level of detail required in these reports.

AIMA acknowledges the multifaceted considerations to be taken into account regarding securitisation, and look forward to a more detailed assessment of these issues in the European Commission’s upcoming securitisation consultation later this year.

<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>

We acknowledge that it is already possible to build up synthetic short positions under the existing legal framework, and we advocate to maintain this. Short positions allow UCITS to provide capital protection to investors in times of wide market downturns or from idiosyncratic events depending on the type of short exposure taken. Some protection and simplification of clearing can be provided by the issuer of the delta-one instrument versus the direct exposure.

Short positions can be used to hedge against potential losses in other parts of the portfolio, providing a form of insurance against market downturns. By allowing short positions, UCITS can diversify their risk management strategies, potentially reducing overall portfolio risk. Short positions enable UCITS to profit from declines in the value of the underlying assets, providing opportunities for gains in bearish markets. The ability to take short positions offers greater strategic flexibility, allowing fund managers to implement more sophisticated investment strategies. Short sellers also provide additional liquidity to the markets.

<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>

We would like to see NCAs commit to greater transparency and providing adequately reasoned decisions regarding the eligibility of various asset classes or instrument types. It should not be sufficient for an NCA to refuse the inclusion of an asset class or instrument type during a Fund’s authorisation process, and to revert to the applicant requiring them to “state why it is considered appropriate that a particular asset class/instrument type is eligible for inclusion in a UCITS fund”.   While we agree that applicants should have the opportunity to rebut an initial authorisation refusal, such refusals should include properly reasoned decisions, referring to the UCITS regulations and publicised guidelines as to the regulations and their applicability and interpretation.

<ESMA\_QUESTION\_EADC\_25>

1. *See*, <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:L_202400927>. [↑](#footnote-ref-2)
2. *See*, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32012R0648>. [↑](#footnote-ref-3)