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 | 21Shares AG |
| Activity | ETP Issuer |
| Country / Region | Switzerland |

# 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>

Currently, varying interpretations and implementations of the UCITS EAD in relation to crypto asset exchange traded products (ETPs) by national competent authorities lead to dispersed levels of investor protection and market practices. These discrepancies create a fragmented regulatory landscape that poses challenges for cross-border distribution and complicates the investor's ability to compare and understand their investments across different member states.

Moreover, retail investors can already access crypto assets by a variety of options, including (i) the regulated, aforementioned crypto asset ETPs, (ii) spot crypto assets, (iii) shares of operating companies that investors believe will provide proxy exposure to crypto assets with limited disclosure about the associated risks. Among them, crypto asset ETPs are regulated investment vehicles, they offer a degree of investor protection, and they leverage vetted parties (i.e. under MiCA) as well as providing comprehensive risk disclosures. As a result, these ETPs would provide a safer and more structured environment for investors to gain exposure to crypto assets compared with other methods to access cryptocurrency directly. UCITS funds including crypto asset ETPs would further enhance investor protection and diversification.

Therefore, 21Shares urges ESMA to establish a set of guidelines for the UCITS EAD in relation to crypto asset ETPs that all member states could adhere to, ensuring a uniform standard of investor protection and operational clarity. Additionally, enhanced collaboration and communication between ESMA and national competent authorities would support the consistent interpretation and enforcement of these guidelines, ultimately contributing to greater supervisory convergence and investor confidence across the EU. 21Shares suggest in their response to explicitly allow indirect exposure to crypto assets through the use of ETPs.

<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>

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<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>

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<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>

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<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>

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<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>

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<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>

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<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>

21Shares has indirectly experienced recurring and significant issues around the consistent application of the 10% limit across different jurisdictions, as elaborated on further in question 19. For example, Spain implicitly allows crypto asset exposure in the 10% limit, while Luxembourg does not allow to invest directly or indirectly in crypto assets at all.

While 21Shares believes that its crypto asset exchange-traded products (ETPs) fulfill the ‘transferable security’ criteria set out in the UCITS EAD (see question 9), Article 50(2)(a) of the UCITS directive would provide an alternative investment route. While ESMA’s Opinion on Article 50(2)(a) UCITS (<https://www.esma.europa.eu/sites/default/files/library/2015/11/2012-721.pdf>) provides certain limitations on eligible investments for the 10% limit, these limitations were not extended to ETPs that use cryptocurrencies as their underlyings. 21Shares is therefore of the opinion that its ETPs may be in any case eligible for investment by a UCITS in this 10% ratio, if the ‘transferable security’ criteria should not be fulfilled.

21Shares therefore recommends that all national regulatory authorities apply the same criteria and guidelines with respect to crypto asset ETPs, facilitated through enhanced coordination and oversight by ESMA.

<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>

Yes, the ‘transferable security’ criteria set out in the UCITS EAD are generally adequate and clear. However, the application of these criteria to crypto asset ETPs is not uniform across different jurisdictions, leading to recurring and significant issues, as elaborated on further in question 19.

The primary issue lies in the varying interpretations and implementations of the criteria when it comes to crypto asset ETPs. Some national regulatory authorities, such as Malta or Germany, consider crypto asset ETPs as eligible transferable securities, while others do not, creating inconsistencies that hinder supervisory convergence and create uncertainty for investors and fund managers. For example, Ireland states that they must be satisfied that assets in which a UCITS invests are capable of meeting the eligible asset criteria and that they have not seen satisfactory information around crypto assets yet. This lack of uniformity can lead to regulatory arbitrage and diminishes the overall effectiveness of the UCITS framework in providing a consistent level of investor protection.

21Shares therefore recommends that all national regulatory authorities apply the same criteria and guidelines with respect to crypto asset ETPs, facilitated through enhanced coordination and oversight by ESMA.

The table below highlights how crypto asset ETPs by 21Shares fulfill the definition of  transferable securities according to Article 2(1) of the EAD:

|  |  |  |
| --- | --- | --- |
| **EAD Article 2(1)** | **Explanation** | **Requirement Met** |
| a) the potential loss which the UCITS may incur with respect to holding those instruments is limited to the amount paid for them; | 21Shares’ ETPs are delta-one securities that provide 1-1 exposure to the underlying. Each ETP has a minimum value of zero, meaning that holders cannot lose more than the purchase price of such ETP. | Yes |
| ii. their liquidity does not compromise the ability of the UCITS to re-purchase or redeem its units (for example, when they are dealt or traded on a regulated market); | 21Shares’ ETPs are open-ended and listed on multiple regulated stock exchanges across Europe, where liquidity is provided by market makers. The ETPs provide a delta-one exposure to the underlying crypto assets and hence liquidity is driven by the underlying crypto asset market, which is highly liquid.  | Yes |
| iii. a reliable valuation is available (for example, in the case of securities admitted to or dealt in on a regulated market, in the form of accurate, reliable and regular prices which are either market prices or prices made available by valuation systems independent from issuers); | Market prices for the ETPs are available from the regulated exchanges on which 21Shares’ ETPs trade. Prices are also provided by 21Shares via Bloomberg. 21Shares employs third party calculation agents that further facilitate reliable pricing.  | Yes |
| iv. appropriate information is available for them (for example, in the case of securities admitted to or dealt in on a regulated market, in the form of regular, accurate and comprehensive information to the market on the security); | 21Shares’ ETPs are exchange listed and 21Shares is therefore required to publish regular information updates on its ETPs. This includes for example the [Base Prospectus](https://5250-prd-web-21shares-cms.s3.amazonaws.com/21_Shares_BP_2023_December13_e023a619cc.pdf) or the [Key Information Documents](https://www.21shares.com/en-eu/ir/kids). | Yes |
| v. they are negotiable; | 21Shares’ ETPs meet this negotiability requirement by virtue of being dealt and traded on regulated markets. | Yes |
| vi. their acquisition is consistent with the investment objectives or the investment policy, or both; | Depending on the aims of the UCITS fund, 21Shares’ ETPs may fall within the relevant objectives and policies. | This determination should be made by the UCITS |
| vii. their risks are adequately captured by the risk management process of the UCITS. | The risk of 21Shares’ ETPs may be captured adequately by a UCITS risk management policy.  | This determination should be made by the UCITS |

<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>

21Shares has indirectly experienced recurring and significant issues around the consistent application of the valuation and risk management-related criteria in relation to crypto assets across different jurisdictions.

The assets in which a UCITS invests must have a reliable valuation and their risks must be adequately captured by the risk management process of the UCITS. Article 40 of the Commission Directive 2010/43/EU (<https://eur-lex.europa.eu/eli/dir/2010/43/oj>, 1 July 2010) further explains what consists of adequate and effective arrangements in order to measure and manage risks, therefore providing an appropriate and market standard risk framework on the UCITS level.

Despite these efforts, certain national regulators, such as Ireland, seem to be doubtful that a UCITS having (direct or indirect) exposure to crypto assets is able to fulfill these criteria. Risks hereby mentioned are liquidity risk, credit risk, market risk, operational risk (including fraud and cyber risks), money laundering / terrorist financing risk and legal and reputational risks, as elaborated on further in question 19. As further highlighted in question 20, most of these risks can be mitigated as there is sufficient historical data with respect to crypto asset ETPs in Europe and US 33 Act ETFs, provided by fund administration and valuation services.

Outside of Europe, the SEC in the US or SFC in Hong Kong have changed their stance towards crypto assets, as shown with e.g. the recent approval of Bitcoin and Ethereum (33 Act, spot) ETFs in the US, demonstrating the increasing worldwide acceptance and operational feasibility of crypto assets as a new asset class. Further markets on which crypto asset ETFs are already available include Brazil, Australia and Canada. 21Shares believes that alignment among world leading regulators will further improve global harmonization.

Article 40(2) mentions the actions each UCITS management company needs to take in order to measure and manage the risks the UCITS is or might be exposed to. 21Shares believes that these risk management criteria are met and can be properly addressed within the context of crypto assets. The below table describes how these points can be applied in the context of crypto assets.

|  |  |
| --- | --- |
| **Commission Directive 2010/43/EU Article 40(2)** | **Application to crypto assets** |
| a) Risk measurement arrangements, processes and techniques that are necessary to ensure that the risks of taken positions and their contribution to the overall risk profile are accurately measured on the basis of sound and reliable data; | Reliable data of price, volumes and volatility on crypto assets and crypto asset ETPs is available through specialized price aggregators, BMR compliant benchmark providers and reputable information services such as Bloomberg. Risk metrics, such as Value at Risk (VaR), volatility and drawdown measures can be calculated. |
| b) Conduct periodic back-tests in order to review the validity of risk measurement arrangements which include model-based forecasts and estimates; | Reliable data of price, volumes and volatility on crypto assets and crypto asset ETPs is available through specialized price aggregators, BMR compliant benchmark providers and reputable information services such as Bloomberg.  |
| c) Conduct periodic stress tests and scenario analyses to address risks arising from potential changes in market conditions; | The crypto asset and crypto asset ETP market itself is stress-tested during various market conditions and historical data can be used to model the level of exposure a UCITS would be comfortable with.  |
| d) Establish, implement and maintain a documented system of internal limits concerning the measures used to manage and control the relevant risk for each UCITS taking into account all risks which may be material to the UCITS; | Clear risk limits for exposure to individual assets, sectors and overall portfolio risk need to be defined with regards to market and liquidity risk. Operational, AML and legal risk can be significantly reduced by employing indirect exposure to crypto assets.  |
| e) Ensure that the current level of risk complies with the risk limit system; | Depends on the choice of risk metrics and risk limit set by the UCITS.  |
| f) Establish, implement and maintain adequate procedures that [...] result in timely remedial actions in the best interest of unit-holders. | Depends on the choice of risk metrics and risk limit set by the UCITS. As the liquidity of both direct and indirect exposure to crypto assets is given (see question 20), remedial actions can be taken swiftly.  |

21Shares therefore proposes that, unless the national regulators acknowledge that the risks of crypto assets can be accurately addressed within the already existing framework as highlighted above, the directives should be further specified on what and how additional risks need to be addressed in relation to crypto 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, the provisions are generally adequate and clear. However, the application of those criteria to crypto asset ETPs is not uniform across different jurisdictions, leading to recurring and significant issues, as elaborated on further in question 19. For example, Ireland states that they must be satisfied that assets in which a UCITS invests are capable of meeting the eligible asset criteria and that they have not seen satisfactory information around crypto assets yet.

However, as highlighted in question 9, 21Shares is of the opinion that its crypto asset ETPs fulfill the eligible asset criteria under the EAD. Additionally, article 2.2(c) EAD explicitly states that transferable securities “*that are backed by, or linked to the performance of, other assets, which may differ from those referred to”* Article 50 in the UCITS directive qualify as transferable securities and are therefore eligible investments for UCITS.

21Shares therefore recommends that all national regulatory authorities apply the same criteria and guidelines with respect to crypto asset ETPs, facilitated through enhanced coordination and oversight by ESMA.

<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>

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<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>

21Shares’ crypto asset ETPs indeed have a delta-one exposure to the respective underlying. For the eligibility of crypto asset ETPs, please refer to question 9, 10 and 11. Further information and data on the crypto asset class and crypto asset ETPs can be found in question 20, including availability of reliable information, liquidity and regulatory compliance.

<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>

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<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>

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<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>

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<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>

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<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>

As elaborated in question 22, 21Shares recommends to not apply a look through approach. However, in case a look through approach should be used, references to MiCA should be included. Financial instruments, which certain crypto assets can be considered, fall within the scope of MiFID II, while MiCA applies to most of the crypto assets that are not already covered by existing EU legislation, in particular by MiFID II. Therefore, this full regulation of crypto assets allows for a comprehensive assessment of allowing direct exposure to crypto assets in UCITS.

<ESMA\_QUESTION\_EADC\_18>

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

<ESMA\_QUESTION\_EADC\_19>

As highlighted in questions 9 and 11, 21Shares is of the opinion that its crypto asset exchange-traded products (ETPs) fulfill the criteria of “transferable securities” and should therefore be an eligible asset under the UCITS framework. However, there are different stances on crypto asset ETPs as eligible assets under the UCITS framework taken by various national regulatory authorities.

Please see the different approaches below:

* **Malta**: There is no specific guidance around crypto asset ETPs as UCITS eligible investments. However, there is already existing exposure to crypto assets via crypto asset ETP in a UCITS fund. Please see question 20 for further details.
* **Germany**: BaFIN classified certain crypto assets as financial instruments (<https://www.bafin.de/SharedDocs/Veroeffentlichungen/EN/Merkblatt/mb_200302_kryptoverwahrgeschaeft_en.html>, 2 March 2020). Based on this definition, crypto asset ETPs can be interpreted in the same way as currency and other ETPs which are generally deemed eligible assets for UCITS. In fact, there is already existing exposure to crypto assets via crypto asset ETP in a UCITS fund . Please see question 20 for further details.
* **Spain**: On 22 April 2024, the CNMV updated their position on crypto currencies (<https://www.cnmv.es/docportal/Legislacion/FAQ/QAsIIC.pdf>) stating that they have not approved crypto exposure that exceed the 10% limit of any UCITS funds aimed at retail investors to date. However, they are also stating that they will follow discussions at ESMA level and the evolution of the applicable regulations.
* **Ireland**: In their UCITS Questions and Answers document from 24 March 2023 (<https://www.centralbank.ie/docs/default-source/regulation/industry-market-sectors/funds/ucits/guidance/ucits-qa-38-edition.pdf?sfvrsn=c8d0991d_1>), the Central Bank of Ireland notes that they “*must be satisfied that assets in which a UCITS invests are* ***capable of meeting the eligible asset criteria*** *for UCITS and that indirect exposure to the assets is* ***capable of being appropriately risk managed.***” They note potential risks, including “*liquidity risk, credit risk, market risk, operational risk (including fraud and cyber risks), money laundering / terrorist financing risk and legal and reputation risks*”. Together with the *“potential that retail investors will not be able to appropriately assess the risks of making an investment in a fund which gives such exposures, the Central Bank is highly unlikely to approve a UCITS proposing any exposure (either direct or indirect) to crypto assets”.*
* **Luxembourg**: On 22 February 2024, the CSSF updated their position on virtual assets in an FAQ (<https://www.cssf.lu/wp-content/uploads/FAQ_Virtual_Assets_UCI.pdf>) in which they clarified that “*investing in virtual assets [...] is* ***not suitable for all kind of investors and/or all investment objectives****. UCITS, UCIs addressing customers other than well-informed investors and pension funds are thus not allowed to invest directly or indirectly in virtual assets.*”

It is apparent that some national regulatory authorities have established stricter rules and guidance regarding the inclusion of crypto ETPs in UCITS. As stated above, certain jurisdictions permit UCITS funds to include crypto asset ETPs within their portfolios, while others prohibit such investments entirely or impose additional restrictions,  without providing sufficient information on how they would like to see their concerns addressed. These divergent approaches and ‘gold-plating’ result in inconsistencies in how crypto asset ETPs are treated across different jurisdictions and ultimately leads to a fragmentation of the regulatory landscape.

As crypto asset ETPs meet all qualifications to be UCITS eligible, it would be correct to explicitly include crypto asset ETPs as eligible UCITS investments to provide retail investors the maximum possible protection, diversification and active management of exposure. The ‘gold-plating’ currently impacts retail investors directly by reducing transparency, clarity and limiting the cross-border supervisory convergence, essentially violating the core pillars of the UCITS framework. Further it leads to the risk that retail investors have to go through less regulated AIF or direct crypto investments to get exposure to this asset class. With the introduction of MiCA, a substantial portion of risk around crypto assets will be mitigated, as the issuance of crypto assets, as well as the service in regards to crypto assets will be regulated from 1 January 2025 onwards.

21Shares therefore proposes ESMA to provide a clear statement around the inclusion of crypto asset ETPs as eligible UCITS investments, facilitated through enhanced coordination and oversight.

<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>

Please refer to row “7. Crypto Assets” in the Annex.

<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>

Generally speaking, retail investors already have various ways of gaining exposure to crypto assets without UCITS, e.g. via ETPs or via directly buying crypto. The latter poses additional operational risks for retail investors, as the direct holdings of crypto assets is often done on (non-regulated) exchanges or via cold storage solutions (i.e. ledger) that have the substantial risk of losing access to the crypto assets. While 21Shares will not go further into the topic of retail investors accessing crypto directly, they appeal to ESMA urgently to explicitly allow exposure to crypto assets within the UCITS framework by an UCITS eligible security to be safeguarded by, the most qualified framework with highest investor protection and most stringent risk management worldwide when it comes to accessing a diversified portfolio. With the increasing interest by institutional investors, including generally more risk-averse pension funds, it will only be a matter of time until crypto assets reach the broad mainstream, including retail investors. Providing crypto asset exposure in a diversified UCITS would ensure that the European Union remains a regulatory leader with clear principles.

While both direct and indirect exposures provide certain advantages, 21Shares believes that indirect exposure through ETPs is superior for UCITS and their investors versus a direct exposure for the various reasons regarding risk and costs.

**Risks**

Factors that decrease risks

* As highlighted in question 20, ETPs provide a regulated structure guided by the EU Prospectus Regulation, the EU Transparency Regulation as well as listing regulations of the competent regulated markets. All risks regarding crypto assets are hereby disclosed in the Prospectus and supporting documents, which are publicly available for investors at all times.
* With regards to the crypto asset itself, legal and regulatory risks are mitigated by employing 3 lines of defense for an indirect exposure. While the UCITS fund selection is the only line of defense when it comes to assessing the risks of a direct investment into a specific crypto asset, an indirect exposure has two additional lines of defense by default of the ETP listing process: the ETP issuer and the regulated market on which the ETP is listed. Both parties have an interest in mitigating legal and regulatory risks to ultimately decrease potential reputational risks for themselves. The regulated market hereby is an independent party that provides their independent assessment of the crypto asset in their approval process.
* If a UCITS would decide to keep direct crypto assets in custody on crypto asset exchanges, ETPs provide an additional reduction of counterparty risks. It is way safer for the investor to invest into regulated securities maintained by an ETP issuer rather than directly on (often not regulated) exchanges, whether centralized or not. These exchanges are often subject to hacks, and users to phishing attempts and have no insurance policies or pledges in place. 21Shares, also based on the requirements of the listing regulations, partners only with top-tier, regulated and institutional custody providers, which are all subject to AML/CTF laws. Selected through rigorous due diligence, 21Shares’ custody providers offer state-of-the-art cold-storage solutions, with segregation per product, multi-sig signing processes backed by additional security procedures (e.g. face identification, video callback, etc.), insurance policies with all underlyings being pledged to investors through an independent collateral agent. The counterparty risk is therefore substantially decreased.
* Decreased risk of money laundering and terrorist financing: All involved parties in an ETP structure, such as APs or custodians, are fully regulated and are subject to AML laws. Compared to direct investments via often non-regulated exchanges, the risks are substantially decreased when accessing crypto asset exposure via ETP.

Factors that increase risks

* Having indirect crypto asset exposure through ETPs adds a layer of counterparty risk by means of operational failures or bankruptcy of the issuer. However, these risks are mitigated by various guardrails as elaborated below.
	+ Mitigation of operational risks: 21Shares has a battle-tested multi-year track-record of operational excellence, navigating cryptocurrency crises and market events while constantly looking at the latest industry innovations. Multiple business continuity and contingency plans are in place to reduce the operational risk, including diversification of providers and dedicated back-up systems. Further, service providers require operational DDQs in order to work with the ETP issuers and operational audits, amongst others, have to be provided to regulated markets on a regular basis.
	+ Mitigation of bankruptcy risk: As a SPV, 21Shares’ sole purpose is the issuance of ETPs. All ETPs are 100% physically collateralized and are pledged to investors with an independent collateral agent.

**Costs**

Factors that decrease costs

* ETPs can achieve cost efficiencies through economies of scale.
* Setting up crypto asset services can be quite costly, especially if no economies of scale are present. Crypto asset ETP issuers are able to negotiate extremely low custody fees due to their high amount of assets under management in this asset class. Typically, the custody fees are priced into the management fee of the ETP. UCITS and their investors therefore profit from excellent custody solutions at a way lower cost than if they would set these solutions up for themselves.
* ETPs can also hold more than one crypto asset to follow an index of different crypto assets. Such ETPs provide investors with a certain degree of diversification within one product. UCITS seeking exposure to multiple crypto assets can further decrease their costs by investing in such ETPs, and therefore avoiding the transaction costs that are associated with buying and selling multiple crypto assets.
* Certain ETPs offer staking, a crypto native way of securing the network and receiving rewards for doing so. As an example, 21Shares’ Solana Staking ETP with $1 billion AuM currently offers an additional yield of around 5%. This additional yield provides an attractive option for UCITS and their investors to achieve additional performance. While UCITS in theory could engage in staking themselves, it is cheaper and more effective for UCITS to do so via ETPs, where economies of scale provide a higher yield.
* Through economies of scale, ETP issuers are also able to reduce the transaction costs involved with buying and selling the underlying asset.
* Lastly, UCITS can leverage the expertise of a crypto asset ETP issuer and can therefore operate on a leaner operational structure, effectively reducing the costs associated with managing the crypto asset exposure.

Factors that increase costs

* Each ETP has management fees that are subtracted in-kind, i.e. the coin entitlement representing the amount of crypto asset that is attributed to each ETP unit is decreased on a daily basis. However, 21Shares offers exposures for as little as 21bps in management fees. Additionally, 21Shares’ ETPs do not charge any performance fee and their products’ spreads on exchange are as low as 6bps, making an investment into crypto assets relatively cost efficient.

<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>

The look-through approach, while beneficial in providing transparency and detailed risk assessment, is not always suitable or necessary, particularly in the context of crypto asset ETPs within UCITS. Furthermore, Article 2.2(c) of the EAD does not foresee the use of a look-through approach by allowing UCITS exposure to transferable securities that are “*backed by, or linked to the performance of, other assets, which may differ from those referred to”* in Article 50(1) of the UCITS Directive.

The core principles of UCITS, diversification, liquidity and investor protection, can be adequately addressed at the ETP level without necessitating a look-through approach. Crypto asset ETPs are designed to provide exposure to the crypto market while adhering to strict regulatory standards that ensure liquidity and investor protection, e.g. EU Prospectus Regulation as discussed in question 20.

Furthermore, the underlying crypto assets of such ETPs are already assessed on a case by case basis in the listing process and meticulous criteria are taken into account, as mentioned in the section for indirect exposure towards crypto assets of question 20. For example, SIX Switzerland recently issued their Directive on Crypto-Assets as Underlying Instruments (<https://www.ser-ag.com/dam/downloads/regulation/listing/listing-rules/dca-en.pdf>, 1 April 2024) that complements the Additional Rules for the Listing of Exchange Traded Products (<https://www.ser-ag.com/dam/downloads/regulation/listing/listing-rules/aretp-en.pdf>, 1 April 2024). Provisions include the underlying to “*have a market capitalisation of at least USD 500 million”* and *“demonstrate average daily liquidity of at least USD 50 million over the past 30 calendar days*”, the ETP to be collateralised “*by presenting the claim for surrender of the underlying instrument”* and additional provisions on the custodians used by the issuer. As a Swiss based issuer with ETPs listed on SIX, 21Shares adheres to these directives.

Other European jurisdictions follow similar criteria when assessing if an underlying is fit for a crypto asset ETP and MiCA provides additional provisions with regards to the service providers, increasing the investor protection on the ETP level.

Therefore, by focusing on the ETP as a whole rather than its crypto asset underlyings, UCITS funds can achieve their investment objectives more effectively and efficiently. The additional insights gained from a detailed examination of underlying crypto assets are often marginal compared to the costs involved. Crypto assets are already characterized by high transparency at the ETP level, where the primary risks and exposures are clearly communicated to investors through the Base Prospectus, Final Terms, Issue Specific Summary and Key Information Document. The marginal benefits of further dissecting these assets through a look-through approach do not justify the considerable expenses and operational challenges it would entail for UCITS. By avoiding the look-through approach, UCITS funds can maintain a more manageable, cost-effective, and investor-friendly framework, ensuring that the core principles of diversification, liquidity, and protection are upheld.

<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.

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<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>

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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.

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