



European Securities and  
Markets Authority

# Discussion Paper

**Share classes of UCITS**



## 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:

1. respond to the question stated;
2. indicate the specific question to which the comment relates;
3. contain a clear rationale; and
4. describe any alternatives ESMA should consider.

ESMA will consider all comments received by Friday 27 March 2015.

All contributions should be submitted online at [www.esma.europa.eu](http://www.esma.europa.eu) 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 publically 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.

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### Who should read this paper

This document will be of interest to UCITS management companies and their trade associations, as well as institutional and retail investors investing in UCITS.



## Table of Contents

1. Executive Summary .....	3
2. Background.....	4
3. What is a share class? .....	4
4. Questions.....	6

# 1. Executive Summary

## Reasons for publication

The UCITS Directive recognises the possibility for UCITS to offer different share classes to investors but it does not prescribe whether, and to what extent, share classes of a given UCITS can differ from each other. ESMA has identified diverging national practices as to the types of share class that are permitted, ranging from very simple share classes (e.g. with different levels of fees) to much more sophisticated share classes (e.g. with potentially different investment strategies). Therefore, ESMA sees merit in developing a common understanding of what constitutes a share class of UCITS and of the ways in which share classes may differ from each other.

## Contents

In this discussion paper, ESMA sets out its views on what constitutes a share class, including how to distinguish share classes from compartments of UCITS. The paper goes on to provide possible approaches to the extent of differentiation between share classes that should be permitted.

## Next Steps

ESMA will take into account the feedback from stakeholders with a view to establishing a common position on the use of share classes by UCITS. ESMA appreciates that national practices on the use of share classes vary significantly. Therefore, ESMA will take into account the possible impact on current market practices when developing its final position on this topic.

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## 2. Background

1. The UCITS Directive recognises the possibility for a UCITS to offer more than one share class to investors but it does not prescribe whether, and to what extent, share classes of a given UCITS can differ from each other. ESMA has identified diverging national practices as to the types of share class that are permitted, ranging from very simple share classes (e.g. with different levels of entry and exit fees) to much more sophisticated share classes with, for example, different investment strategies. Therefore, ESMA is considering the merits of developing a common understanding of what constitutes a share class of UCITS.
2. For the avoidance of doubt, in this document the terms 'share' and 'share class' cover all UCITS, whether they take the form of common funds that issue units or investment companies that issue shares. Also, UCITS includes investment compartments thereof.

## 3. What is a share class?

3. First of all, it is important to distinguish between share classes and compartments of UCITS. Each compartment of a UCITS is a sub-fund which differs in its investment strategy, or in other characteristics, from the other compartments. This means that investors in each different compartment of the same UCITS may not necessarily be exposed to the same investment strategy as investors in the other compartments. Usually, assets of compartments are legally segregated so a liability arising in one compartment cannot be offset by the assets of other compartments.
4. Share classes, in contrast, are not sub-funds but categories of share which belong to the same UCITS and allow subsets of investors in a UCITS to achieve some level of customisation which accommodates their specific needs (e.g. the distribution of revenues, a particular tax treatment under national law or a different minimum investment amount).
5. There is no legal segregation of assets between share classes. This means that investors in a UCITS all own a portion of the same pool of assets.
6. ESMA has identified the following principles that should be used in assessing the legality of different share classes:
  - o Share classes of the same UCITS should have the same investment strategy.
  - o Features that are specific to one share class should not have a potential (or actual) adverse impact on other share classes of the same UCITS.
  - o Differences between share classes of the same UCITS should be disclosed to investors when they have a choice between two or more classes.

7. ESMA is of the view that UCITS management companies which seek to offer different investment strategies to investors should create a separate UCITS for each strategy.
8. ESMA has identified the following non-exhaustive list of types of share class that would be compatible with the principles set out in paragraph 6:
  - Share classes that differ according to the maximum or minimum investment amounts, or values of holdings allowed to be retained;
  - Share classes that differ in terms of the type of investor (e.g. institutional investors vs. retail investors);
  - Share classes that differ according to the types of charges and fees that may be levied and their amount (on-going charges, subscription and redemption fees, performance-related fee);
  - Share classes that differ according to the currency in which they are denominated;
  - Share classes that differ according to the allocation of revenues to investors (by capitalisation or distribution, either subject to or exempt from withholding tax).
  - Share classes that differ according to their characteristics: registered or bearer.
  - Share classes that differ in terms of voting rights; and
  - Share classes that provide currency hedging when share classes are denominated in different currencies from the base currency.
9. With respect to the last example above, ESMA is of the view that currency hedging at the level of a share class could be considered as compatible with the principle of a common investment strategy. This is because such hedging arrangements are intended to ensure that investors receive as nearly as possible the same results of the investment strategy, even though their exposure is obtained through a different currency. Nevertheless, currency hedging should only be possible if it cannot have an adverse impact on the unit-holders of the other share classes of the UCITS and the costs of the hedging should only be borne by the unit-holders of the hedged share class.
10. ESMA has identified the following non-exhaustive list of types of share class that do not appear to be compatible with the principles set out in paragraph 6:

- Share classes that are exposed to different pools of underlying assets. For example, a UCITS that offers two share classes, one tracking the Eurostoxx and one tracking the S&P 500.
  - Share classes whereby the same underlying portfolio is swapped against different portfolios of assets (i.e. the final exposures of the share classes are different).
  - Share classes that offer differing degrees of protection against some market risks such as interest rate risk or volatility risk.
  - Share classes that are exposed to the same pool of assets but with different level of capital protection and/or payoff. For example, a UCITS offers two share classes. One share class protects 80% of the initial NAV and delivers 100% of the performance of an index after a fixed term (5 years) and the other share class protects 100% of the initial NAV and delivers 50% of the performance of the same index after the same 5 year term.
  - Share classes that differ in terms of leverage.
11. Unlike currency hedging referred to in paragraph 9 above, ESMA believes that interest rate hedging performed at the level of share classes does not comply with the principle of having the same investment strategy, because it modifies the investment strategy of the share class. For example, a share class that reduces the duration of the portfolio should not be considered as compatible with the principle of a unique investment strategy because investors in that class are not exposed to the same interest rate risk as investors in the other classes of the fund.

## 4. Questions

- 1. What are the drivers for creating different share classes?**
- 2. Why do certain UCITS decide to create share classes instead of setting up a new UCITS?**
- 3. What are the costs of creating and operating a new share class compared to the cost of creating and operating a separate UCITS?**
- 4. What are the different types of share class that currently exist?**
- 5. How would you define a share class?**
- 6. Do you agree that share classes of the same UCITS should all share the same investment strategy? If not, please justify your position.**

- 7. Could you explain how the operational segregation between share classes works in practice?**
- 8. Do you agree that the types of share class set out in paragraph 8 are compatible with the principle of having the same investment strategy? In particular do you agree that currency hedging that is described in paragraph 8 complies with that principle? If not, please justify your position.**
- 9. Do you believe that other types of share class that comply with the principle of having the same investment strategy exist (or could exist) and should be allowed? If yes, please give examples.**
- 10. Do you agree that the types of share class set out in paragraph 10 above do not comply with the principle of having the same investment strategy? If not, please justify your position.**
- 11. Please provide information about which existing UCITS do not comply with the criteria laid down in paragraph 6 as well as an indication of the assets under management and the number of investors of these UCITS.**
- 12. Do you see merit in ESMA clarifying how regulatory ratios such as the counterparty risk limit should be calculated (e.g. at the level of the UCITS or share classes)?**
- 13. Do potential and current investors get adequate information about the characteristics, risks and return of different classes in the same UCITS? If not, what else should be provided to them?**
- 14. Do you agree that ESMA should develop a common position on this issue? If not, please justify your position.**