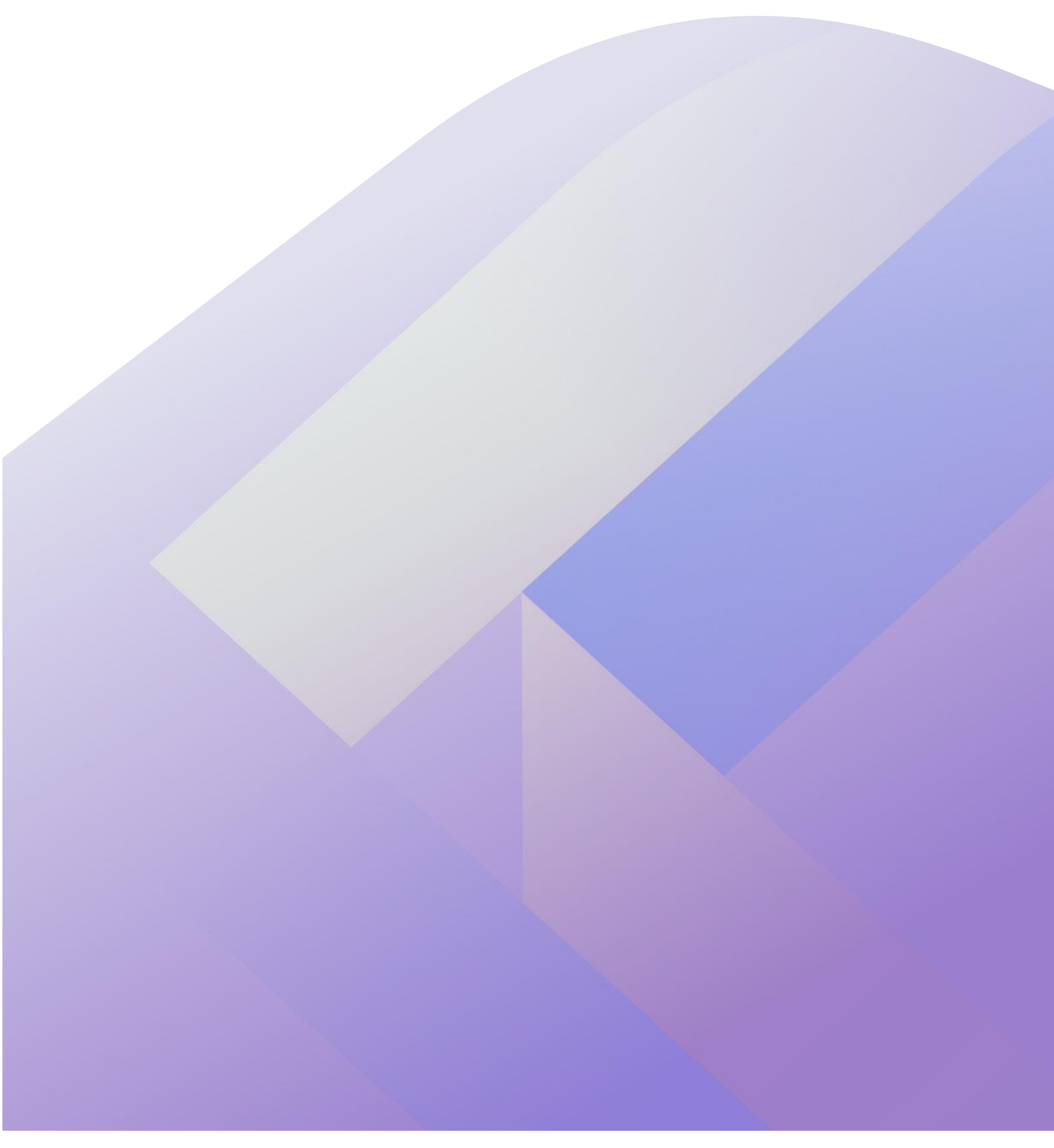


Reply form

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 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 under the heading '[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.

1 General information about respondent

Name of the company / organisation	The Investment Association
Activity	Trade Association – Asset Management
Country / Region	UK

2 Questions

Q1 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>

It is our view that overall the UCITS EAD is functioning well and the directive itself does not need to change at the present time. The EU UCITS framework has become recognised as a gold standard for retail funds frameworks, establishing strong investor protection credentials combined with sufficient investment flexibility to accommodate the majority of mainstream investment strategies.

While it is true that some UCITS have experienced high profile difficulties with liquidity, notably the Woodford Equity Income Fund in the UK (pre-Brexit) and the H2O funds in Luxembourg/France, these examples are a very small constituent of more than 30,000 UCITS funds across the EU. In the view of the IA, the difficulties that emerged in these funds point to supervision issues rather than fault with the framework itself.

There are areas where there can be ambiguity over definitions – the notion of liquidity is an example. However, many of these terms, such as liquidity, are very difficult to precisely define and quantify in legislative terms, and an element of judgement, by both managers and supervisors is required. It is our view that such ambiguities where they exist in the UCITS EAD can be addressed where necessary through Level 3 measures, such as supervisory coordination, guidance (including in the form of FAQs) or industry good practice initiatives.

<ESMA_QUESTION_EADC_1>

Q2 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>

We are not aware of any significant difficulties in the industry with the interpretation of the UCITS EAD in respect to financial indices, although some challenges arise with their application. We are aware that restrictions can be problematic in the case of some indices following markets in a geographical location or a sector where there is a single dominant constituent, e.g. South Korea or Taiwan. Recognising though the intent of risk diversification within the UCITS framework, these are challenges that the industry has found solutions for UCITS focusing on these markets.

The requirements in Article 9 of the EAD set detailed criteria that a financial index should meet. In order to demonstrate compliance, extensive due diligence of financial indices is undertaken by many firms. These requirements in the EAD pre-date the introduction of the Benchmark Regulation (BMR), which requires benchmark administrators to be regulated and benchmarks to meet set criteria. We consider that while the standards outlined in the EAD for benchmarks are appropriate, established indices in UCITS eligible transferable securities for developed and other mature markets, which are regulated under the BMR, can be assumed to meet these criteria, avoiding the need for detailed due diligence and documentation on established market indices, eg Eurostoxx 50, S&P 500, FTSE All Share, which offers little value. We recognise that more due diligence may be required on indices that track more specialist markets and in particular on indices that have non-UCITS eligible assets as constituents. We suggest that the principle of proportionality regarding due diligence on indices can be reflected in guidance and supervisory expectations.

We understand that in the case of UCITS tracking an index, there has been divergence in the way some competent authorities have applied the provisions in Article 53 of the UCITS Directive that permit these UCITS to raise the spread limit to 20% per issuer for shares/debt securities, and to 35% for a single issuer in exceptional market conditions, in particular in regulated markets which have a highly dominant issuer. While most national competent authorities permit this diversification, some authorities (eg. Germany, Ireland) require additional certification for those indices that exceed the standard 5/10/40 diversification in Article 52 of the UCITS directive, even though they are within the 20/35 limits of Article 53,

creating additional frictions for managers operating in those markets. Harmonisation should be undertaken between national competent authorities so that the Article 53 20/35 diversification limit for indices is accepted universally without the frictions of additional certification.

We consider that these suggestions can be addressed through guidance and harmonisation measures. We do not consider that changes are needed to the Level 1 UCITS EAD rules in respect of financial indices.

<ESMA_QUESTION_EADC_2>

Q3 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>

Since the introduction of the Money Market Funds Regulation (MMF Regulation), there has been some divergence between the eligibility criteria for non-MMFs holding money market instruments, and the eligibility criteria for MMFs. We do not, however, consider this divergence to be a material concern. The stricter rules for MMFs, which invest heavily in money market instruments and have an objective to preserve capital, are understandable. Non-MMF UCITS do not typically have the same capital preservation objective – they are more broadly seeking risk exposure, and where they hold money market instruments, tend to hold a relatively small quantity for liquidity management purposes. We consider that the definitions of money market instruments in the UCITS EAD are clear and do not need further definition.

<ESMA_QUESTION_EADC_3>

Q4 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 understanding around the notions of “liquidity” or “liquid financial assets” can be challenging for managers, given the dynamic nature of liquidity in many asset classes. The possibility of being able to liquidate an asset can never be guaranteed for any asset class – this will always depend on there being active buyers or intermediaries willing to make markets. It makes little sense to exclude an asset from being considered eligible on the basis there is a small possibility that in an extraordinarily stressed market it may be difficult to find a buyer, if in the ordinary market conditions that prevail the majority of the time there will be readily available buyers or intermediaries willing to make markets.

With only limited exceptions, a pragmatic and proportionate view has been taken of these notions by the majority of UCITS managers, who have avoided substantial positions in securities where there is little to no trading activity, even where these are technically listed. Liquidity as a concept is very difficult to define precisely or quantify in legislative terms, and we do not therefore believe that amendments to the UCITS EAD are a necessary or appropriate means to address the challenges around these notions. Rigid definitions of liquidity could end up being too restrictive, preventing UCITS from being able to access highly investible assets, to the detriment of their investors. We consider that any challenges, as they arise, with the notions of “liquidity” or “liquid financial assets” can and should be addressed through guidance from supervisors, including Q&As, and take principles-based interpretations into consideration.

<ESMA_QUESTION_EADC_4>

Q5 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 presumptions of liquidity and negotiability in the UCITS EAD remain appropriate and do not need to be revisited. It is though incumbent on both supervisors and

UCITS management companies to ensure these rules are interpreted with regard to their intention. For example, it is not reasonable to apply a presumption of liquidity on a security which has a technical listing on a small regulated exchange, but where in practice there is no active market for that security. Similarly, if a bespoke loan has been structured so that it is technically tradeable, but in practice there is no and not likely to be any market for that security, it is most likely not reasonable to apply a presumption of liquidity or negotiability to that security. Such examples will be difficult to legislate against precisely – in this respect, we do not consider the UCITS EAD can be improved. These are better addressed through guidance from supervisors, who can consider unique characteristics or circumstances of the particular asset types.

Whether (i) an asset is eligible, and (ii) managing the overall liquidity risk of the portfolio, are separate considerations. The fact that the assets held by a UCITS, considered on their own merits, are deemed eligible, does not mitigate the liquidity risk management responsibilities of the manager – the manager is still obliged to ensure the portfolio overall is sufficiently liquid to meet the obligations of the UCITS, and no investment within the UCITS will compromise the overall liquidity of the UCITS. Guidance in recent years, particularly around liquidity monitoring and liquidity stress testing has addressed this latter obligation.

In practice, cases of inappropriate holdings that compromised liquidity have proved rare for UCITS. UCITS management companies typically employ robust risk management programs overseen by “second line” independent risk management teams (i.e. who are not part of the portfolio management, or “first line”), ensuring genuine liquidity on reasonable terms is available for all assets held by UCITS. These teams will prevent investment into assets that are likely to compromise the liquidity of the UCITS.

<ESMA_QUESTION_EADC_5>

Q6 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>

The IA is not aware of any significant issues that have arisen in respect of the notion of ancillary liquid assets. Our understanding is that ancillary liquid assets will include cash held in bank deposits at sight, as well as highly liquid and/or short-term securities such as government

securities, money market instruments and units of money market funds. Ancillary liquid assets are usually held in the base currency of the fund, but may occasionally be held in foreign currencies, particularly when needed for purposes such as coverage of derivatives positions.

<ESMA_QUESTION_EADC_6>

Q7 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 consider that the UCITS directive permits the use of foreign currency being acquired or held for investment purposes. Article 50(1)(f) permits UCITS to hold deposits with credit institutions. Article 50(g)(i), when listing the permissible underlying of derivatives, also refers to "...currencies, in which the UCITS may invest according to its investment objectives...". These are also references in Article 8(1)(iii) of the EAD.

We do not consider any clarification or amendment is needed regarding foreign currency held for investment. Active management of foreign currency and exchange rates is inherent in managing assets of UCITS that are not denominated in the base currency. The risks of holding foreign currency are not materially different to holding assets denominated in foreign currencies (those not the base currency of the fund), or benchmarks that are unhedged against currency. Foreign currencies can be a useful diversifier in multi-asset UCITS. Provided these activities are consistent with the investment objective and policy of the UCITS, and the risks associated with currencies are properly disclosed to investors, we consider this flexibility to be beneficial to investors.

<ESMA_QUESTION_EADC_7>

Q8 Have you observed any recurring or significant issues with the interpretation or consistent application of the 10% limit set out in the UCITS Directive for investments in transferable securities and money market instruments other than those referred to in Article 50(1) of the UCITS Directive? If so, please explain the issues and how you would propose to address them in the UCITS EAD with a view to improving investor protection, clarity and supervisory convergence.

<ESMA_QUESTION_EADC_8>

No. The understanding and interpretation of the 10% limit for investments in transferable securities is generally consistent across the industry. There have been some exceptional cases, such as those mentioned in our response to question 1, but the circumstances of these are well known, and those cases did not reflect broader industry practice. In our experience, it is rare for questions from members to arise on the interpretation of the 10% unapproved transferable securities limit.

<ESMA_QUESTION_EADC_8>

Q9 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>

It is our view that the “transferable security” criteria set out in article 2 of the UCITS EAD is adequate and clear enough. The definitions around closed ended funds constituted as investment companies have been particularly helpful for UK UCITS managers, providing criteria that clarified that UK listed investment companies could be considered as eligible investments for UCITS.

This is not to say that challenges in interpretation don’t arise. Such challenges are inevitable when considering the different structures available in jurisdictions across the world, which are subject to different legal and regulatory frameworks. We consider though that the UCITS EAD sets out sufficient legislative criteria for the industry and supervisors to review particular securities and apply these to specific cases. Where clarifications around particular securities are required, these are better addressed by discussions between UCITS management companies and their depositaries, and if necessary, their supervisors, where specific characteristics of the asset type can be considered. The IA and other trade associations have produced industry guidance around particular securities on whether they can be considered to meet the UCITS EAD criteria.

<ESMA_QUESTION_EADC_9>

Q10 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>

The range of assets eligible for UCITS means that a one-size-fits-all approach cannot be applied to valuation or risk management criteria. Nonetheless, there are common practices within the industry. For certain asset classes (e.g. those not listed on large recognised exchanges, or below a certain market cap), second line risk management teams will require advance notification of an intention of the portfolio manager to invest, so that a full review of the potential risks that may arise from investment in the asset, and the source and reliability of pricing and other market information for valuation purposes can be assessed ahead of the investment being made.

Market risks are captured monitored through Global Exposure calculations. In particular, the Value-at-Risk (VAR) method is normally employed by UCITS with more sophisticated investment strategies, as this is effective in capturing exposure risks arising from multiple derivatives contracts. Where UCITS invest heavily fixed income securities, risk team perform detailed credit assessment to assess credit risks, and ensure these are commensurate with the objective and investment policy of the fund.

We consider that the criteria set out in the UCITS EAD for valuation and risk management are widely understood and we are not aware of any significant issues that arise with the legal definitions. Pricing information is typically sourced from observable prices, such as exchange data or market data vendors sourcing from multiple counterparties, and fair value pricing processes are well established where there are challenges obtaining data for particular assets. As with our response to question 9, applying the interpretations to some asset types can be challenging, but the industry has been able to address these through industry guidance and good practice where required.

<ESMA_QUESTION_EADC_10>

Q11 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>

We consider that the provisions on asset backed securities (ABS) are clear enough. We have not observed any significant issues, but understand that there is greater scrutiny of ABS and similar assets at the authorisation stage. NCAs could assist in improving the efficiency of authorisations through providing criteria for assessing these instruments to UCITS managers in advance.

<ESMA_QUESTION_EADC_11>

Q12 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>

The concept of embedded derivatives is one of the more challenging in UCITS, and does lead to member queries. Securities will usually need a case by case assessment on whether they have characteristics that embed a derivative. Overall, we are comfortable that Article 10 of the UCITS EAD sets out sufficient legal criteria for defining an embedded derivative. The nature of financial innovation is such that in this area, there is always likely to be a need to consider new asset classes against the UCITS EAD criteria, and in some cases further guidance might be needed by the industry. Such additional guidance and clarity is better served through Level 3 measures, such as Q&As, that can consider the principal definitions in the EAD and apply to particular asset classes, or discussions with national competent authorities.

<ESMA_QUESTION_EADC_12>

Q13 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>

We do not consider that the UCITS EAD requires amendment in the case of delta-one instruments. Delta-one instruments enable UCITS to indirectly access a range of asset classes with the tradability and liquidity of transferable securities. We do not see an issue with UCITS gaining some indirect exposure via delta-one instruments to asset classes that would otherwise be ineligible for UCITS, provided that throughout the UCITS remain funds that overall give exposure to transferable securities. Indeed, such diversification in a UCITS can be beneficial for investors. We would consider the use of delta-one instruments being circumvention if these led to the UCITS offering an undiversified exposure to a non-eligible asset class, rather than being a diversifying component of a transferable securities portfolio. (See also our response to Q23.

<ESMA_QUESTION_EADC_13>

Q14 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 do not consider issues to have arisen regarding the eligibility of investment into other UCITS. Investment into AIFs require more due diligence, to ensure that these meet the UCITS criteria, including the criteria in Article 2 for closed-ended AIFs constituting transferable securities. In particular, understanding regulatory frameworks that apply, and whether the investment powers and restrictions align with UCITS is more challenging, particularly for AIFs that are established outside the UK or EU. These latter challenges arise due to differences in legislative frameworks and market practice, and this tends to restrict investment in non-EU or UK AIFs.

In the case of UK UCITS (both before and subsequent to the UK leaving the EU), investment into AIFs is primarily in UK listed investment companies (which are closed-ended), that are subject to the Listing Rules of the London Stock Exchange, and UK Non-UCITS Retail Schemes, which are subject to similar investment protection requirements as UCITS. Otherwise most UK UCITS will, where they invest in other funds, only invest in other UCITS, including MMFs for holding liquidity.

Although it would be preferable to align the UCITS EAD to refer to the AIFMD regime, in practice this discrepancy due to the UCITS EAD predating the AIFMD has not resulted in any issues of interpretation – the distinction between UCITS and other funds in the UCITS EAD aligns with the distinction in the AIFMD. We therefore do not consider that it is necessary to reopen the UCITS EAD solely to address this issue.

<ESMA_QUESTION_EADC_14>

Q15 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>

Since the majority of EU ETFs are established as UCITS, we are not aware of any significant or recurring issues regarding the interpretation of or consistent application of the UCITS EAD regarding these investments.

Issues can arise with the application of the UCITS rules to non-EU ETFs, e.g. those structured in the US. Broadly, the industry interprets these as collective investment undertakings, and looks through the ETF to ensure that it has investment powers and restrictions consistent with

a UCITS. In particular, non-EU ETFs do not typically contain specific clauses that restrict them from holding more than 10% in other collective investment schemes, even though this not in line with their objectives – whereas historically, confirmation letters from ETF managers were accepted, these are no longer considered acceptable. This can limit the ability of UCITS to access highly liquid and cost-effective US ETFs, even though these are generally consistent with the investment criteria for UCITS.

Arguably, there may be scope to interpret certain non-EU ETFs, such as those that take a corporate structure (such as US registered investment companies), as transferable securities (noting ETFs are classed as financial instruments under MiFID). Again, this is an area where guidance could be useful rather than requiring the UCITS EAD itself to be amended.

<ESMA_QUESTION_EADC_15>

Q16 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 the definition of Efficient Portfolio Management (EPM) in the UCITS EAD needs to be amended. In respect of securities financing transactions (SFTs), the SFT Regulation introduced additional requirements around these transactions, which along with the ESMA Guidelines on ETFs and Other UCITS Issues, ensure that there is strong transparency around the use of SFTs and that these are undertaken for the benefit of investors in the UCITS. These measures complement, rather than conflict with, the UCITS EAD provisions on EPM.

When it was introduced, the concept of EPM caused investors, particularly international investors, some confusion and concern on what it meant and what it permitted in respect of the use of derivatives, e.g. whether the use could extend beyond hedging. Significant investor education has been undertaken by the industry on the understanding of EPM, other benefits that can arise for investors with the use of derivatives beyond hedging but in keeping with the risk profile of the UCITS (e.g. the generation of additional income), and the concept of EPM is now widely understood. Amending the definition in the UCITS EAD would undermine

understanding of and confidence in the UCITS brand, built up over many years of engagement, with international investors.

We consider the matters raised in the question to be supervisory matters that do not require legislative changes. Guidance around supervisory expectations on security lending fees for SFTs would be welcome. We caution though against hard limits on security lending fees – there are variations in the scale and range of securities included in the different securities lending programs of different UCITS managers. Some have narrow programs focused only on the most popular SFTs that can attract the lowest fees, but due to their narrowness only generate limited revenue, whereas other UCITS have broader programs lending a wider range of securities, including those requiring higher securities lending fees but which overall generate more income due to the wider program. We support full investor transparency on securities lending fees, but the potential to use SFTs to generate revenues for investors and offset management fees could be severely limited by inappropriate measures to limit security lending fees.

<ESMA_QUESTION_EADC_16>

Q17 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>

As noted in our response to Q17, we do not consider it necessary to replace the notion of EPM in the UCITS EAD with the notion of securities financing transactions in the SFT Regulation.

<ESMA_QUESTION_EADC_17>

Q18 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>

The IA has no further points it wishes to raise regarding these directives.

<ESMA_QUESTION_EADC_18>

Q19 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>

We understand that there are differences in the interpretation of the eligibility of some delta-one instruments that are linked to the performance of non-UCITS eligible assets amongst national regulators. We would encourage national regulators who take a stricter interpretation to consider experiences in other EU jurisdictions regarding indirect exposures, noting permitting limited exposures to these instruments has allowed increased diversification without introducing significant risks.

<ESMA_QUESTION_EADC_19>

Q20 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>

The IA has provided information on asset classes in the table in the attached Annex to Question 20. We have provided approximate percentages of the UCITS in IA sectors that invest in each asset class, but there were limitations in being able to break down the information we were able to obtain during the consultation period into the categories specified by ESMA. As such, we were unable to give breakdowns on all the asset classes specified, and the information provided should be considered indicative only.

Should this be of interest to ESMA, the IA is willing to assess and provide, as far as possible, more granular information on the asset classes specified on request.

<ESMA_QUESTION_EADC_20>

Q21 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 allow UCITS to avoid some of the risks and challenges that UCITS would bear through direct exposures to certain asset classes. In some areas, these can increase costs for UCITS compared to more direct exposures. For example, IA members report that exposure to commodities via ETNs is more expensive, and these are less traded, than futures in those commodities would be.

Overall, the IA does not consider the UCITS eligible asset rules should be amended. The UCITS brand is widely recognised, and the introduction of new asset classes for direct investment would change the nature of the UCITS product and introduce new risks.

<ESMA_QUESTION_EADC_21>

Q22 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 applied to securities that given exposures to non-UCITS eligible assets, provided that their use is proportionate and does not give rise to the UCITS having overall a concentrated exposure to non-eligible assets. Provided the UCITS is not exposed to risks that go beyond those associated with transferable securities, we do not consider it inappropriate for UCITS to hold transferable securities that offer indirect exposure to ineligible asset classes, as diversifying components within a transferable securities portfolio.

However, we are of the view that circumvention should be considered at the level of the overall UCITS. For example, if a UCITS were to invest only in a series of gold ETCs, thereby the UCITS itself giving only exposure to the gold price, that would legitimately be considered a circumvention that is not in line with the intent of UCITS.

<ESMA_QUESTION_EADC_22>

Q23 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>

UCITS funds can benefit from securitisation vehicles to gain the opportunity of enhanced investment returns, eg. structuring tranches of loans that meet align with the investment objective and risk appetite of the UCITS. Securitisations also play an important role in capital markets and funding for the real economy, allowing for investors to gain access to attractive loan tranches and freeing bank capital for further lending activities. The UCITS directive and the EAD combined with EU securitisation legislation provide clarity on the treatment of EU securitisations, and the liquidity, valuation and transparency requirements that should be met. We do not consider that there is any need for legislative changes to the UCITS directive or EAD, though there is less clarity around the treatment of non-EU securitisations or private securitisations, and these could benefit from additional guidance at Level 3, including in the securitisation templates being developed by ESMA.

<ESMA_QUESTION_EADC_23>

Q24 What are the risks and benefits of permitting UCITS to build up short positions through the use of (embedded) derivatives, delta-one instruments or other instruments/tools? Please share evidence and experiences on current market practice and views on a possible need for legislative clarifications or amendments.

<ESMA_QUESTION_EADC_24>

The ability for UCITS to take short positions through the instruments mentioned can allow UCITS to offset risks elsewhere in the portfolio and allow investors to gain access to total return strategies designed to provide net positive returns in all market conditions. The risks of such strategies need to be properly disclosed to investors, and subject to robust risk management. It is our understanding that short exposures are only gained in a relatively small number of UCITS, and these are subject to additional scrutiny by supervisors during the initial application process and in subsequent supervisory monitoring, eg. based on reporting of risk management processes by UCITS managers.

We do not consider that any legislative amendments or clarifications are required.

<ESMA_QUESTION_EADC_24>

Q25 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>

As noted elsewhere in our response, we do not consider that any changes are needed to the UCITS EAD. The framework is well understood and accepted by industry and investors, and a strong and well-known brand has been established based on the UCITS regulation. The current rules provide sufficient flexibility for a range of strategies based on transferable securities to be held within UCITS, based on a strong and trusted investor protection framework. The IA cautions against making changes to the UCITS EAD that could have limited benefit and undermine international confidence in the UCITS brand.

<ESMA_QUESTION_EADC_25>