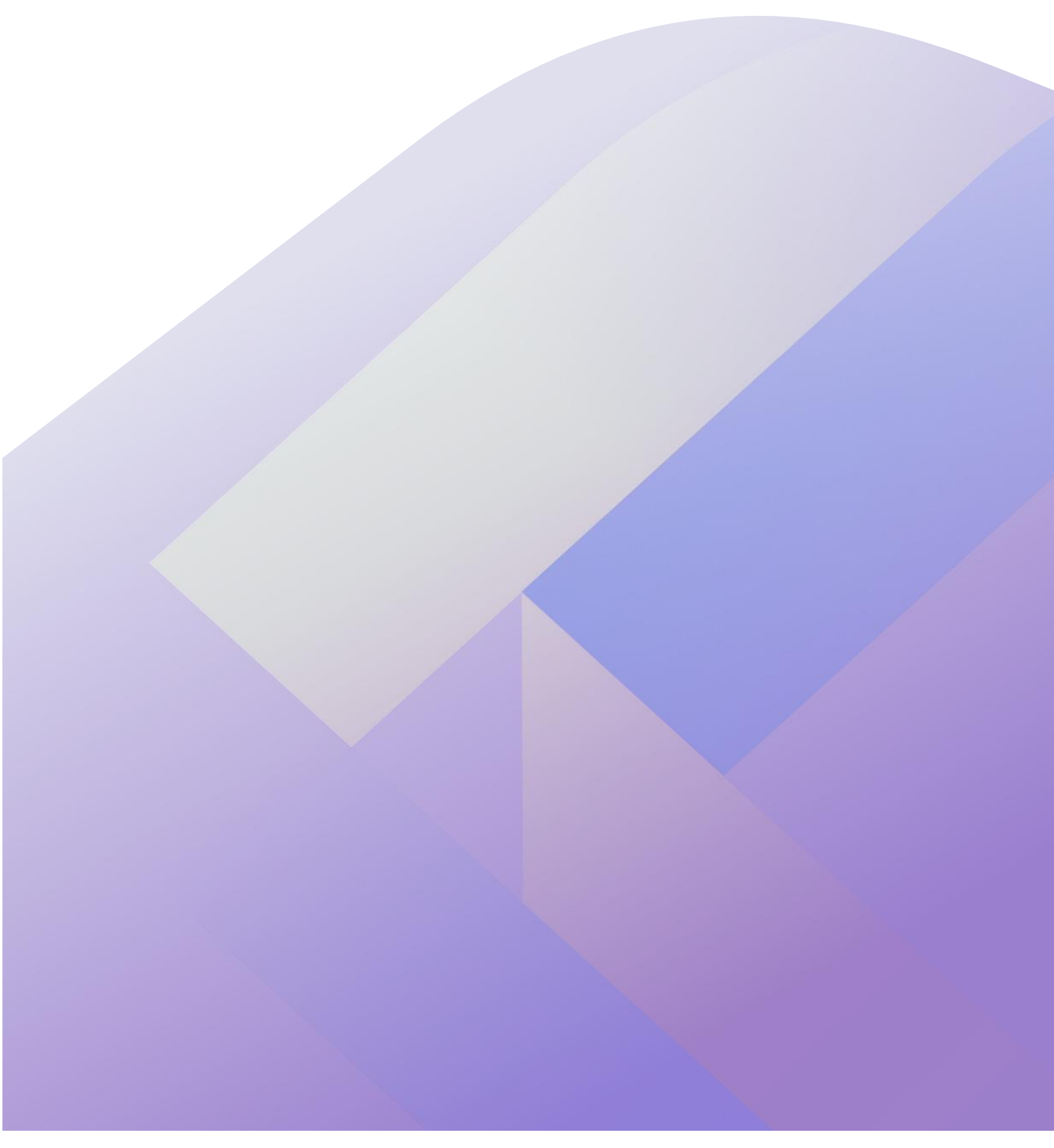


# Reply form

**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](#)'.

## **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	ICI Global
Activity	Asset management trade body
Country / Region	United States

## 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>

ICI Global<sup>1</sup> appreciates the opportunity to provide comments in response to the Call for Evidence from the European Securities and Markets Authority (ESMA) on the UCITS Eligible Assets Directive (UCITS EAD).<sup>2</sup> ICI Global members manage more than €5 trillion in assets in UCITS, and these UCITS pursue a myriad of investment strategies.

A thoughtful and robust regulatory framework has facilitated the growth of UCITS into a premier global investment vehicle, offered to retail and institutional investors throughout not only the European Union, but dozens of jurisdictions around the world. The strong reputation of the UCITS is built on the product being a well-diversified, tax efficient, liquid, and transparent collective investment vehicle.

Assets under management in UCITS have grown substantially over the past 25 years. As ESMA undertakes this review, we stress the importance of striking a balance between (1) preserving the existing framework for UCITS and its brand as a robustly-regulated retail product and (2) modernising the product to allow greater flexibility for investments into

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<sup>1</sup> [ICI Global](#) carries out the international work of the [Investment Company Institute](#), the leading association representing regulated investment funds. With total assets of \$45.0 trillion, ICI's membership includes mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and UCITS and similar funds offered to investors in Europe, Asia, and other jurisdictions. ICI's mission is to strengthen the foundation of the asset management industry for the ultimate benefit of the long-term individual investor. ICI Global has offices in Brussels, London, and Washington, DC.

<sup>2</sup> Commission Directive 2007/16/EC on UCITS eligible assets.

new and evolving instruments that have emerged since the enactment of the UCITS EAD. These instruments include, for example, direct and indirect exposures to delta-one derivatives, indirect exposure to digital assets, liquid fixed income instruments, commodities, loans, private equity and private credit, and other non-UCITS. Proper diversification between traditional and alternative assets, including a limited but balanced access to alternative investments can enhance returns and income, when accompanied by guardrails that ensure less volatility, and thorough due diligence processes.

Overall, what is crucial is allowing EU investors access to investment strategies and underlying assets that are adjusted to current market conditions and allow diversification in a way investors have globally in similar investment vehicles. This is important both in terms of maintaining the global success of the UCITS brand, and the overall competitiveness of the EU market. We believe that an updated approach is needed to align UCITS with contemporary investment needs that can leverage and draw from the experience of similar vehicles such as U.S. registered investment companies. Such vehicles provide investors with access to a broader range of investible assets, provided they comply with specific restrictions, including liquidity risk management criteria and thorough due diligence requirements.

We further recommend that efforts be made to create a framework that fosters consistent implementation and application of the UCITS EAD across Member States. Inconsistent implementation and application across Member States can lead to jurisdictional arbitrage, undermine the credibility of the UCITS brand, and create confusion among investors.

<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>

The rules for determining whether an index can be used by a UCITS in various ways are complex and impose a significant compliance burden. We recommend consideration of whether and how these rules can be simplified while addressing concerns regarding potential circumvention of the UCITS diversification and/or eligibility rules. A simpler

framework around index eligibility assessments would lighten the burden from an operational and compliance perspective and benefit investors.

The requirement to ensure that an index is “diversified” has posed challenges for certain UCITS management companies due to differing interpretations across Member States. Consistent interpretation across Member States would be beneficial. For example, most EU regulators allow indices to be considered diversified according to the “20/35 rule.”<sup>3</sup> Ireland and Germany, however, allow the use of the “5/10/40 rule”<sup>4</sup> for determining index diversification but permit the use of “20/35 rule” upon regulatory submission. Denmark has yet a different approach, only permitting investment in indices that are included in a list on its website. A consistent application of “diversification” permitting the use of the “20/35 rule” as the default position on a routine basis would eliminate the challenges and uncertainty created by disparate application.

We also note that the current verification provisions require each firm to individually determine whether an index is eligible as a UCITS investment. This results in every firm duplicating the same work. While we recognize that it may be legislatively challenging, we would favour the provision of a non-exhaustive list of indices that are accepted as diverse, with managers still being able to individually determine eligibility themselves.

<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.**

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<sup>3</sup> The “20/35 rule” means that index-tracking UCITS can invest up to 20% of assets into securities from the same issuer, with this limit being raised to 35% in exceptional market conditions.

<sup>4</sup> The “5/10/40” rule requires that no single asset can represent more than 10% of the fund's assets; holdings of more than 5% cannot in aggregate exceed 40% of the fund's assets.

In the context of eligibility in Ireland, if the UCITS can invest on a “look-through” basis in the constituents of the index (e.g. in accordance with the 5/10/40 rule) then no index certification filing is required. Alternatively, if the index is based on eligible assets but (i) it would not be possible for the UCITS to invest directly in such assets without the UCITS transgressing the diversification rules and (ii) no single constituent represents more than 20% of the index, then an index certification filing must be submitted to the Central Bank of Ireland.

<ESMA\_QUESTION\_EADC\_3>

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<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>

We note that investors may seek a mix of investments that allow them access to a broader range of investment opportunities, in particular in cases such as private equity, where market growth is an important source of capital formation and value-creation. Firms themselves are best placed to manage liquidity for their own products in accordance with investor needs and redemption parameters of these products. Liquidity is assessed in a multitude of ways across the entire portfolio and individual holdings.

Maintaining flexibility for firms to implement their own liquidity risk management processes within the UCITS legislative framework is important. Notably, liquidity management processes have recently been reinforced through ESMA's Common Supervisory Action on Liquidity Risk Management, ESMA's Stress Testing Guidelines, and the broader increased focus on liquidity management for UCITS and alternative investment funds. Certain national competent authorities (NCAs) have imposed limitations on asset classes such as contingent convertible capital instruments (CoCos) and collateralized loan obligations (CLOs), in part due to concerns with respect to the risk profile (including liquidity) of these instruments. We believe that the risk profile of these instruments can be adequately managed and that such arbitrary limits are not beneficial to end investors in UCITS.

<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 support retaining this presumption of liquidity, which forms only part of the overall liquidity risk management framework operated by UCITS management companies pursuant to the UCITS requirements. Firms operate detailed liquidity management frameworks to ensure that a UCITS can meet its redemption terms. Removing the presumption would have the effect of requiring a perfunctory analysis in situations where doing so adds little value. Additionally, UCITS are already required to evidence pre-trade liquidity analysis where appropriate after taking into account the nature of a foreseen investment. Rather than add prescriptive rules that may be impractical and have unintended consequences, the current framework with respect to the presumption of liquidity and negotiability should be retained.

<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 UCITS Directive does not currently define a set limit for ancillary liquid assets. As a result, this has given rise to national divergences among Member States. For example, ancillary liquid assets are understood in Luxembourg as including only bank deposits at sight, such as cash held in current accounts with a bank accessible at any time. The holding of ancillary liquid assets is limited to 20% of the net assets of the UCITS, which can be exceeded temporarily only when, due to exceptionally unfavourable market conditions, circumstances so require and where such breach is justified having regard to the interests of the investors. The Central Bank of Ireland, on the other hand, has a different interpretation of ancillary liquid assets. It has not imposed any limit on the amount of ancillary liquid assets that a UCITS may hold subject to the UCITS Directive limit of 20% of net assets in deposits with a single counterparty. Clarification (e.g. through Level 3 measures such as guidelines) on the definition of ancillary liquid assets, limits and use would reduce differing treatment among Member States. We believe that investors would benefit from firms having the flexibility to manage liquidity across differing market conditions, and therefore recommend the removal of national level limitations.

<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 believe that UCITS should be permitted to acquire or hold foreign currency for investment purposes, provided the risks are adequately disclosed to investors. This could bring benefits for investors, such as enhanced portfolio diversification and risk reduction. Such exposures can be monitored by firms pursuant to the existing UCITS investment limits. In any case, UCITS are permitted to invest in short-dated government debt denominated in any currency, thereby giving exposure to foreign currency for investment purposes which is managed through the normal risk management process of a firm.

<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>

Members have observed national divergences across Member States on the interpretation and 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. These divergences create challenges for management companies and inconsistency for investors.

In order to reflect regulatory developments that took place since the enactment of the UCITS EAD, we recommend clarifying (e.g., through Level 3 measures such as guidelines) that a regulated open-ended collective investment scheme that meets the criteria for constituting a transferable security but which does not fully comply with the requirements of Article 50(1)(e) of the UCITS Directive can be included within the 10% limit under Article 50(2)(a). This would allow a UCITS to invest in units/shares of other types of non-UCITS

funds that are subject to equivalent regulation at the product level and/or the management level. These regulated open-ended funds should be allowed to have exposure to non-UCITS eligible assets (e.g., commodities and digital assets). This permission also should include ETFs listed on regulated markets in the EU and the United States to allow UCITS more investment flexibility that can bring benefits to investors.

<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>

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<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>

We note that the interpretation of the phrase “risk to be adequately captured” is ambiguous, and additional guidance on this matter would be beneficial. In particular, the factors that need to be taken into account when investing in instruments that provide indirect exposure to UCITS eligible and non-eligible assets should be clarified, such as exposures obtained via delta-one instruments. Please see responses to Q21 and Q22.

<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>

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<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>

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<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 support harmonised interpretation of the treatment of delta-one instruments across Member States. In particular, and as noted in response to Q10, the situations in which the investment manager is required to conduct a look-through to assess the eligibility of the

underlying assets should be clearly defined. Further, we recommend that delta-one instruments that meet the definition of transferable securities be determined to be eligible for investment to allow a UCITS to take indirect exposures to non-eligible direct assets, including commodities, provided this is sufficiently disclosed to investors. All such investments would be subject to compliance with the detailed risk management framework operated by the manager of the UCITS.

Delta-one instruments with commodities as the underlying can offer three main benefits to portfolios: diversification, inflation protection, and return potential and therefore exposure to commodities through an exchange traded commodity (ETC) structure should be considered an important portfolio allocation over the long term for UCITS.

<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 would reiterate our comments made in response to Q8 above. In order to reflect regulatory developments that took place since the enactment of the UCITS EAD, we recommend clarifying that a regulated open-end collective investment scheme that does not fully comply with the requirements of Article 50(1)(e) of the UCITS Directive can be included within the 10% limit under Article 50(2)(a).

In addition, the requirement for closed-ended funds to meet certain corporate governance standards can limit investment in certain instruments. In contrast, UCITS can invest in preference shares in both fixed income and equity mandates, so this creates a slightly unlevel playing field by mandating that the manager must have the right to vote in relation to a closed-ended fund.

The above alterations would assist in ensuring investors in UCITS may obtain the same exposures as investors in other retail products.

<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>

Members have observed divergences across Member States on the interpretation and application of the rules on UCITS investments in EU and non-EU ETFs.

In order for a UCITS to purchase shares of a U.S. ETF, the U.S. ETF must qualify as an equivalent collective investment scheme, which includes (among other criteria) demonstrating that the ETF does not borrow more than 10% for emergency purposes or invest more than 10% of its assets in other funds (and for the latter condition to be specifically included in the constitutional document of the ETF). These conditions are particularly problematic for U.S. domiciled ETFs that are regulated under the Investment Company Act of 1940 (1940 Act), a highly regulated retail fund regime.<sup>5</sup> As a result, these conditions limit the universe of U.S. ETFs that a UCITS can invest in and, thus, potentially has an adverse impact on investors in terms of costs and performance. We suggest that UCITS, at the very least, be allowed to invest in U.S.-domiciled ETFs within the 10% limit under Article 50(2)(a) without having to qualify the ETF as an equivalent collective investment scheme.

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<sup>5</sup> By way of example, section 18(f)(3) of the Investment Company Act allows a U.S. ETF to borrow money from a bank in an amount not exceeding 33.3% of its total assets (including the amount borrowed) less liabilities (other than borrowings).

We recommend that ESMA take a further step to allow UCITS to invest in 1940 Act ETFs that qualify as equivalent collective investment schemes and be able to rely on a “comfort letter” from the US ETF provider that it will adhere to the relevant UCITS rules on this point (i.e. that the US ETF is a UCITS equivalent collective investment scheme and complies with relevant UCITS rules), rather than be required to provide explicit confirmation in the ETF’s organizational documents and prospectus. Such a pragmatic approach, which has been accepted by some, but not all, national regulators, would significantly reduce a UCITS’s operational and compliance burden.

<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>

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<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>

We would not see merit in linking or replacing the notion of EPM techniques set out in the UCITS Directive and UCITS EAD with the notion of the securities financing transaction (SFT) set out in SFTR because such fundamental change could lead to unintended

consequences (e.g. impact positions already taken in the absence of guidance) without commensurate benefit.

<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>

We welcome the efforts to promote consistency in the interpretation and application of the UCITS EAD across the EU. Clear and consistent definitions help ensure a level playing field and enhance investor protection across Member States. However, while we are supportive of consistency, we stress the importance of allowing flexibility to accommodate specific market conditions and practices in different EU jurisdictions. We suggest that ESMA consider a balanced approach that maintains core harmonization principles while permitting flexibility and discretion where necessary.

We acknowledge that ESMA has already addressed many of the critical areas requiring clarification and there does not seem to be need for immediate change to the UCITS Directive itself. Improvements and clarifications have also been made in recent Q&As and guidance issued by ESMA.

We recommend that ESMA maintain a continuous review and adaptation of definitions to keep pace with evolving market practices and financial innovations. One possible way to achieve this would be to enhance consultations with market participants to gather ongoing feedback and ensure the UCITS framework remains relevant and effective. We further recommend that, due to the complexity resulting from this matter being addressed in numerous directives and regulations, ESMA consider undertaking a mapping table of the provisions and/or FAQs to assist firms with compliance.

<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>

Currently there are no definitive regulatory policies available on whether crypto exchange traded notes (ETNs) are UCITS-eligible investments. Certain European regulators accept crypto ETNs as eligible assets while others seem to take a more restrictive view. The Federal Financial Supervisory Authority of Germany, BaFin, defined crypto ETNs to meet the definition of “transferable securities that do not embed a derivative” of the UCITS EAD. BaFin allows German UCITS to participate in the price performance of crypto assets indirectly via delta-one instruments.

With respect to bank loans that are secured loans distributed through syndication, there is a divergent approach among national authorities as regards their treatment, including as to whether they should be classified as money-market instruments or transferable securities. The CSSF announced in February 2020 that bank loans do not constitute eligible investments for UCITS due to concerns from a liquidity viewpoint. In other jurisdictions (such as Ireland), investment in bank loans is permitted up to 10% of NAV (within the 10% limit under Article 50(2)(a)), where such bank loans constitute money-market instruments.

<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>

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<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>

Members have noted that delta-one instruments with commodities as the underlying can offer three main benefits to portfolios: diversification, inflation protection, and return potential and therefore exposure to commodities through an ETC structure should be considered an important portfolio allocation over the long term for UCITS. Having the ability to invest indirectly in these instruments can provide a UCITS with optionality, cost reduction, risk reduction and operational simplicity.

More broadly, members have noted with respect to potential commodity exposure that cash-settled commodity derivatives are more liquid, have better use cases and are typically cheaper than ETCs.

<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 believe that a look-through approach should be required to determine the eligibility of assets (noting that a look-through requirement is already in place with respect to derivatives).

We note that commodity ETCs and delta-one instruments meet the definition of financial instruments under the UCITS EAD and are already a well-established asset class for many investors. These products are used extensively for diversification purposes and partly for more tactical positioning and inflation hedge. Markets in delta-one products are often very active and liquid with exchange-turn over and spreads being comparable to large cap equities. Liquidity is generally driven both by the liquidity of the underlying asset through the ETF like subscription and redemption model of these instruments as well as secondary liquidity directly on exchange.

In our view, permitting exposure to the above instruments as part of a firm's overall investment and risk management process would be beneficial to UCITS investors.

<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>

Given the utility of certain investments in providing diversification, hedging (e.g. commodities, real estate), and exposure to different asset classes, a look through on indirect holdings would not be beneficial. The way in which UCITS achieve exposures to these instruments occurs in a manner that avoids the typical liquidity issues associated with them (e.g., exposure to Real Estate Investment Trusts versus physical property). Mandating a look-through and thereby potentially rendering them as ineligible would be counterproductive.

UCITS continue to face challenges investing in securitisations issued by U.S. issuers, due to the requirements of the Securitisation Regulation. One particular issue with the Securitisation Regulation relates to the requirements on the completion of a detailed questionnaire for non-EU issuers. This creates an important hurdle for UCITS's access to this asset class, as many U.S. issuers are not seeking to comply with the regulation. This is particularly problematic in the commercial mortgage-backed securities sector and non-agency residential space. We understand that the securitisation regime overall, including the reporting templates, are to be reviewed and we consider a balanced approach should be taken allowing UCITS to participate in the full investable universe. We recommend that EU policymakers consider revisions to the Securitisation Regulation that achieve policymakers' goals while not unnecessarily limiting investment in securitisations issued by U.S. issuers.

<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>

While UCITS can obtain short exposures by using derivatives, the use of synthetic short positions can be a less efficient, more limiting and more expensive way to execute investment strategies. For “To Be Announced Securities” (TBAs), for example, when treated as transferable securities, there are potential limitations in obtaining short exposures, in certain jurisdictions. The intention of these trades is often not to speculate, but for example to reduce trading costs while retaining liquidity, so an inability to engage in such trades could be adverse to investors’ interests.

<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>

The clarifications and guidelines that ESMA has been providing have been beneficial in guiding market practices. We see no immediate need for changes to the UCITS Directive itself, given the extensive work already undertaken by ESMA to address key issues. However, we recommend that ESMA undertake an analysis of certain instruments that have originated post the enactment of the UCITS EAD, such as cryptoassets, to evaluate their appropriateness as eligible assets.

<ESMA\_QUESTION\_EADC\_25>

