.BVI

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BVI[1] position on the ESMA Call for Evidence on the review of the UCITS Eligible Assets Directive

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?

It is important and should be recognised that the UCITS project is a success story. The UCITS brand, as it stands, is recognised far beyond the EU borders. This is primarily due to its high investor protection standards and comprehensive legal framework which as a whole has proved very effective. The UCITS EAD has contributed to that success. Therefore, apart from perhaps marginal adjustments, the UCITS EAD is and should remain the basis for the success of UCITS for retail investors.

- **Preserving the successful UCITS model and developing it for the future:**

UCITS are a suitable investment vehicle for retail investors to gain access to a broad investment universe (different types of securities, asset classes, sectors, countries, regions) and, thus, offer the opportunity to participate in its performance. Access to assets can be direct (either as an explicitly permissible asset or as an "other" asset with limited exposure); indirect access to assets that are not explicitly eligible can also take place via UCITS if they fulfil the criteria for financial instruments or securities as defined by the EAD. Rather than regulating the eligibility of individual asset classes, the UCITS EAD took a principles-based approach and permitted exposure to asset classes that were not directly eligible for a UCITS provided that this exposure is conveyed through sufficiently liquid securities. This approach maintains flexibility and offers retail investors access and exposure to a wide array of asset classes (managed by licenced professionals) – all while maintaining the required liquidity for the UCITS.

As in the past, the future UCITS EAD should be principles-based and not aim to specify every single detail, which should rather be left to the discretion of the NCAs.

In order to accommodate for market as well as supervisory developments, a breathing legal framework is preferable. In contrast, if regulations are too rigid, they rarely meet all practical needs, or show their weaknesses in application (as we currently see, for example, in context of ESG-related regulations that face the challenge of accompanying the transformation process of the economy through the financial industry).

- **Recognition of recent development at UCITS Level 1:**

A review has just taken place at Level 1 of the UCITS Directive as part of the AIFMD review, which has further developed and concretised the existing and functioning principles, including

[1] BVI represents the interests of the German fund industry at national and international level. The association promotes sensible regulation of the fund business as well as fair competition vis-à-vis policy makers and regulators. Asset managers act as trustees in the sole interest of the investor and are subject to strict regulation. Funds match funding investors and the capital demands of companies and governments, thus fulfilling an important macro-economic function. BVI's 115 members manage assets of some EUR 4 trillion for retail investors, insurance companies, pension and retirement schemes, banks, churches and foundations. With a share of 27%, Germany represents the largest fund market in the EU. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit www.bvi.de/en.

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- New Article 18a UCITS Directive: new requirements for liquidity management
- New Article 20a UCITS Directive: new requirements for regular reporting obligations to the NCAs on the markets and instruments in which a UCITS invests
- New Article 84 UCITS Directive: For UCITS, NCAs are authorised to require an asset management company to suspend the issue or redemption of fund shares. The NCA of a Member State in which a UCITS is marketed may in future even require the NCA of the Member State in which the UCITS is domiciled to exercise this requirement towards the management company in case the stability of the financial system is at risk.

The relatively limited scope of the changes following from the review further underlines that the UCITS Directive (and, by extension, the UCITS EAD) already provide a robust and effective framework.

- **UCITS-inherent risk diversification reduces the risk of cluster risk investments:**

A broad investment spectrum enables better risk diversification and a reduction in the individual value risk for the investor. Diversification at product and investor levels avoids risks from direct acquisition (cluster risk). The broader and more diverse the investment universe, the greater the possibility of combining different assets and reducing the overall risk in a retail product. Even where UCITS provide exposure to other asset classes, this must be through liquid securities. It is crucial that the UCITS' ability to fulfil investors' redemption requests at all times is not impaired.

- **Maintaining opportunities for cost efficiencies:**

Practical and cost-efficient rules for structuring multi-asset exposures (e.g., allowing indirect investments in, e.g., precious metals, oil and other commodities indices, vs. (currently non-permitted) direct investments) result not only in a well risk-diversified portfolio but also in lower costs for investors.

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.

In our opinion, the existing UCITS EAD has proven to be suitable. Fund management and market operations are running smoothly, with the existing NCAs' practices serving as a reliable guidance.

In Germany, BaFin reacted early in the wake of the financial crisis with workshops in 2008 to discuss practical and legal interpretation issues together with the industry. As a result, it published FAQs in 2013, the revised version of which is also based on ESMA's requirements in the guidelines on ETFs and other UCITS issues. The guidelines and recommendations previously issued by CESR as ESMA's predecessor authority (such as CESR guidelines on eligible assets, CESR Guidelines on the classification of hedge fund indices as financial indices, CESR Advice on eligible assets) and the Commission recommendation of 27 April 2004 on the use of financial derivative instruments for UCITS provided a good basis for preparation and interpretation.

With regard to the current practice concerning indices, we refer to questions 5, 7 and 23 of the BaFin FAQ on eligible assets.

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.

We see no need for further clarification. Here, too, BaFin set out recommendations for interpretation in its FAQ on eligible assets at an early stage (see question 16 of the BaFin FAQ).

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.

In our opinion, the regulatory requirements are sufficient and do not need to be adapted. Where difficulties have arisen in individual cases, these are more likely to be due to operational deficits.

The monitoring of liquidity (and its risk) in UCITS has become increasingly important in practice and in the UCITS legal framework. It has therefore been necessary in recent years to systematically measure and document the liquidity risks of UCITS and other open-ended funds on an ongoing basis and to monitor their cash flows. This prompted the BVI to develop solutions for assessing liquidity risks with a working group back in 2010. As a result, the working group has established guidelines which also contain practical interpretation aids as to when eligible assets can be valued as liquid assets. According to the definition of liquidity risk in Article 3(8) of the UCITS Implementing Directive 2010/43/EU, the key factor is whether a position in the fund portfolio cannot be sold, liquidated, or closed at limited cost in an adequately short time frame. As market liquidity is constantly changing, it is advisable to continuously monitor the assessment of which assets are considered liquid. These processes must be practicable and must not be restricted by overly narrow definitions. In all cases it has to be ensured that the UCITS is able to fulfil its obligations as regards portfolio liquidity, as resulting from Article 84 of the UCITS Directive.

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.

In our opinion, the regulatory requirements are sufficient. A Common Supervisory Action (CSA) with NCAs is an appropriate instrument for identifying any weaknesses in practice and for fulfilling ESMA's mandate to take an active role in building a common supervisory culture among NCAs and promote sound, efficient, and consistent supervision throughout the EU. The 2020 ESMA CSA on UCITS liquidity risk management was overall satisfactory, with ESMA identifying only a few cases of significant liquidity risks or cases in certain key areas such as documentation or governance processes. These requirements are already comprehensively covered in the UCITS regulations. We note that ESMA has clarified in its UCITS Q&As that a management company must satisfy itself that the presumption of liquidity at least for MTF-traded securities is well-founded. This already undermined the general presumption of liquidity and has imposed obligations on the management companies that no longer can simply rely on that presumption. Against this background, we see no need for further measures. Rather, it is the task of the NCAs to following up with market participants to address the supervisory findings identified in the context of the CSA or as part of their supervisory activities.

Irrespective of this, an improvement to the CSA could be to create more transparency about the specific EU member states in which there are shortcomings and those in which the processes are running well. An evaluation at country level would therefore be welcome.

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.

Please note that the issue of "ancillary liquid assets" has not been transposed into German law. Generally, German law only transposes the UCITS requirements on bank deposits and does not differentiate further between bank deposits as such and ancillary liquid assets.

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.

We believe that this issue should rather be dealt with at Level 1 and not within the EAD. We note that neither Level 1 nor the German transposition currently prohibit or restrict investments into currencies for investment (or any other) purposes, provided these are held as an eligible asset (e.g. through bank deposits, MMF, ETP or derivatives).

However, already today, asset managers handle the devaluation/depreciation of currencies for investment (or any other) purposes, for instance when they invest in assets that are not denominated in the funds base currency. Asset managers are able to handle such currency risk through bank deposits, MMF, ETP or OTC derivatives. Please note that the base currency of UCITS funds or share classes is not always EUR, i.e. from a fund perspective the definition of a "foreign currency" depends on the funds base currency. We do not see any impediments to handle the same risk arising from the holding of foreign exchange. Therefore, UCITS should be allowed to hold foreign currencies for investment purposes.

According to the BaFin FAQ (Question 8), currency-hedged 1:1 certificates (quanto certificates, Quantity Adjusted Option) or capital-guaranteed certificates with a participation level = 100 per cent are regarded as securities if they fulfil the criteria set out in Article 2(2)(c) of Directive 2007/16/EC. Quanto is not an asset class in its own, but a name suffix for currency-hedged products of all kinds. Naturally, quanto certificates relate to underlyings such as shares, indices or commodities whose prices are not quoted in euros. A quanto certificate therefore eliminates any currency fluctuations. In contrast, capital-guaranteed certificates with a participation level ≠ 100 per cent are to be classified as financial instruments with a derivative component.

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.

In our opinion, the requirements are sufficiently clear and we would not expect any changes to this limit. We note in this context that the ESMA Opinion concerning Article 50(2)(a) of Directive 2009/65/EC has clearly prohibited UCITS from holding units in other (otherwise ineligible) collective investment schemes within that quota.

We believe that, given the changed European landscape for collective investment schemes, the position of the European Commission could be refined and open-ended collective investment schemes that do not meet the criteria of the requirements of Article 50(1)(e) of the UCITS Directive could be included within the 10% limit under Article 50(2)(a). This extension should in particular include funds which are subject to strict regulation at management level, such as EU AIFs, or specific regulation at product level, such as ELTIFs/EuSEF/EuVECA.

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.

In our opinion, the existing criteria have proven suitable.

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.

In our opinion, the existing criteria have proven to be suitable and therefore do not need to be adjusted. The German legislator has further specified the requirements for the valuation of assets in a separate regulation (cf. paragraphs 26 et seq. Kapitalanlage-Rechnungslegungs- und -Bewertungsverordnung, KARBV).

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.

In our opinion, the existing criteria have proven suitable. It is worth noting though that – as shown by this call for evidence – there is currently not a level playing field across Europe in the application of this. German administrative practice (in our view: correctly) applies 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 to permit investments in delta-one certificates regardless of the underlying. This is why German UCITS can invest into delta-one notes (e.g. referencing to precious metals). Certain EEA member states follow that approach, while others are applying a much narrower application. We believe that the German position that permits investments into securities agnostic of their underlying complies with the spirit of the UCITS EAD and offers an important contribution to ensuring a healthy asset diversification for UCITS funds. We would appreciate a more harmonised approach based on this understanding across Europe. In this respect we also refer to our response to Q13.

With regard to commodities and precious metals, it should be clarified that delta-one instruments may refer to the futures prices of these underlyings.

It is also worth noting that delta-one investments are often also used to provide exposure to eligible investments, e.g. in cases where these are simpler to structure for basket investments and others.

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.

Article 10 in connection with Article 2(3) of the UCITS EAD clearly describe the concept and requirements.

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.

In general, the use of delta-one instruments generates a cost-efficient way for structuring multi-asset exposures in UCITS (e.g., allowing indirect investments in, e.g., precious metals, oil and other commodities indices, vs. (currently non-permitted) direct investments), which not only improves the risk-diversification of portfolios but also results in lower costs for investors compared to an even riskier, non-diversified direct investment in, e.g., commodities.

Indirect exposure via delta-one instruments additionally offers benefits of an institutional-grade product due diligence and the benefits of liquidity, transparency and overall efficiency of ETP investments. First, allowing UCITS fund managers to invest into delta-one products ensures an institutional due diligence of the product structure, assessing the legal, operational and service provider setup. Such institutional product research due diligence must also take into account particularities of the underlying, such as specific custody requirements. Thus, allowing indirect exposure ensures an institutional product due diligence, which is likely to be significantly more detailed than any due diligence that retail investors may perform prior to directly investing in such products. Second, delta-one instruments in the form of ETP investments offer the typical inherent structural benefits of liquidity and transparency, increasing the overall efficiency of the investment. Such delta-one instruments are typically issued by SPVs that may or may not purchase the underlying investments to hedge their risk. Given the limited commercial activities and the typical legal documentation of these SPVs, the underlying assets will be available as – formal or informal – collateral to secure the liabilities vis-à-vis the investors, including UCITS funds. This effectively limits the risk of the investing UCITS funds.

Delta-one instruments have to fulfil the criteria for financial instruments / securities as defined by the EAD. The eligibility assessment of structured financial instruments (with or without an embedded derivative) is governed by Article 2(2)(c)(3) in conjunction with Article 10 of the EAD. The latter article sets forth a three-prong test to identify if a structured financial instrument contains an "embedded derivative". Article 10(1)(a) EAD requires that the "cash flow" of a host contract is "modified".

In this respect, the German investment funds industry follows the criteria in BaFin's eligible assets FAQ (cf. questions 1, 3, 4, 7, 12):

https://www.bafin.de/SharedDocs/Veroeffentlichungen/DE/Auslegungsentscheidung/WA/ae_130722_fragen_ea.html

BaFin prescribes that for delta-one instruments (i.e., the instrument's performance is one-to-one linked to the performance of the underlying which means that the "cash flow" of the host contract is **not** modified) no look-through is required for eligibility reasons.

In our opinion, BaFin's administrative practice balances opportunities and risks, has proven to be effective and was carefully established.

All in all, in order to harmonise the diverging interpretations on the treatment of delta-one instruments across the European Union, we believe it is advisable to apply the current German administrative practice across all EU Member States. This proposal generally enables UCITS fund managers to profit from diversification benefits and provides flexibility, while ensuring investor protection and consistent and clear implementation across all EU Member States.

Conversely, we would firmly oppose any change in supervisory practice suggested by a revised EAD that would entail restrictions or would lead to relevant changes in the portfolio composition of German UCITS and which would lead to detrimental effects for retail investors (riskier, non-diversified direct investment instead of access to risk-diversification of portfolios and with lower costs for investors).

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.

In our opinion, in general the existing rules on UCITS investments in other UCITS and AIFs have proven suitable. However, given the greater level of standardisation for AIF, including through the AIFMD and the introduction of the ELTIF, it might be worth to establish more clarity regarding the equivalence of the level of protection pursuant to Article 50(1)(e)(i) UCITS Directive.. Further, we propose to reconsider the relationship between Article 50(1)(e) UCITS Directive and Article 2(2)(a) and (b) UCITS EAD.

We note that the UCITS EAD allows a UCITS to invest in closed ended-funds, e.g. venture capital vehicles from non-EU jurisdictions (subject to certain requirements), while investments in some open-ended funds are currently not possible.

We agree that the reference in the EAD to 'closed-ended funds' is outdated, not only taking into account Article 1 of Delegated Regulation (EU) No. 694/2014 which uses the term 'closed-ended AIF', but also from a regulatory perspective.

From our point of view, if a collective investment undertaking (CIU) does not meet the criteria of Article 50(1)(e) UCITS Directive, an UCITS should still be able to invest in a CIU provided this CIU, whether open or close ended, meets the criteria of a transferable security pursuant to Article 2(2)(a) and (b) UCITS EAD. Therefore, these CIU should be explicitly classified as an eligible investment within the 10% limit of Article 50(2)(a) UCITS Directive.

Consequently, Article 2(2) UCITS EAD should be revised by replacing the term 'closed-ended funds' with 'collective investment undertakings which do not fulfil the criteria of Article 50(1)(e) Directive 2009/65/EC'.

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.

We did not identify any pressing issue in this respect.

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.

Peer Review on the ESMA Guidelines on ETFs and other UCITS issues: As stated multiple times and with regard to various legislative procedures (e.g. EMIR, SFTR, UCITS Directive), we would like to take the opportunity to strongly reiterate that UCITS have substantial difficulties to provide cash collateral in cases of centrally and bilaterally cleared OTC derivative transactions under EMIR. The ESMA Guidelines on ETFs and other UCITS issues restrict the re-use of cash obtained from UCITS repo transactions for such purpose. In practice, paragraph 43 letter (j) of the Guidelines hampers UCITS' ability to access CCP clearing. The mentioned guideline considers the obtained purchase price under a repurchase agreement as collateral. Such artificial construct (e.g. the purchase price) breaches with EU law as it creates a new legal obligation on the level of an ESA guideline rather than interpreting existing rules. It is also in contrast to any and all known master agreements worldwide. The consequence of the artificial re-classification of a purchase price to collateral is a very restrictive prohibition. The mentioned guideline restricts the use of collateral. In particular, it prohibits posting the purchase prices (e.g. cash) received in a repo transaction as collateral to a CCP, respectively the clearing member. Since UCITS' borrowing is restricted to 10% of the net asset value (NAV), it is obvious that UCITS will be hampered to use OTC derivatives subject to a clearing obligation. Therefore, UCITS are forced to generate liquidity by switching from physical into synthetic investments. This generates additional costs which have to be borne by the investors without creating any regulatory benefit. Therefore, we encourage ESMA to amend paragraph 43 letter (j) of the Guidelines in order to clarify that the purchase price should not be considered under a repurchase agreement as collateral. The EU Commission should also clarify this in EMIR in order to overrule ESMA. Functioning EU Capital markets and access to liquidity during a financial crisis should be prioritised over legal interpretations.

CSA on costs and fees: The discussions regarding the design of securities lending fees are more complex than a simple comparison of individual funds and their income and cost allocations would suggest.

For a serious, thorough analysis, both the type of securities (i.e., extremely liquid vs. niche stocks) and the volume of the individual transactions should be taken into account. In addition, we believe that it cannot be productive to tempt fund managers to outsource securities lending in order to be able to allocate lending fees as third-party costs.

Instead, UCITS EAD should explicitly allow for a fee-split with respect to EPM related issues. UCITS management companies, irrespective of whether the activity is outsourced to a third-party or performed

by the management company itself, should be allowed to deduct a fair market rate fee (including a margin) for the initiation, preparation and execution of securities lending transactions of the gross revenues generated by these transactions. It should further be provided that all direct and indirect costs must be borne by the management company out of its portion of the fee-split. Such a fee-split provides the most clarity to investors of what portion of the generated fees the UCITS will receive. It should also be noted that many cost elements such as collateral management and custody, as well as the operational and financial risk borne by the investment manager related to EPM increases with increases volume. As the basis for the fee-split are the gross revenues, there is no risk that any hidden revenues will be deducted. Further, investors can easily compare UCITS which apply such a fee-split.

Based on the key points mentioned in the reports, ESMA is concerned about exemptions from collateralisation, hidden fees, and unfair market rates. In order to address these concerns, we propose to distinguish between two cases:

(i) when a management company conducts securities lending transactions with its own lending desk, and
(ii) when the management company outsources these transactions to an agent lender.

In case (i), the management company incurs costs associated with securities lending, such as wages, systems maintenance and development, membership fees, etc. In case (ii), the management company faces third-party costs, particularly the fees charged by the agent lender for its services.

Both cases involve costs that are subject to change, such as increasing wages or fees. However, there are differences between the two. In case (i), management companies have the flexibility to adjust and expand their systems, such as onboarding multiple tri-party agents, connecting to clearing platforms, or renegotiating agreements. On the other hand, in case (ii), management companies have limited control over the infrastructure of securities lending and heavily rely on the services provided by the agent lender. Switching to a different agent lender may pose challenges, as it requires establishing new connections, negotiating agreements, and potentially interrupting securities lending operations.

It is important to note that the lending fee obtained from securities lending transactions depends on the infrastructure built by the lender or agent lender and their trading experience. Lower infrastructure costs often result in lower lending fees and vice versa. ESMA acknowledges this correlation in its discussion on costs and fees. However, ESMA is concerned that management companies may not consider competitors offering similar quality services at better rates due to a lack of review and adjustment of fees.
We understand these concerns but believe that it would be difficult for management companies to conduct a comprehensive review due to the following reasons:

1. Lack of Information: Management companies do not have access to the internal securities lending infrastructure and trading experience of other companies or agent lenders. This information is considered proprietary and there is no way to determine which companies or lenders offer similar quality services.
2. Difficulty in Comparisons: Even if a comparison were possible, it would have to be highly granular, considering various factors such as asset class, region, rating, maturity, liquidity, and volume. Data on lending fees of competitors or agent lenders is not available to management companies.
3. Volume Dependency: Lending fees also depend on the volume of securities lent. If borrowers need to conduct multiple transactions with different lenders to obtain the necessary securities, it increases their operational efforts and costs. Higher volume concentration with a single lender

reduces operational efforts and costs for borrowers, leading to a willingness to pay higher lending fees. Management companies cannot determine the quality level achieved by other companies or lenders if they do not know whether higher lending fees are the result of higher volume or other factors.
4. Borrower Quality: Lending fees also vary depending on the quality of the borrower.

Considering these challenges, it is not feasible to conduct a review as mentioned in ESMA's discussion on costs and fees.

Focusing solely on fees without considering the quality of service may lead to management companies replacing higher-fee agent lenders with lower-fee ones, potentially reducing the gains from securities lending for investors. Example: it does not make sense to compare solely the fee, billed to the UCITS by the rate (e.g. 15% of the lending fee versus 30% of the lending fee) because, if lending agent "A" offers its services for 15% of the lending fee but only achieves 4 bps for lending a bond while the management company "B" charges 30% of the lending fee but achieves 16 bps for lending a bond, the investors do benefit more, where the fee is higher. In the given example, A would be much "cheaper" but investors would only receive 3.4 bps compared to 11.2 bps achieved by involving B. We do not see that investors are overcharged in that case.

Therefore, we believe that the approach taken by BaFin, and potentially applicable across the EU, offers a viable solution. Management companies can choose between a fixed fee rate (with self-borne costs of securities lending infrastructure) or reimbursement of costs incurred when an agent lender is involved.

We believe that the fixed fee rate proposed by BaFin provides an incentive for management companies to improve their securities lending infrastructure. This improvement would result in higher lending fees, benefiting both the companies and investors. If management companies do not see any additional income from improving their services, they would not consider making the necessary investments. Undertaking securities lending is always beneficial for investors, but it requires investments in trading infrastructure to increase lending fee rates and volumes.

When referring to the approach supported by BaFin, we avoid using the term "fee-split" because we believe that its meaning could be misunderstood:

ESMA's final Report on the 2021 CSA on costs and fees (ESMA34-45-1673) from May 21, 2022 refers to "fee splits" (page 13). According to Article 22(3)(d) of the UCITS Directive (respectively Article 32(3)(b), a depository shall ensure that in transactions involving a common fund's assets any consideration is remitted to it within the usual time limits. Against that background it is our understanding that 100% of the lending fee forms part of the UCITS (no split). The management company would claim its (fix) fees afterwards and it is within the responsibility of the depository to effect the payment of these fees from the UCITS assets. However it might be the case that an interpretation of ESMA's guidelines on ETFs and other UCITS issues (ESMA/2014/937) and in particular para. 29 have opened the possibility to deduct fees from EPM income before any such income has been received by the depository ("All the revenues arising from efficient portfolio management techniques, net of direct and indirect operational costs, should be returned to the UCITS."), which would be a split of fees before they are received by the investors. The term "fee split" used by ESMA would support the latter. We believe that any hidden costs could be avoided when it is ensured that lending fees must be paid in full onto an account maintained at the depository before effecting the payment of any costs or (fix) fees claimed by the management company or the agent lender from that resource.

Regarding the exemption from collateralisation mentioned in the peer review, we propose supplementing the UCITS EAD with a regulatory basis for voluntary central clearing of efficient portfolio management (EPM) activities.

The German approach, referred to by ESMA (§ 202 of the German Investment Code), may not be sufficient as clearing is typically offered by exchanges through a central counterparty, not by central securities depositories. In order to enable voluntary clearing of EPM, UCITS should have the flexibility to deviate from regulatory restrictions, such as the way collateral is to be provided (pledge/full title) or limitations on securities lending transactions with the same counterparty. UCITS EAD should provide a general framework for such deviations to facilitate access to clearing via an exchange.

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?

We do not see a merit in linking or replacing the notion of EPM techniques with the notion of securities financing transactions set out in the SFTR as this would limit EPM techniques to SFTs. There is the risk that techniques developed in the future would not fall under such definition. Repos, reverse-repos and securities lending transactions are EPM techniques and SFTs. However, any link to SFTR may result in unintended effects in case of an amendment of SFTR. It is our understanding that EPM include a wider range of instruments compared to SFTs; see CESR/06-005, Advice, p. 38, Box 10, No. 3):

> *"Based on the above-mentioned criteria, techniques and instruments relating to transferable securities and money market instruments include, but are not limited to, collateral under the provisions of Directive 2002/47/EC on financial collateral arrangements, repurchase agreements, guarantees received, and securities lending and securities borrowing."*

Hence, replacing the notion of EPM by SFT could create misinterpretations in case of alignments through a linkage between EPM and SFT.

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.

No. We do not see 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.

The agreed EMIR 3.0 package includes also an amendment to the UCITS Directive, notably lifting the existing counterparty limits if OTC derivatives are cleared through an EUCCP. Central clearing arrangements reduce the counterparty risk that is inherent to derivative contracts.

However, the current UCITS regime further discourages central clearing with respect to the counterparty limits for securities financing transactions (SFT), e.g. repo and reverse repo transactions. In order to ensure consistency between the recent changes in the UCITS framework for exempting centrally cleared OTC derivative transactions from the counterparty limits, we strongly suggest to also exclude centrally cleared SFT transactions from the current counterparty limits (Article 52(2) UCITS Directive). This will encourage more usage of central clearing for the buy-side without restricting the use of the bilateral markets. Central clearing of SFT transactions minimises also the counterparty risk, thereby contributing to more financial stability within the EU. More central clearing for SFTs could make the EU more attractive as the Securities and Exchange Commission (SEC) has approved a final rule requiring firms to begin central clearing eligible trades in Treasury securities by the end of 2025 and repurchase agreement (repo) transactions by June 2026.

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.

Yes, § 200 para 1 German Investment Code includes a prohibition to conclude securities lending transactions of more than 10 percent of NAV of the respective UCITS with the identical counterparty. The scope of this requirement is wide and captures both the clearing member and the CCP of an exchange. This limits the ability to access the full advantage of clearing.

In order to improve the effectiveness and efficiency of clearing infrastructure we propose to clarify that access to clearing of EPM should not be hampered by national regulation.

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.

We understand that direct exposure refers to directly held assets by the UCITS. We further understand that indirect exposure refers in particular to exposure through, e.g., derivatives, certificates and indices. We believe that the question of eligibility of delta-one instruments should not be regularised on the basis of the underlying asset class. Rather, the decisive criterion needs to be whether the delta-one instrument as such qualifies as an eligible security per the UCITS EAD, regardless of the underlying exposure.

See Annex to Q20 below.

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.

The main advantages are operational ease and regulatory security, reducing costs and risks borne by UCITS investors. First, UCITS asset managers may not have the necessary expertise to operationally enabling direct investments and or doing so would require many resources (e.g., setting up custody for carbon allowances (union registry account), crypto assets (crypto asset custody account), precious metals) or access the liquidity venues for these assets. Issuer risk resulting from the SPV structure can generally be mitigated through collateral and/or appropriate contractual documentation. UCITS asset managers must of course still perform detailed due diligence on the indirect access vehicles they invest in and confirm adequateness of the product setup (e.g., custody), which however is less burdensome than in case of a direct investment. Second, ETCs are a regulated well-established transparent security form typically held within a regulated Central Securities Depository. ETCs are traded on regulated exchanges throughout the day and offer increased liquidity over the physical market.

Derivatives are in the interest of investors as well because in many cases, it would be more cost efficient (e.g. no management fee, tighter bid-ask-spreads) than the current repackaging into investable ETN via an investment bank.

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.

We would like to point out that the possibility to invest into asset classes that are otherwise ineligible for an UCITS is not a circumvention but has been introduced through the UCITS EAD that clearly permits investments into transferable securities that are backed by, or linked to the performance of, other assets which may differ from those referred to in UCITS Level 1. Framing the question to indicate a “circumvention” of UCITS Level 1 Directive does not seem to consider the express permissibility of such investments. Investments through delta-one instruments are instrumental in ensuring a broad asset mix in UCITS and help with diversification.

In this respect, we refer to the existing practices and considerations of BaFin in its FAQ on eligible assets. For example (question 14 of the FAQ), for units in closed-end funds that fulfil the criteria set out in Article 2(2)(a) and (b) of Directive 2007/16/EC and can therefore be acquired as securities, the obligation to look through for clarification of acquisition eligibility does not apply in principle. The assets in which the closed-end fund invests do not have to be among the assets that can be acquired by UCITS. Any investments of the closed-end funds in derivatives do not result in the units in the closed-end funds being categorised as structured products with a derivative component within the meaning of Directive 2007/16/EC. Irrespective of this, in accordance with Article 2(1)(g) of Directive 2007/16/EC, risk management must be able to adequately reflect the risks.

See also our answer to question 13.

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.

Diversification: ABS invest in a broad range of assets (typically for ABS/RMBS: >1,000, for CLO: 100-400) across various industries and geographies. Adding ABSs to a fund's investment universe expands its exposure to non-traditional credits, sectors, and regions, helping to reduce concentration risk and potentially enhance risk-adjusted returns.

Tranching: ABS are structured with different tranches of varying risk profiles. These tranches allow investors to choose their preferred level of risk exposure. UCITS can invest in tranches that align with their risk appetite, allowing for better risk management and the potential to optimise the risk-reward tradeoff within the portfolio.

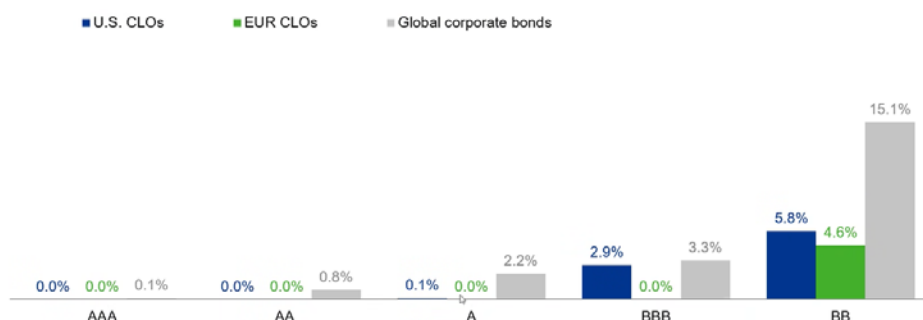
Liquidity: ABS can offer an enhanced liquidity comparable to corporate bonds with corresponding ratings.

Past Performance: Securitisations like ABS and CLO have a much lower default rates than corporate bonds with comparable ratings over the last 25 years. Reasons are additional credit support through tranching and secured nature of loans.

In case of “BB” historical default rates of 5.8% for U.S. CLOs and 4.6% for EUR CLOs compared to 15.1 % for global corporate bonds (example: 10-year default rates, 1983-2019, sources: Barclays and Moody’s, 2021) show the structural benefits of collateralisation with CLOs.

Historical default rates show the structural benefits of collateralisation with CLOs

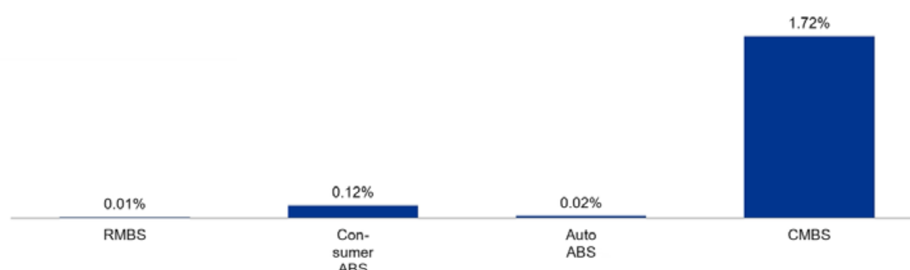
Cumulative 10-year default rates*, weighted by number



* Corporate bonds: average rolling cumulative 10-year default rates, 1983–2019; CLOs: average rolling cumulative 10-year rate for payment defaults, 1993–2019.
Sources: Barclays, Moodys, January 2021.

Global securitisations show a high level of stability

Cumulative loss rates of European ABS
(issuances 2000 to 2016)



As of September 2017
Source: Fitch, Moody's

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.

By employing short positions, fund managers can also generate positive returns during market phases characterised by declining or volatile markets. Compared to long-only strategies where fund managers bet only on rising prices, the ability to bet both on rising and falling prices offers greater flexibility and can hedge against portfolio losses.

The additional advantages include risk neutralisation and improved risk-return profile. Short positions can help neutralise specific risks and achieve market direction neutrality, reducing portfolio volatility and potential risks. Moreover, through selectively building short positions, the risk-return profile of the fund can be improved. The ability to profit from both rising and falling prices provides more opportunities for positive returns, while short positions can also limit loss potential and enhance the resilience of the portfolio against market disruptions. Further, through short positions it is possible to mitigate risks that are less obvious, e.g. by economically hedging foreign currency exposures in opaque target funds or similar financial risks contained in eligible instruments. These practices require careful risk management.

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.

1) “tokenised” traditional financial instruments

It should be clarified that “tokenised” traditional financial instruments, such as fixed income instruments, are also eligible assets for UCITS. Article 18 of the DLT Pilot Regime Regulation (EU) 2022/858 introduced a similar clarification in the MiFID context. Article 4(1)(15) MiFID reads as follows:

'f*inancial instrument' means those instruments specified in Section C of Annex I, including such instruments issued by means of distributed ledger technology."*

2) Collateralisation requirements

According to German law (§ 200 para 3 German Investment Code), securities lending transactions must be fully collateralised at any time. On top, over-collateralisation is required. The security value is determined from the market value of the securities to be transferred as a securities loan and the associated income. The German legislation is consistent with the international applied concept of collateralisation which is also basis of the GMSLA (Global Master Securities Lending Agreement), an international standard master agreement governing securities lending transactions, see ISLA, GMSLA, 5.4 (a), p. 11).

> *"(a) the aggregate Market Value of the Collateral delivered to or deposited with Lender (excluding any Equivalent Collateral repaid or delivered under paragraphs 5.4(b) or 5.5(b) (as the case may be)) (Posted Collateral) in respect of all Loans outstanding under this Agreement shall equal the aggregate of the Market Value of Securities equivalent to the Loaned Securities and the applicable Margin (the Required Collateral Value) in respect of such Loans;"*

On top, any decrease of collateral below the real value of the securities lent is to be reported immediately to the German NCA, including the reasons for the decrease (§ 200 para 4 German Investment Code). This approach has proven as robust in practice and corresponds to international market practice.

However, ESMA has created requirements laid down in ESMA's guidelines on ETFs and other UCITS issues (ESMA/2014/937), under which the over-collateralisation of securities loan transactions is achieved via a haircut on the collateral received (a concept which is common for derivatives, but not so much for securities lending transactions). That means that collateral received is deemed to have a lower value. This has been "ratified" into German law in parallel to the German regulatory requirements by amending the German Derivative Regulation which is also applicable on securities lending transactions, § 27 para 6 Derivative Regulation.

Consequently, German UCITS have to comply simultaneously with two different methods of calculating the collateral required.

Whenever master agreements for securities lending transactions are negotiated, counterparties (borrowers) wonder about the complexity created by that overlapping approach as the approach of the German Regulation is based on the Global Master Securities Lending Agreement (GMSLA) and hence, reflecting the international market standard, and on top of the compulsory framework by ESMA.

We propose to align the ESMA and/or UCITS EAD approach accordingly with the GMSLA to reduce regulatory complexity and support the effectiveness and competitiveness of EU-Asset Management Industry or alternatively to allow market participants to choose between the two approaches.

Annex to Q20

Asset class	Merits of allowing direct UCITS exposures	Merits of allowing *indirect* UCITS exposures	Extent/amount of existing UCITS exposures	Additional comments
1. Loans	Diversification of issuer types versus standard bonds, offering a complement to traditional credit exposure. Accessing an established market, in line with US 40-Act rules for standardised loans especially senior/leveraged loans. Diversification of different types of credit exposure, e.g. senior secured. Investing in large floating rate market (1,400 bn USD-market, 300 bn EUR-market)	ABS, e.g. CLOs Regulatory Support: There is a high regulatory protection standard: AIFMD Level 2 and Regulation (EU) 2017/2402 contain a 5% risk retention requirement and risk transparency requirements. Diversification: CLOs invest in a broad range of loans (100-400) across various industries and geographies. Adding CLOs to a fund's investment universe expands its exposure to non-traditional credits, sectors, and regions, helping to reduce concentration risk and potentially enhance risk-adjusted returns. Tranching: CLOs are structured with different tranches of varying risk profiles. These tranches allow investors to choose their preferred level of risk exposure. UCITS can invest in tranches that align with their risk appetite, allowing for better		Traditionally, as loans are not *stricto sensu* “transferable securities”, the fit to UCITS was technically limited. It is however possible to revert the *status quo*, as e.g., deposits with financial institutions, which are not transferable securities, are allowed, loans not yet. Asset managers should be in a position to develop market understanding and risk assessment approaches (incl. transferability and liquidity) regarding the selection of loans.

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		risk management and the potential to optimise the risk-reward tradeoff within the portfolio. Enhanced Liquidity: CLOs can offer a degree of liquidity comparable to corporate bonds with corresponding rating. Past Performance: ABS/CLO have a much lower default rates than corporate bonds with comparable ratings over the last 25 years. Reasons are additional credit support through tranching and secured nature of loans. Merits are also valid for funds, derivatives and indices investing in CLO/ABS		
2. Catastrophe bonds ('Cat bonds')	Natural disasters and the resulting damage are on the rise worldwide, leading to higher costs for traditional insurance solutions and creating insurance gaps. Cat bonds are an instrument that can address this problem. From an investor's perspective, Cat bonds offer a comparatively high return and at the same time diversification advantages, as the risks of Cat bonds have only a low correlation with traditional asset classes such as stocks or corporate bonds. The Cat bonds market is liquid and transparent. In addition, ESG investment strategies can	See left column		Cat bonds provide insurance and support especially for developing countries or regions in need in dealing with natural disasters and reconstruction. In Germany UCITS are not allowed to invest in Cat bonds (No. 15 BaFin FAQ Eligible Assets), whereas in Luxembourg Cat bonds are eligible for UCITS.

	also be pursued using Cat bonds. Social impact: Even the European Central Bank (ECB) together with the European Insurance and Occupational Pensions Authority (Eiopa) have recently pointed out the added value of Cat Bonds in relation social impact: https://www.ecb.europa.eu/pub/pdf/other/ecb.policyoptions_EIOPA~c0adae58b7.en.pdf			
3. Contingent Convertible bonds ('CoCo bonds')	Diversifying seniority exposures, very liquid, attractive relative value along the capital structure. While a disclosure seems to be appropriate, CoCo investments can be very beneficial and as such in the best interest of investors.	Provides access to a broadly diversified universe and selection expertise if not provided internally. CoCos are a "*different type of financial instrument*" and require multi factor analysis to properly analyse and value associated risk.		In our view, a 100% allocation to a diversified portfolio of Cocos should be permissible without investor restriction in our view. As there are already UCITS ETFs tracking Coco indices, a level playing field should be established. Different discretionary conversion/write-down rights are now common practice for domestic and foreign bonds. A common definition of CoCo would bring more clarification.
4. Unrated bonds	Risk diversification and additional source of performance. Access to undervalued investment opportunities: Unrated bonds can provide UCITS with access to investment opportunities that may	See left column		

	be overlooked by traditional investors due to the absence of a credit rating. Diversification: Unrated bonds often represent a different risk profile and credit exposure compared to rated bonds. Lower reliance on rating agencies: The inclusion of unrated bonds in UCITS reduces the reliance on credit rating agencies as the sole source of credit analysis. UCITS managers can conduct their own thorough due diligence and credit assessment to evaluate the creditworthiness of issuers. This allows for a more independent and nuanced evaluation of credit risks, potentially reducing reliance on external rating agencies.			
5. Distressed securities	Frequently equity like risk/return profile with limited downside and significant upside if company and bondholder find a proper restructuring solution. Also, if company or bond surprisingly gets into distress, only keeping those assets (selectively) will allow for a partial recovery. Lastly, as there is no official definition of distressed investments, normal High Yield benchmarks and ETFs do have exposure to distressed names (defined as rated below CCC-). As such, UCITS have to have distressed investments simply by benchmark universes.	see left column (potentially unavoidable if other UCITS funds have little distressed exposure).		Distressed securities defined by rating are not necessarily trading illiquid or at distressed prices. Main problem is that distress per se is not a bad thing for investors and return potential can be significantly positive. We are not aware of any legal definition of “distressed”

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6. Unlisted equities	Exposure to unlisted equity can created passively through a corporate debt restructuring involving debt-for-equity swaps. As this will always provide positive optionality, there is a potential strong incentive to keep those assets in the best interest of the investors Unlisted equities allow an investment before listing. Potential for higher return: These investments can allow UCITS to access private companies at an early stage of development, where the potential for growth and higher returns can be significant. Diversification: Unlisted equities can provide diversification to a UCITS portfolio, as they often have different risk and return characteristics compared to listed equities	See left column		Especially pre-IPO investments are crucial.
7. Crypto assets	Diversification: Including crypto assets in a UCITS fund can offer a new asset class that is has low correlation with traditional financial markets. Innovation and access to new markets: Crypto assets represent an innovation in finance, and including them in UCITS funds could enable investors to participate in the growth and development of this emerging	See questions 13 and 21. Indirect crypto asset exposure enables UCITS managers to conveniently gain exposure via traditional wrappers while abstracting certain challenges of direct investments, such as <u>specialised crypto asset custody setup</u> and a<u>ccess to crypto asset-specific liquidity venues</u>: Derivatives with cash settlement on single crypto assets should be allowed as well. This		A new asset class with growing importance. Especially indirect investments are becoming more and more popular. It is important to differentiate between MiCAR crypto assets and tokenised traditional instruments ("MiFID crypto

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	sector. It allows for the inclusion of innovative technologies and access to new investment opportunities. Increased investor diversity: The inclusion of crypto assets in UCITS funds could attract a new segment of investors who are interested in this asset class. Direct exposure to crypto assets via on-chain investing is the most secure, least expensive and transparent way to gain crypto exposure Is the most technological advanced solution Gives future on-chain opportunities such as staking, trading, lending and borrowing on decentralised market places (if regulatory approved) tracks and monitors risk and return in real-time	would be in the interest of investors because it would be more cost efficient than the current repackaging into investable instruments via an investment bank. Furthermore, it would give the possibility to hedge exposure in highly liquid instruments.		assets"). Regarding the latter category please also see our comment to Q25 below.
8. Commodities and precious metals[1]	Diversification: Commodity investments can provide liquid diversification benefits to a UCITS portfolio. Commodities tend to have low correlation with traditional asset classes like stocks and bonds, which can help reduce overall portfolio volatility and enhance diversification.	Risk diversification and additional source of performance. Commodities and precious metals, as an underlying, have low or no correlation with traditional asset classes, diversifying the portfolio and reducing risk, while also providing		

[1] With respect to indirect exposures, ESMA is particularly interested in stakeholder input on ETFs with commodities/precious metals as underlying. Please note that under the current UCITS rules, precious metals and certificates representing them are not eligible (Article 50(2)(b) of the UCITS Directive).

	Inflation hedge: Commodities, such as precious metals, have historically acted as an inflation hedge. As commodity prices tend to rise with inflation, including them in a UCITS fund can help protect against the erosion of purchasing power during inflationary periods. However, UCITS, as the name already suggests, are intended to invest in securities, which distinguishes them from AIFs, which is why we do not consider an extension to include direct exposure to be necessary.	a good hedge against inflation. Indirect exposures may be achieved through (i) derivatives, such as ETCs and commodity-linked derivatives like futures, options, swaps linked to the performance of commodities or commodity indices; Delta-one instruments are necessary to invest into commodity benchmarks or indices Derivatives with cash settlement on single commodities should be allowed as well. This would be in the interest of investors because it would be more cost efficient than the current repackaging into investable instruments via an investment bank (ii) equities related to commodities, such as shares in mining companies or ETFs which hold such shares or which trade commodity indices; (iii) structured products, such as commodity-linked notes. Generally, good to high liquidity.		
9. Exchange-traded commodities ('ETCs')	Risk diversification and additional source of performance Description: ETCs are financial instruments	Risk diversification and additional source of performance ETCs are standard instruments for commodity		**Liquidity**: as ETCs are listed on major stock exchanges, they are highly liquid in nature.

	which are traded on a stock exchange and which track the price of a commodity or commodity indices. ETCs can be physically backed or synthetic. (1) Commodities have low or no correlation to traditional securities, diversifying the portfolio and reducing risk, while also providing a good hedge against inflation. (2) ETCs permit indirect exposure to the performance of commodities without direct physical ownership. ETCs are standard instruments for commodity investments (see answer to no. 8 re commodities and precious metals).	investments (see answer to no. 8 re commodities and precious metals).		**Reliable Valuation**: valuation of ETCs is typically based on its market price, which is readily available. The fund manage obtains the latest available close price of the instrument on the exchange which is the primary market for the instrument or that on which the trade occurred.
10. Real estate				Indirect exposure via e.g. liquid German, Austrian or French real estate funds would give multi asset funds more diversification and attractive risk/return Profiles
11. Real Estate Investment Trusts ('REITs')	Risk diversification and additional source of performance REITs provide the possibility of receiving a stream of income through dividends paid out by the REIT, with the income being generated through rent. They also allow for risk mitigation through diversification across different sectors and locations of real estate			Exchange traded REITs should be allowed in any case: In practice it is difficult to distinguish whether shares in REITs should be treated as securities or as AIFs. The reason is that it is not always

	via a tax transparent vehicle, without requiring a direct ownership of the underlying real estate. The REIT structure exists in a number of EU and third country jurisdictions, and the regulation applicable to them provides safeguards for investor protection which is consistent with requirements for UCITS investing in transferable securities.			easy to separate an investment strategy and a corporate strategy. Solution for this difficulty: Exchange-traded REITs should be allowed as securities if they meet the securities criteria of the Eligible Assets Directive. In the case of non-exchange-traded REITs, it is still advisable to examine each case on a case-by-case basis. **Liquidity**: REITs are listed and traded on stock exchanges, providing high liquidity. **Reliable Valuation**: as REITs are publicly traded, obtaining a valuation is similar to valuing listed equities – i.e., by referencing the market price of the shares. A valuation may also be obtained by reference to the NAV of the REIT, which will typically be periodically assessed internally within the

				REIT or by a third party.
12. Special Purpose Acquisition Companies ('SPACs')	Risk diversification and additional source of performance			From time to time an attractive opportunity for some equity funds Combination of eligible assets (stock and warrant)
13. EU AIFs[2]	Diversification: Private equity and infrastructure investments provide Investing in an AIF permits exposure to a diversified portfolio of underlying to which the UCITs may not be able to obtain direct exposure. This can bring diversification benefits and a higher return potential. Closed-ended: private equity and infrastructure investments provide exposure to a distinct asset class with the potential for higher returns and low correlation with traditional asset classes Including closed-ended funds in a UCITS portfolio can enhance diversification and reduce portfolio risk. Higher returns may also be generated by virtue of the flexibility of AIF managers in their investment approaches (e.g. leverage and short selling strategies) as well as the	See left column		

[2] Where relevant, please distinguish between different types of AIFs (e.g. open-ended, closed-ended) and investment strategies (e.g. real estate, private equity, hedge funds).

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	expertise of AIF managers in this domain.			
14. Non-EU AIFs	(1) Investing in an AIF permits exposure to a diversified portfolio of underlying to which the UCITs may not be able to obtain direct exposure. This can bring diversification benefits and a higher return potential. Higher returns may also be generated by virtue of the flexibility of AIF managers in their investment approaches (e.g. leverage and short selling strategies) as well as the expertise of AIF managers in this domain.			Should be allowed if UCITS requirements are fulfilled
15. Emission allowances	Description: these are tradable certificates/permits issued by a government permitting an entity to emit a set quantity of emissions Regulatory Support: Governments and regulatory bodies worldwide are increasingly implementing policies to regulate and control carbon emissions. These regulations create a stable and transparent market for emission allowances. Low correlation to traditional securities, diversifying the portfolio. It can also represent a hedge where the UCITS is exposed to sectors which are sensitive to, e.g., carbon pricing or regulation.	See left column Indirect exposure can avoid the potentially significant operational and regulatory hurdles to direct exposure due to the requirement to have a Union Registry account (an electronic system used to track the issue, transfer and cancellation of emission allowances under the EU Emissions Trading System) and the operational expertise required to manage the account. Additionally, the purchase and sale of emission allowances may require specific regulatory permissions.		Asset with growing importance as the EU emission allowances market will grow over the coming years. **T**hese assets are traded on established markets, so they are liquid and market prices are available.

	Possibility for capital appreciation, as the value of these assets can fluctuate based on factors such as regulatory changes and supply and demand. However, governments and regulatory bodies worldwide are increasingly implementing policies to regulate and control carbon emissions. These regulations create a stable and transparent market for emission allowances.			
16. Delta-one instruments	See above the arguments on the merits of indirect exposure to a range of different underlying assets. Delta-one is an easy, cost efficient and flexible way to invest into defined assets. Diversification: Delta-one instruments aim to closely track the performance of an underlying asset or index, providing investors with a way to gain exposure to different markets or sectors. Avoiding disadvantages of direct investments: e.g. physical delivery and storage of oil and precious metals and crypto	See left column		Very important instrument for UCITS
17. Exchange-	Risk diversification and additional source of performance	See left column		

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traded notes ('ETNs')	Liquidity and trade Execution: these instruments are typically traded on regulated exchanges with high liquidity.			
18. Asset-backed securities ('ABS') including mortgage-backed securities ('MBS')	Description: an instrument issued by an SPV which references a pool of underlying assets (typically for ABS/RMBS: >1,000, for CLO: 100-400; across various industries and geographies) held by the SPV The underlying assets generate cash flows paid to investors as interest and which also serve as collateral for the securities. ABS are often structured into tranches (senior, mezzanine and junior) which each carry a different degree of risk and return. Exposure to a wide, diversified range of underlying assets (including non-traditional credits, sectors, and regions) in a cost-effective manager, helping to reduce concentration risk and potentially enhance risk-adjusted returns. Consistent receipt of income through interest and principal payments. Potential for higher yields than other fixed-income securities, depending on the tranche selected. These tranches allow investors to choose their preferred level of risk exposure.	All merits of the left column are also valid for derivatives and indices investing in securitisations like CLO and ABS		Very important investment for short duration fixed income funds with better credit quality (compared to only a few corporate bond issuers AAA ratings)

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	UCITS can invest in tranches that align with their risk appetite, allowing for better risk management and the potential to optimise the risk-reward tradeoff within the portfolio. ABS can offer an enhanced liquidity comparable to corporate bonds with corresponding ratings Past Performance: Securitisations like ABS and CLO have a much lower default rates than corporate bonds with comparable ratings over the last 25 years. Reasons are additional credit support through tranching and secured nature of loans.			
19. Other relevant asset classes (please specify)				