

**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?**

### **AFG response**

For AFG members the priority is to maintain the global reputation of the UCITS “brand” as a secure, well-diversified, liquid, and transparent collective investment vehicle. The “UCITS” brand offers investors diversified investments (and protection) and its success at European and international level should be preserved. Accordingly, it would be dangerous for the brand to distinguish within UCITS between complex and non-complex UCITS.

Consequently, the regulatory stability is of utmost importance and there is no need at the European level to re-open the level one directive for additional changes; this review should be limited to situations where it is strictly necessary, i.e. in a “targeted and limited review” spirit.

The most pressing issue in such necessary review is to reach a better convergence between National Competent Authorities in the implementation of the current rules (e.g. look-through approach) to foster the competitiveness of the EU AM market.

The second priority for AFG members is to eliminate wherever it is possible the cases of unlevel playing fields between EU countries.

**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.**

### **AFG response**

No issues have been flagged

**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.**

**AFG response**

No issues have been flagged

**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.**

**AFG response**

Many additional works have been done on these notions since 2007. AFG members believe that there is no need to be more precise given the fact that fund managers are required to design and apply elaborated liquidity risk management policies.

**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.**

**AFG response**

This presumption of liquidity should not be amended.

It is not the objective of UCITS EAD to define the liquidity risk management requirements. Other pieces of regulation deal with such subject matter such as ESMA guidelines on liquidity stress tests and Commission Directive 2010/43.

The presumption of liquidity and negotiability set out in EAD is focused on the financial instruments level. But the question of liquidity risk management must be assessed at portfolio level.

**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.**

#### **AFG response**

The UCITS level 1 Directive exposes that “UCITS may hold ancillary liquid assets” on one side and lists deposits with banks as eligible investments assets on the other side. UCITS Directive permits investment in deposits since the Product Directive and sets a specific ratio for that. Deposits were introduced as an investment asset with the Product Directive, distinct from ancillary liquid assets that are foreseen since the Original 1985 Directive, which mentioned ancillary liquid assets that would be used to cover payments, facilitate reinvestment of proceeds from the sale of portfolio holdings or where market conditions require suspension of investment in other financial assets. The UCITS Directive distinguishes thus between cash held at sight and bank deposits held for investment under the UCITS prospectus as part of its investment strategy. A UCITS can always use ancillary liquid assets, while some investment strategies will not cover deposits in their scope.

Level 1 Directive does not set a ratio for ancillary liquid assets as some market situations may necessitate to hold more ancillary liquid assets than normal “business as usual” circumstances. This is thus not harmonized at European level since 1985 (with no problem arising from this and leaving thus room to enough flexibility to adapt). Only a level 1 measure could eventually set a ratio.

In France, AMF has set for ancillary liquid assets a separate ratio from the UCITS Directive’s deposits. Ancillary liquid assets can have a maximum of 10% that can be raised up to 20% in case of exceptional circumstances. In this case, AMF sets the obligation to respect a maximum of 30% exposure with a counterparty in total, by including this (unsegregated) cash held at sight.

AFG members are well aware of the fact that other local rules are stricter. But they are worried that these local problems may trigger a detrimental harmonization at pan-European level.

It can be observed that in the context of shortening of the settlement cycle in the US to T+1, some implementations prove to be more efficient.

**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.**

**AFG response**

AFG do not see why such investment possibility should be specifically contemplated. There is no reason to restrain UCITS fund's possibility to be exposed to foreign currency for investment purposes. These investments should naturally be subject to the risk management policy of the fund manager (market risk, liquidity risk, etc ...) and an appropriate disclosure in the documents, whether they are implemented directly through bank deposit or indirectly with FX forward typically.

**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.**

**AFG response**

AFG members spotted one significant issue. In 2012, ESMA issued an opinion on the eligibility on units or shares of collective investment undertakings to this ratio. ESMA's opinion is that UCITS may only invest in units or shares of collective investment undertakings as defined in Article 50(1)(e) of the UCITS Directive. AFG sees merits in allowing other type of units of CIS to be eligible to the 10% trash ratio. Being allowed to invest in funds that do not comply with the "4 Criteria" of Article 50(1) (e) would allow new investment opportunities to asset managers.

Some of these CIS give exposure to assets already compliant with the derogation in Article 50(2)(a) of the UCITS Directive such as ELTIF. But it could also be expanded to non-UCITS eligible underlying such as commodities.

**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.**

**AFG response**

AFG suggests aligning with Article 4(1)(44) of MiFID II in order to streamline the criteria and foster clarity and supervisory convergence

**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.**

**AFG response**

No issues have been flagged. The AFG understanding is that such criteria include both risk manager skills but also IT infrastructure capability to integrate and compute risk metrics by the fund manager (Art 2g).

**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.**

**AFG response**

No issues have been flagged regarding those provisions. Typically, Asset Back Securities should remain eligible for UCITS funds.

**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.**

**AFG response**

Please refer to Q13

**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.**

**AFG response**

AFG considers that the diverging interpretations on the treatment of derivatives are very detrimental to the UCITS "brand". They lead to distortions of competition and numerous possibilities for arbitrage between jurisdictions. AFG calls for clarification and harmonization of these rules in Europe.

AFG is not opposed to let UCITS funds offering exposure to non-eligible assets using delta one instruments. This possibility is very useful as a tool for portfolio diversification notably during stressed markets when all classic asset classes become correlated. It helps to amortize market shocks and is valuable from an investor's protection perspective. UCITS funds should benefit from a minimum of flexibility and leeway regarding their investment universe, but it must be limited so as not to distort the "UCITS" brand.

Therefore, a room should be arranged to allow an allocation in such instruments. This could be done by setting out a ratio in UCITS EAD or any limit defined by the fund manager according to its risk management rules and processes.

**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.**

#### **AFG response**

France faces a real issue regarding the application of the rules on UCITS investments in other UCITS and alternative investment funds (AIFs). This issue comes from an incorrect translation into the French version of the level one Directive of the word "asset segregation" in article 50 (1) e (ii). This translation issue led the AMF to interpret those criteria as equivalent to the current risk spreading rule of the UCITS (5/10/20/40) of Article 52.

This is a case of divergence which handicaps French UCITS because most of the AIFs are not eligible to the 30% ratio according to the prevailing rules in France.

AFG is of the view that this translation problem should be fixed.

Another problem regarding the closed ended funds has been raised by AFG members. Most of the French funds are FCP (Fonds Commun de Placement, ie common funds format) with no legal personality. Hence, they cannot comply with the governance requirement of Art 2.2 of UCITS EAD. In such case, these requirements should apply to the management company who runs the FCP

**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.**

**AFG response**

AFG believes that ETF are a category of funds and as such must comply to the same rules.

Please refer to comments above on the French translation issue and the compliance with the 4 criteria of article 50 (1) e

**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.**

**AFG response**

The existing regulations are satisfactory.

**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?**

**AFG response**

These two notions do not cover the same perimeter. Consequently, AFG is not in favour to replace or link one with another.



**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.

**AFG response**

**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.

**AFG response**

**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.

**AFG response**

Please see our comments in the annex table

**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.**

**AFG response**

Indirect exposure may increase costs: structuration fees, index license fees, costs of market data. On the other hand, indirect exposure grants access to asset classes which are difficult to access directly (NFD or emerging markets). Economies of scale can be achieved by using bank capital market infrastructures.

It is the responsibility of the management company to choose whether direct or indirect investment is in the best interest of the UCITS shareholders.

The choice should be preserved as it allows the manager to select the appropriate solution from a risk/return perspective and for the ultimate benefit of investors.

Risks management processes should be systematically applied in order to avoid erroneous assessment in risk spreading UCITS rules.

**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.**

### **AFG response**

Regarding the delta one instruments,

AFG is of the view that a complete harmonization of the rule is desirable for numerous reasons (distortion of competition, legal certainty, clarification for investors, strengthening of the UCITS brand, etc.)

Without the look-through approach, a UCITS fund can indirectly and significantly expose itself to assets not eligible for the UCITS Directive. This makes the Directive incoherent because it grants an access to asset classes by delta one instrument, which are not directly investible.

But the 100% application of the look-through approach, as in France, limits the possibilities of diversification in uncorrelated assets.

AFG proposes an intermediate solution which allows an indirect exposure to non-eligible assets to a limited extent which could be the trash ratio for example.

**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.**

### **AFG response**

The current regulation is satisfactory.

**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.**

**AFG response**

AFG members believe that short positions should remain permitted as long as it is necessary to the investment strategy (ex: long/short equity strategy)

However, this possibility should not be used for the sole purpose of circumventing the rules.

**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.**

**AFG response**

Along with the discussions regarding this analysis of the level 2 directive, many points arose regarding divergences of interpretation of the level 1 directive among the NCAs, such as basic interpretations of diversification rules. We strongly advise running the same work for the level 1 than the current one for the level 2.