Response to the ESMA consultation on the review of the UCITS Eligible Assets Directive

Assogestioni[1] welcomes the opportunity to respond to the ESMA's Call for Evidence on the review of the UCITS Eligible Assets Directive.

We fully agree with ESMA that "*UCITS are a key pillar of the EU capital market and the UCITS Directive has created a harmonised and well-functioning regime throughout the European Union for the management and cross-border marketing of investment funds*" and that "*the acclaimed success of UCITS as a brand for retail and institutional investors, both within the European Union and globally, hinges on their established reputation of being well-regulated and supervised investment products that provide for a high level of investor protection*".

Accordingly, we are glad to support the objective of achieving greater consistency concerning the understanding and implementation of the UCITS framework to enhance trust and confidence and the high quality of the UCITS brand while preserving consumer choice and innovation in market developments, other than level playing field across Member States.

In general, we believe that many issues and principles addressed so far with the EAD and UCITSD are still relevant, and we do not see the need to amend them as they offer an established, generally applicable baseline.

However, some areas would benefit from clarification or targeted amendments.

We are indeed aware of the existence of diverging interpretations on whether certain exposures in a UCITS fund are admissible, and we advocate for supervisory convergence and clarification, especially on direct and indirect investments and exposure to ineligible assets, bearing in mind that the final interpretations will imply a greater or lesser possibility of obtaining indirect exposure to some underlying assets and opportunities for cost efficiencies.

A general remark is that an overly restrictive approach may negatively impact the UCITS in terms of diversification and its risk-adjusted return profile. 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.

In view of the timeframe that we imagine is needed to consider a revision of the EAD and, if appropriate, also of the UCITSD, we would like to take this opportunity to ask for, in any case, clarification - through other types of European instruments - on whether a look-through approach is required to determine the eligibility of certain financial instruments to gain exposure to asset classes that are not directly investible.

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[1] Assogestioni is the trade body for Italian asset management industry and represents the interests of members who manage funds and discretionary mandates around € 2,344 billion (as of May 2024).

It is also worth noting that any impact of further regulatory developments on the EAD/UCITSD or clarifications on existing UCITS must be carried out in such a way as not to jeopardise investors' confidence in the UCITS brand and in the investment fund market in general.

Q1: In your view, what is the most pressing issue to address in the EAD with a view to improving investor protection, clarity and supervisory convergence across the EU?

The EAD, together with Directive 2001/108/EC (UCITS III), broadened the investment spectrum of UCITS funds, especially through indirect exposure, introducing, among all, financial instruments backed by, or linked to the performance of other assets not directly eligible, and relaxed some restrictions for index funds. With the EAD, the legislators provided a broad class of "transferable securities", encompassing both the investment opportunities, that were available when the Directive was created, and those that have arisen subsequently.

As financial markets evolve and financial instruments and products innovate, it is inevitable that some national supervisory authorities and asset managers will identify problems with certain financial instruments/asset classes that others do not and may make different judgments about the information identified.

Although we assume that differences in the approach to investment decisions and risk management among asset managers will continue to exist, it is expected and hoped that the same rules will be followed.

Therefore, apart from the primary purpose of achieving greater consistency, we believe that the most pressing issue to address is whether a look-through approach is needed to assess the eligibility of certain financial instruments that may not be directly eligible but meet the formal and qualitative requirements to be recognised as 'securities'.

Indeed, if such a security is 'liquid', it may also represent the basis for the construction of a diversified portfolio. 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.

The process of “wrapping” assets into eligible securities is not new but has become more relevant as the types of instruments continue to evolve. We refer to some legal structures, such as Exchange Traded Commodities or Exchange Traded Notes, that allow exposure to individual precious metals (such as gold), or other single commodities (such as oil, metals, energy) or, more recently, to cryptocurrencies.

Clear guidance should also be provided for investments in other collective investment undertakings (CIUs), including ETFs, both open-ended and closed-end structures. It is worth noting that some regulated AIFs were created specifically in the European Union to obtain investments and savings for channelling long-term investments within the Capital Markets Union (CMU). However, since the underlying assets of such AIFs, for example ELTIFs, may include not directly eligible assets for a UCITS or have varying degrees of liquidity, it is crucial to gain more clarity on whether or not a UCITS can also directly contribute to the CMU.

Q2: Have you experienced any recurring or significant issues with the interpretation or consistent application of EAD rules with respect to financial indices?

Yes, additional clarity could be provided on some topics related with the concrete application of the EAD, the UCITSD, the CESR Guidelines on Eligible Assets (CESR 07-044b) and the ESMA guidelines on financial indices introduced with ESMA's Guidelines on ETFs and other UCITS issues (ESMA/2012/832).

First of all, there is a need for a consistent approach across Member States with regard to Article 9(1)(a)(iii)[2] of EAD, i.e. financial indices whose underlying components are not themselves part of the assets that can be acquired by UCITS (for example, commodities and precious metals).

- Index composed of assets other than those referred to Article 50(1) of the UCITSD - minimum diversification requirement. It should be clarified whether it is possible to exceed the 20% limit and reach 35% for an index component composed of non-eligible assets (e.g. commodities). Divergent interpretations between Member States lead to differences in the eligibility of certain existing indices whose components are capped to that only one component can reach a maximum weight of 35% and no remaining component's weight can exceed 20%.

- Index composed of assets other than those referred to Article 50(1) of the UCITSD – no look-through for the diversification requirement of the index if derivative on the index is used for risk-diversification purposes**.** It should be clarified if the following CESR Guidelines on Eligible Assets, to be read together with other Guidelines[3], is still relevant *"[…] If derivatives on the index are used for risk-diversification purposes, provided that the exposure of the UCITS to the individual indices complies with the 5/10/40% ratios, there is no need to look at the underlying components of the*

[2] EAD. Article 9 - Article 19(1)(g) of Directive 85/611/EEC - Financial indices 1. "The reference in point (g) of Article 19(1) of Directive 85/611/EEC to financial indices shall be understood as a reference to indices which fulfil the following criteria: (a) they are sufficiently diversified, in that the following criteria are fulfilled: i. the index is composed in such a way that price movements or trading activities regarding one component do not unduly influence the performance of the whole index; ii. where the index is composed of assets referred to in Article 19(1) of Directive 85/611/EEC, its composition is at least diversified in accordance with Article 22a of that Directive; iii. where the index is composed of assets other than those referred to in Article 19(1) of Directive 85/611/EEC, it is diversified in a way which is equivalent to that provided for in Article 22a of that Directive;"

[3] ESMA's Guidelines on ETFs and other UCITS issues (ESMA/2014/937). Point. 50 "A UCITS should not invest in commodity indices that do not consist of different commodities. Subcategories of the same commodity (for instance, from different regions or markets or derived from the same primary products by an industrialised process) should be considered as being the same commodity for the calculation of the diversification limits. For example, WTI Crude Oil, Brent Crude Oil, Gasoline or Heating Oil contracts should be considered as being all sub-categories of the same commodity (i.e. oil). Sub-categories of a commodity should not be considered as being the same commodity if they are not highly correlated. With respect to the correlation factor, two components of a commodity index that are sub-categories of the same commodity should not be considered as highly correlated if 75% of the correlation observations are below 0.8. For that purpose the correlation observations should be calculated (i) on the basis of equally-weighted daily returns of the corresponding commodity prices and (ii) from a 250-day rolling time window over a 5-year period."

individual indices to ensure that they are sufficiently diversified"(CESR 07-044b, Point 22, Article reference 9(1)(a)(iii)). The investment of small portions of a portfolio in less diversified sector-index based derivatives could improve the efficiency of the overall portfolio without raising diversification concerns for the whole portfolio.

Second, regarding both EAD and UCITSD, further clarification is needed on the calculation of the concentration limit in case of investment in derivatives on financial indices whose underlying components are themselves part of the assets that can be acquired by UCITS.

- Index composed of assets referred to Article 50(1) of the UCITSD and look-through approach. According to Article 51, paragraph 3, sub-paragraph 3, second sentence of the UCITS Directive *"Member States may provide that, when a UCITS invests in index-based financial derivative instruments, those investments are not required to be combined for the purposes of the limits laid down in Article 52".* Since UCITSD allows some flexibility in its national implementation, different rules may apply in different Member States.

  It is worth noting that divergent interpretations on the need to look at the underlying components of the individual indices on an ongoing basis for the calculation of the UCITS investment limits in a single issuer imply greater or lesser costs of indices licenses (daily licenses) other than operational and administrative burden. Indeed, on the topic of costs, we would like to highlight the significant increase in costs recorded by the industry in the last decade related to the use of indices and the access, among other things, to underlying data components.

  Therefore, to keep the right balance between regulatory obligations and avoiding excessive burden and costs that will ultimately be passed over to users of benchmarks and end clients, we suggest proposing an amendment to the UCITSD as follows: "*~~Member States may provide that,~~ when a UCITS invests in index-based financial derivative instruments, those investments are not required to be combined for the purposes of the limits laid down in Article 52*".

  In view of the timeframe we imagine is needed to consider a revision of the UCITSD, we suggest clarifying with L3 provision that in the presence of a diversified financial index in accordance with Art. 53 UCITSD (i.e. up to 20% for investment in shares or debt securities issued by the same body under Art. 53(1) or up to 35% for a single issuer in the case of exceptional market conditions within the meaning of Art. 53(2)), there is no need to apply a look-through approach to verify that the overall position held by the fund directly and indirectly respects the fund's concentration limits (i.e. consolidate exposure on individual stocks or bonds gained through the financial derivative index with exposure gained through other financial derivative index or direct investment in these stocks or bonds).

Third, please find some further issues with the interpretation of some requirements for investing in financial indices which function as the underlying for derivative instruments.

The investment requirements have been modified over the years and are now spread across the EAD, the UCITSD, the CESR Guidelines on Eligible Assets (CESR 07-044b) and the ESMA's Guidelines on ETFs and other UCITS issues (ESMA/2012/832)[4]. Despite or because of the stratification of provisions, the rationale for a whole series of details is no longer entirely clear or reflects market practices/development and thus creates some issues especially for indices not composed by stock or debt securities, where the strict application of all the provisions is challenging, particularly if applied in a narrow sense.

For example, we refer to financial derivatives in some credit indices, that could be composed also of non-eligible assets (i.e. a loan, where the reference entity does not issue any bond):

EAD – Article 9(1)	Due diligence analysis*
(b)(ii) the index is revised or rebalanced periodically to ensure that it continues to reflect the markets to which it refers following criteria which are publicly available	the index is rebalanced periodically, but this is done through the creation of a new "version", whilst the CDS already in position remains on the previous version;
(c) they are published in an appropriate manner, in that the following criteria are fulfilled: (i) their publication process relies on sound procedures to collect prices and to calculate and to subsequently publish the index value, including pricing procedures for components where a market price is not available;	the index value (which, in this case, does not represent a return, but a credit spread) is not published by the index calculator but is quoted OTC by market participants;

*Analysis provided by a Member.

We also refer to the components of an ethical/sustainable/ESG index selected based on the index administrator's proprietary methodology (e.g. only securities rated above a certain threshold), where the methodology cannot be replicated without an index provider's license. Some asset managers believe that in light of the provisions in the ESMA Guidelines on index disclosure and index replicability, the only permissible way to invest in such ethical/sustainable/ESG index derivatives is to consider them as financial derivatives on a combination of assets in accordance with Article 9(2) EAD[5], which entails licensing costs.

Please also note that the entry into force of the Regulation (EU) 2016/1011 (Benchmarks Regulation or BMR) did not alleviate the obligation for asset managers. Legislators (and ESMA in providing draft proposals for RTS) did not consider it possible to grant the requests made so far to align all the transparency requirements for benchmark administrators under

[4] ESMA Questions and Answers. Application of the UCITS Directive. Section III. Question 7b: "Do the guidelines on financial indices apply only to index-tracking UCITS? Answer 7b: No, the guidelines on financial indices apply to any UCITS investing in financial indices and not only to index-tracking UCITS. This means that the guidelines on ETFs and other UCITS issues take precedence over the guidelines on eligible assets issued by CESR in 2008 (Ref. CESR/07-044b) and that UCITS should not invest even a small amount of their assets in financial indices that do not comply with paragraphs 48 to 61 of the guidelines."

[5] EAD. Article 9(2) "Where the composition of assets which are used as underlyings by financial derivatives in accordance with Article 19(1) of Directive 85/611/EEC does not fulfil the criteria set out in paragraph 1 of this Article, those financial derivatives shall, where they comply with the criteria set out in Article 8(1) of this Directive, be regarded as financial derivatives on a combination of the assets referred to in points (i), (ii) and (iii) of Article 8(1)(a)."

the BMR with the due diligence requested to asset managers on financial indices by the UCITS framework.

Since some requirements are considered too demanding, especially for non-index replicating UCITS, and not all provisions seem providing a real additional benefit, while increasing operational burden and administrative costs other than diverging practices, we believe it would be useful to make further assessment on the concrete application of those criteria in order to review and/or eliminate from EAD (and subsequent guidelines) the provisions that are not adequate or do not reflect the market developments and/or strictly necessary to streamline compliance burdens and provide better clarity and legal certainty for asset managers.

In such valuation we deem still relevant recital 11 of EAD that states "*The need for clarification is particularly pressing for derivatives on financial indices. …These indices may vary as regards their composition or the weighting of their components. 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 37 of Directive 85/611/EEC, and the calculation of the net asset value and that those obligations are not negatively affected by the features of the underlying of a derivative.*"

Q3: Have you experienced any recurring or significant issues with the interpretation or consistent application of EAD rules with respect to money market instruments?

No, we have not.

Q4: Have you experienced any recurring or significant issues with the interpretation or consistent application of EAD provisions using the notions of « liquidity » or « liquid financial assets »?

No, we have not. Article 2(1)(b) of the EAD and the relevant CESR Guidelines on Eligible Assets (CESR 07_044)[6] were helpful in overcoming significant issues emerged regarding the eligibility of a security assessed with insufficient liquidity to meet foreseeable redemption requests.

It is worth reminding that the permissible extent of less liquid assets to be included within the 10% limit under Article 50(2)(a) of the UCITSD also provides a light flexibility for a UCITS fund to support CMU policy goals.

[6]CESR Guidelines on Eligible Asset (CESR 07_044), Point 17, Article reference 2(1) "[…] If the security is assessed as insufficiently liquid to meet foreseeable redemption requests, the security must only be bought or held if there are sufficiently liquid securities in the portfolio so as to be able to meet the requirements of Article 37."

Q5: The 2020 ESMA CSA on UCITS liquidity risk management identified issues with respect to the presumption of liquidity and negotiability set out in 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 EAD.

We believe that the presumption of liquidity and negotiability set out in EAD is intended not to create complicated or onerous pre-investment analysis, particularly when asset managers are investing in widely traded, publicly listed securities.

Investment due diligence, liquidity risk management and pricing policies are key activities of UCITS asset management in identifying the financial instruments in which the UCITS can actually invest. The monitoring of liquidity (and its risk) in UCITS has become increasingly important in practice and in the UCITS legal framework.

The way fund liquidity is measured and classified is subject to ongoing evaluation by the risk management according to its corporate policy, which also reflects how redemptions and other potential liabilities are managed in practice. Indeed, asset managers use several approaches with the final aim of safeguarding the interest of investors.

We therefore support maintaining all principal-based approaches envisaged in UCITSD, in EAD and in the following ESMA guidelines that allow the liquidity requirements to be tailored, as market liquidity is constantly changing.

The key question is how governance is implemented and how the supervisory framework is decided to ensure that managers exercise their best judgment based on evolving market dynamics. The identification of deficiencies in some cases in the CSA on UCITS liquidity management does not necessarily mean that the rules themselves are inadequate or prevent NCAs from carrying out further investigations, but that in some cases standards need to be raised.

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.

As far as is known of national practices, ancillary liquid assets are sight deposits held on depositary in the fund's base currency, while holding cash in non-base currency is not considered ancillary liquid assets but investments in deposit.

According to national rules, ancillary liquidity held in sight deposits on depositary is not subject to any limit unlike investment in bank deposits. This seems in line with the UCITSD where the notion of ancillary liquid assets has been present from the creation of the UCITSD and therefore before the UCITS III allowed for investment in deposits whether certain conditions (art. 50(1)(f) UCITSD) and specific concentration limits (article 52(1)(b) UCITSD) were met.

The function of ancillary liquid assets, although such assets are also held in a bank, is distinct from that of investments in deposits. We believe that its function is well addressed in recital 41 of the UCITSD[7] and it is still relevant as it enables appropriate liquidity management to cover current or exceptional payments and consequently should therefore not be subject to the same concentration rules.

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.

Yes, UCITS should be permitted to acquire or hold foreign (based or not based) currency also for investment purposes, either directly or indirectly. In this regard, we noted that for investment in bank deposit the UCITSD put limits on concentration and counterparty risk but not on currency.

It is worth noting, that at a national level it is already possible to make these types of investments, which allow complete and efficient active management of currency risk. According to NCA rules, please also note that FX transactions with settlement after 5 days are treated as futures contracts.

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?

Based on the rules in force in Italy, a UCITS fund can hold in the 10% limit referred to Article 50(1) of the UCITSD the following <u>not "listed"</u> financial instruments:

- transferable securities and money market instruments that are admitted to or trading on regulated market or on a third-country market assimilated to an EU-regulated market but do not comply with the eligible asset criteria defined in Article 2(1)(c)(i) and 2(1)(d)(i) of the EAD;
- eligible closed-end AIFs;
- eligible financial instruments backed by or linked to the performance of other assets which may differ from those referred to in Article 50(1) of the UCITSD.

[7] UCITSD. Recital (41) "In addition to the case in which a UCITS invests in bank deposits in accordance with its fund rules or instruments of incorporation, it should be possible to allow all UCITS to hold ancillary liquid assets, such as bank deposits at sight. The holding of such ancillary liquid assets may be justified, inter alia, in order to cover current or exceptional payments; in the case of sales, for the time necessary to reinvest in transferable securities, money market instruments or in other financial assets provided for in this Directive; or for a period of time strictly necessary when, because of unfavourable market conditions, the investment in transferable securities, money market instruments and in other financial assets is suspended."

Q9: Are the 'transferable security' criteria set out in the 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 EAD to improve investor protection, clarity and supervisory convergence.

The "transferable security" criteria are set out in Article 2 of the EAD. While paragraphs 1 and 3 of Article 2 of the EAD are broadly considered still appropriate, it might be useful to revise paragraph 2, letters (a) and (b) on closed-end funds. With respect to Article 2(2)(c)(ii) related to financial instruments backed by or linked to the performance of assets other than those listed in Article 50(1) of the UCITSD, please see our response to Question 11.

Regarding the "transferable security" criteria for closed-end funds the existing criteria have proven suitable for REITs (please also see our responses to Questions 14, 20 and 21).

However, a lot of uncertainty has been raised with the concrete application of the following principle included in the CESR Guidelines on Eligible Assets for other type of closed-end funds: "UCITS may not make investments in closed end funds for the purpose of circumventing the investment limits provided for UCITS by Directive" (CESR 07_044b).

It is not clear the meaning of "circumventing" and whether there is an obligation to look through the underlying asset to determine its eligibility, since CESR itself had suggested the possibility of investing in a real estate fund at the time[8], i.e. a CIU whose underlying is not directly eligible for a UCITS.

More guidance and/or a broad revision on the rules on UCITS investments in other CIUs would therefore be welcome. Please also see our response to Question 14.

Q11: Are the 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 EAD to improve investor protection, clarity and supervisory convergence.

The concrete interpretation of this provision has always been ambiguous and there were different opinions on the legal structure of the financial instruments identified therein and on the eligibility of some underlying exposures.

Regarding the legal structure, it was wondered whether this EAD provision also covers ETFs, and thus CIUs, in addition to ETCs and ETNs. While, concerning exposure, clarification was requested on the eligibility of a financial instrument that replicates the performance of a single commodity (as indirect exposure to commodities through indices should only be

[8] CESR's Advice to the European Commission on Clarification of Definitions concerning Eligible Assets for Investments of UCITS (CESR/06-005) Point 43 "[…] will allow UCITS to invest into closed end real estate funds and private equity funds".

made on indices consisting of different commodities) or a single precious metal (as UCITS shall not acquire either precious metals or certificates representing them).

In general, and if we exclude the recent topic of the eligibility of indirect exposure to crypto currencies or non-traditional crypto underlyings for a UCITS, the majority of our Members believe that the look-through of the financial instrument falling under this definition is not required to determine its eligibility, since national regulation reflects the EAD and the EAD does not explicitly require a look-through approach, except when the financial instruments embed a derivative component. Thus, in line with the spirit of the EAD, together with UCITS III, to enlarge the investment spectrum of UCITS funds, especially through indirect exposure.

However, it was also noted that even if the look-through approach is not expressly required by the EAD for the eligibility of the single security, this does not affect the obligation of the asset manager to:

- assess the individual risk positions of these financial instruments and their contribution to the overall risk profile of the portfolio as part of the risk management framework (understand, measure, monitor and stress the possible risks) other than the need to meet the other criteria stated in the UCITSD and in the EAD for the investment in a financial instrument, among them, liquidity, reliable valuation and appropriate information;
- verify that the purchase does not lead to physical delivery, where the financial instrument is backed by or linked to the performance of a commodity;
- provide appropriate disclosures in the fund rules, and where relevant, in other fund documents, including the risk of these investments.

Considering the above, we totally agree with ESMA that questions regarding whether certain exposures in a UCITS fund are admissible and, if so, whether it is still shared or agreeable today to allow such exposure is a relevant theme.

Regarding exposure to commodities, please also see our response to Q25.

Q12: Is the concept of « embedded » derivatives set out in the 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 EAD to improve investor protection, clarity and supervisory convergence.

We ask to clarify how a certificate on crude oil, which reflect the performance of crude oil by reference to crude oil futures without any leverage effect should be classified as a security or as a financial instrument with an embedded derivative component.

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 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.

As mentioned in other responses, we are aware of diverging interpretations, and we advocate for supervisory convergence and clarification, bearing in mind that the final interpretations will imply a greater or lesser possibility of obtaining indirect exposure to some underlying assets and opportunities for cost efficiencies.

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 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 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.

Yes, we see some issues in the interaction and logical consistency between the different rules especially considering the regulatory developments in CIUs which have taken place at the EU and Member State level since the enactment of the UCITSD and EAD.

For investments in closed-ended structures, as already mentioned in the response to Question 9, a lot of uncertainty has been raised with the concrete application of the following principle included in the CESR Guidelines on Eligible Assets (CESR 07_044b): "UCITS may not make investments in closed end funds for the purpose of circumventing the investment limits provided for UCITS by Directive". Clarification on the eligibility of closed-ended structures is also relevant today because under EU regulation there are new CIUs (ELTIF, EuVECA, EuSEF) that are strictly regulated at the management level and at the product level, whose underlying assets may involve assets not directly eligible or of varying degrees of liquidity. ELTIF, for example, was specially created, and recently revised, to get investments and saving to channel long-term investments as part of the capital market union (CMU).

For investments in other non-EU open-ended funds, instead, specific challenges are observed in fulfilling the requirement referring the equivalent level of protection for unit-holders to permit UCITS funds to invest according to article 50(1)(e)(ii) of UCITSD.

In addition, since some open-ended CIUs are also traded on secondary markets, questions have been raised in relation to the different treatment between open-ended and closed-end funds, especially if the latter are not obliged to comply with the same equivalence rules as for open-ended funds.

Therefore, we would suggest valuating some further reflection and improvement to the EAD and/or to the UCITSD, where necessary, to clarify, among other things:

- the criteria to identify which types of CIUs, other than UCITS, a UCITS is allowed to invest in, what limits apply and whether a look-through approach is required to determine its eligibility;
- the rules to apply if the CIU is traded on secondary markets;
- the special case of Real Estate Investment Trusts (REITs) and Stapled Security (please see our answer to Question 21).

It is worth noting to remind that the look-through approach for a CIU does not mean to verify compliance with the concentration and diversification limits by considering, on an ongoing basis, the combination of investments made directly and indirectly through other CIUs. In our understanding, it is based on due diligence and appropriate information on the target CIU to allow, among other things, considering whether an investment is suitable for the UCITS and its compatibility of the investment policies, monitoring the relative risk and verifying the absence of a concentration of risk incompatible with the parameters defined by the UCITS fund itself. To verify compatibility as well as to guarantee compliance with the principles and criteria established in the UCITS framework, it is therefore not strictly necessary to monitor the composition of the underlying UCI's assets on a daily basis. These activities can also be carried out using alternative methods which provide, for example, an ex-ante evaluation and a periodic ex post-evaluation of the prevalent exposure of the CIU through the analysis of the fund documentation, the benchmark, if present, or the investment policy adopted, as well as the actual portfolio or other risk measures.

As regards the need to update the legal wording used in the EAD and UCITS Directive with the notion of "AIFs", we agree with ESMA's suggestion, which is in line with what has already been done at national level, that identifies both EU and non-EU AIFs as "AIFs".

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.

Please refer to the answer to Question 14.

Q16: How would you propose to amend the 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.

Please find an issue linked to ESMA Guidelines on ETFs and other UCITS issues on the management of collateral that could be revisited:

- Paragraph 43 (e) requires that any collateral received be "sufficiently diversified" and consist of at least six different issues. This level of diversification is not necessary for collateral – the collateral represents a secondary guarantee after the first guarantee formed by the counterparty. Consequently, we support less stringent criteria for collateral than UCITS diversification rules. Liquidity, credit quality and haircuts are also relevant key factors in this case.

Q17: Would you see merit in linking or replacing the notion of EPM techniques set out in the UCITS Directive and 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?
No, we do not see merit in replacing the notion of EPM techniques set out in the UCITSD[9] and EAD[10] with the one of securities financing transaction (SFT[11]) as the latter does not

[9] UCITSD. Art.51(2). "Member States may authorise UCITS to employ techniques and instruments relating to transferable securities and money market instruments under the conditions and within the limits which they lay down provided that such techniques and instruments are used for the purpose of efficient portfolio management. When those operations concern the use of derivative instruments, the conditions and limits shall conform to the provisions laid down in this Directive."

[10] EAD. Article 11, Article 21(2) of Directive 85/611/EEC, Techniques and instruments for the purpose of efficient portfolio management "1. The reference in Article 21(2) of Directive 85/611/EEC to techniques and instruments which relate to transferable securities and which are used for the purpose of efficient portfolio management shall be understood as a reference to techniques and instruments which fulfil the following criteria: (a) they are economically appropriate in that they are realised in a cost-effective way; (b) they are entered into for one or more of the following specific aims: (i) reduction of risk; (ii) reduction of cost; (iii) generation of additional capital or income for the UCITS with a level of risk which is consistent with the risk profile of the UCITS and the risk-diversification rules laid down in Article 22 of Directive 85/611/EEC; (c) their risks are adequately captured by the risk management process of the UCITS. 2. Techniques and instruments which comply with the criteria set out in paragraph 1 and which relate to money market instruments shall be regarded as techniques and instruments relating to money market instruments for the purpose of efficient portfolio management as referred to in Article 21(2) of Directive 85/611/EEC."

[11] SFTR. Article 3, point 11," 'securities financing transaction' or 'SFT' means: (a) a repurchase transaction; (b) securities or commodities lending and securities or commodities borrowing; (c) a buy-sell back transaction or sell-buy back transaction; (d) a margin lending transaction;"

include derivatives used also for EPM purposes and, therefore, there may be some unintended effects for a UCITS if the replacement would be made.

Q18: Apart from the definitions and concepts covered above, are there any other definitions, notions or concepts used in the 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.

Please find below some consideration regarding certain concepts and definitions used in other pieces of EU financial legislation.

MiFID. Broadly speaking, we see no need to align the definitions in the UCITS framework concerning regulated markets with those in the MiFID one. Should the need be recognised, we have the following recommendations:

- Regulated market (main investment of a UCITS)
  - as regards EU trading venues, we agree to include MTFs as additional trading venues where a financial instrument may be listed, in line with what is already expressed by ESMA (see Q&A No. 3, Section I-General of the ESMA Q&A on UCITSD[12]);
  - as regards non-EU trading venues, we are strongly opposed to considering the MiFID framework, as third country markets are recognised as regulated markets only if an equivalence decision of the European Commission pursuant to Article 25(4) of MiFID II is taken. We note that MiFID provisions have a different purpose and their application to the UCITS framework will limit the universe of the eligible investments for a UCITS fund: currently, equivalence decisions have been adopted only for some markets in Australia[13], Hong Kong SAR[14] and United States of America[15]. We strongly believe that UCITS should be able to continue investing in financial instruments traded in all third country markets that meet the conditions set in Article 50(1) of UCITSD other than in the EAD, regardless of the adoption of an equivalence decision by the Commission. For further comments on third country markets please also see to our response to Question 18.

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[12] ESMA Questions and Answers. Application of the UCITS Directive. Section I, Question 3a [last update 12 October 2016] “Q&A 948: Can the term “regulated market in a Member State” in Article 50(1)(b) of the UCITS Directive be understood to include a “multilateral trading facility” (MTF) as defined in Article 4(1)(15) of MiFID? Answer 3a: Yes. An MTF operated in the EU is a regulated market within the scope of the UCITS framework as long as it meets the requirements set out in Article 50(1)(b). Instruments in which a UCITS invests that are traded on such an MTF on behalf of a UCITS must comply with the Eligible Assets Directive9, in particular with its Article 2(1). If a UCITS proposes to invest in such an instrument, it should actively seek and review information regarding the liquidity and negotiability of that instrument in order to be satisfied that that the presumptions of liquidity and negotiability in the last sub-paragraph of Article 2(1) are well-founded.”

[13] Commission Implementing Decision (EU) 2017/2318 of 13 December 2017

[14] Commission Implementing Decision (EU) 2017/2319 of 13 December 2017

[15] Commission Implementing Decision (EU) 2017/2320 of 13 December 2017

Benchmark Regulation. We see no need to align the definition of indices in the EAD with those of benchmark under Benchmark Regulation, as it could imply the limitation on the financial instruments which references an index or a combination of indices eligible by UCITS. We are concerned about possible limitation on the financial instruments which references an index or a combination of indices eligible by UCITS, even if the holding of financial instruments referencing a certain benchmark is not considered to be the use of the benchmark[16]. It is worth noting that not all indices might fall within the scope of the BMR and this situation could get worse when the BMR will be revised and rationalised to remove the usage restrictions contained in the third country chapter of the current BMR, which were identified as an impediment to the use of the majority of non-EU benchmarks.

MiCA. With the implementation of MiCA and to article 4(1)(15) of MiFID, which provides that a *'financial instrument' means those instruments specified in Section C of Annex I, including such instruments issued by means of distributed ledger technology"*, we suggest clarifying that "tokenized" traditional financial instruments (such as fixed income instruments or funds whose shares or units are issued on a distributed ledger for digital circulation) are also eligible assets for UCITS funds. In providing such clarification, we would suggest considering the Assogestioni Guidelines on "Italian Digital Funds" which provide, inter alia, recommendations for the pricing of DLT financial instruments, the custody of such assets and the mitigation of security risks linked to the management of cryptographic assets within the framework of DLT financial instruments (such as generation of cryptographic keys, creation of Wallets, storage of keys, use of keys, policy in case of key impairment and for allowing and revoking keyholders).

Q20: Please fill in the table below on the merits of allowing direct or indirect UCITS exposures to the asset classes listed therein, taking into account the additional instructions provided in the footnotes.

Below are some evidence collected from members on their actual exposure to certain asset classes. The information does not claim to be representative of the industry represented by Assogestioni.

- direct and indirect (usually through other UCITS) exposure to:
    - CoCo bonds, ABS (including MBS), securities issued by securitization vehicles. The exposure to each individual asset class might be either significant (i.e over 75%) or not (up to 10%). Indeed, there are UCITS specialised in these asset classes.

[16] BMR. Article 3, Point 7 'use of a benchmark' means: (a) issuance of a financial instrument which references an index or a combination of indices; (b) determination of the amount payable under a financial instrument or a financial contract by referencing an index or a combination of indices; (c) being a party to a financial contract which references an index or a combination of indices; (d) providing a borrowing rate as defined in point (j) of Article 3 of Directive 2008/48/EC calculated as a spread or mark-up over an index or a combination of indices and that is solely used as a reference in a financial contract to which the creditor is a party; (e) measuring the performance of an investment fund through an index or a combination of indices for the purpose of tracking the return of such index or combination of indices, of defining the asset allocation of a portfolio, or of computing the performance fees;

        - The risk of these assets is captured through an adequate risk management process and a risk platform used to monitor financial risk. There may also be specific modelling of market risk factors and full revaluation for computing risk measures.
        - The Liquidity Risk Policy could complement the methodology used for corporate bonds with one based on trades, volume and liquidity score available through info providers. Specific modelling of liquidity surfaces could also be envisaged.
        - Pricing policy with market sources for both valuation and vertical/horizontal control purposes;
    - CLO, unrated bond, REITs, SPAC. Where used, the exposure is usually up to 5-10%;
- indirect exposure to:
    - commodities & precious metals: for a UCITS specialised in these asset classes the minimum indirect exposure (derivatives, ETC, ETF) is at least 30%;
    - commodities (index financial derivatives, ETC, ETF). Where used, the exposure is either < 5% or up to 10%;
    - precious metals (ETF). Where used, the exposure is either < 5% or up to 10%;
- direct exposure to:
    - EU AIF - closed-ended fund of private equity funds. Where used, the exposure is usually up to 5%.

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 exposure to the asset classes referred to in our response Q20 is made to improve risk return, enhancement/investment opportunity and/or to diversify the risk of a UCITS fund.

The use of ETC instruments allows to achieve a dual objective:

- increase (indirect) exposure in the "commodity" asset class, thanks to the diversified offer built by several investment houses of primary standing, with a 5% exposure limit per counterparty;
- diversify the allocation between commodities of different types, which is more complicated if not impossible through ETFs and derivatives on commodity indices that tend to follow the trend of the generic index.

On investments in REITs (Real Estate Investment Trusts), please note:

- Within the sector of companies that administer and manage real estate assets, there has been, for reasons mainly of a fiscal nature, the diffusion of legal models of organizing economic activity as an alternative to the corporation model. This phenomenon is evident in countries such as the USA, Canada, Singapore, Hong Kong and Australia, where the Real Estate sector is characterised by the predominance of the REITs model or the PT (Property Trusts) model. In Australia, stapled securities are also widespread.

- The major equity index providers include a significant number of such organisations among the constituents of their indices.
- The sector classification model GICS (Global Industry Classification Standard), jointly developed by MSCI and S&P, provides for the "Financial" sector (code 40), the "Mortgage Real Estate Investment Trusts (REITs")" industry sector and for the "Real Estate" sector (code 60), the "Equity Real Estate Investment Trusts (REITs)" industry group (code 6010)[17].

Any reflection on possible changes to the current eligibility of REITs or on the EAD's eligibility criteria for closed-ended funds should consider the duality of listed companies vs listed closed-end funds with the same liquidity levels, to avoid any disadvantage on the latter.

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 believe that the potentially unlimited range of assets a fund may indirectly invest in and the investment techniques it may implement strongly suggest setting exact limits on the extent to which a UCITS may invest. However, at the same time, the EAD has already broadened eligible investments through 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.

As already indicated in our answers to Questions 11 and 13, we totally agree with ESMA that questions of whether certain exposures in a UCITS fund are admissible and, if so, whether it is still shared or agreeable today to allow such exposure, are relevant themes that need to be clarified. We advocate for supervisory convergence and clarification, bearing in mind that the final interpretations will imply a greater or lesser possibility of obtaining indirect exposure to some underlying assets and opportunities for cost efficiencies.

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

[17] The REITs Industry Group is further subdivided into eight further specific sectors: *Diversified REITs, Industrial REITs, Hotel & Resort REITs, Office REITs, Health Care REITs, Residential REITs, Retail REITs, Specialized REITs*.

instruments/tools? Please share evidence and experiences on current market practice and views on a possible need for legislative clarifications or amendments.

Asset managers, as professional investor, who decide to invest in delta-one instruments or other similar instruments should have the appropriate competence to understand and monitor the risks embedded in the structure of the wrapper, whether long or short. In the presence of a leverage effect, similarly to what happens with other exposures, it is obvious that the effect and the speed of the price change is amplified.

Article 2(1)(a) of EAD states that the potential loss of a transferable security which the UCITS may incur with respect to holding those instruments should be limited to the amount paid for them. Therefore, we do not see risks coming from short positions build up through delta-one instruments that are particularly different from those associated with other securities.

As regards the other short positions build up using derivatives, we believe that the current UCITS framework well balances the risks and benefits deriving from building eligible short positions.

In this regard, it is worth noting that our NCA has regulated both the method of calculation of the amount to cover the cash commitment arising from short positions in derivative financial instruments (50% of the value of the short position calculated using the commitment method) and the assets that may be used to cover such commitment (cash, short-term MMF, risk-free assets, liquid debt instruments or liquid financial instruments positively correlated with the underlying of derivative financial instruments, the current value of which is reduced by an appropriate haircut). CESR/10-788 Guidelines do not define how such amount should be calculated[18].

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 EAD? If so, please describe the issues and how you would propose to revise the EAD or UCITS Directive with a view to improve investor protection, clarity and supervisory convergence.

Please find below some issues that need supervisory convergence for a level playing field and could be revisited and/or clarified.

EAD Implementation

- Derivatives on commodities. Art. 8(5) of EAD states that “The reference in Articles 1(2) and 19(1)(g) of Directive 85/611/EEC to liquid financial assets shall be

[18] CESR’s Guidelines on Risk Measurement and the Calculation of Global Exposure and Counterparty Risk for UCITS – CESR/10-788. Cover rules for transactions in financial derivatives instruments. Box. 28. “1. A UCITS should, at any given time, be capable of meeting all its payment and delivery obligations incurred by transactions involving financial derivative instruments. 2. Monitoring to ensure that financial derivative transactions are adequately covered should form part of the risk management process.”

understood as excluding derivatives on commodities". Among the main issues that merit further attention are regulatory/market practices to ensure that the eligibility rules on direct and indirect investment in the asset class "commodity" are implemented uniformly in all Member States. To complement our responses Q2, Q11 and Q12, it should be clarified whether cash-settled commodity futures (and other possible cash-settled commodity derivatives that are likely to refer to price indexes for commodities rather than to commodities as such) are or not eligible financial instruments.

UCITSD implementation:

- Transparency of third country trading venues: article 50(1) of UCITSD states that the investment of a UCITS shall comprise, among other, … "*c) only investment in transferable securities admitted to or dealt in on a regulated markets or on stock exchange in a third country or in another regulated market in a third country which operates regularly and is recognized and open to the public provided that the choice of stock exchange or market has been approved by competent authorities or is provided for in law or the fund rules or the instruments of incorporation of the investment company.*" Divergent approaches are seen across Member States regarding transparency in the fund rules/prospectus or the instruments of incorporation of the investment company, where only a few Member States requiring a specific disclosure. In this context, we note that the eligible assets regime for UCITS also sets out the requirements relating to the eligible markets on which eligible assets are traded and, even if the overall market meets the criteria, it does not necessarily ensure that all investments on the market are appropriate investments. Therefore, taking into account the technical nature of the information to be made available to a retail investor and markets development over time, we ask to modify the provision or, in any case, to harmonize its interpretation across Member States. For example, we suggest providing general information in the fund regulations or in the prospectus on the criteria used by the management company to identify markets in line with UCITSD, as indicated below: "regulated market: a regulated market within the meaning of Directive 2004/39/EC of the European Parliament, or any other market in an eligible state, country, or territory that the [management company] consider to be regulated, regularly operating, recognised, and open to the public".

- Derogations granted by Member States. The UCITSD contains provisions that may be derogated by Member States which, by definition, introduce divergent application of the UCITSD across EU. If more consistency could not be achieved with L2/L3 measures, we suggest reviewing the UCITSD to eliminate/reduce such possible derogations that could lead to regulatory arbitrage. For example
  - on limit concentration in transferable securities or money market instruments issued or guaranteed by a third country (art. 52(3) UCITSD[19]). According to

[19] UCITSD. Art. 52(3). "… Member States may raise the 5 % limit laid down in the first subparagraph of paragraph 1 to a maximum of 35 % if the transferable securities or money market instruments are issued or guaranteed by a Member

national rules, the 5% concentration limit can be increased to 35% only for OECD countries (in addition to Member States and their local authorities and public international bodies to which one or more Member States belong).

L3 measures implementation:

- Specific rules are identified at the national level by the NCA in the implementation of CESR's Guidelines on Risk Measurement and the Calculation of Global Exposure and Counterparty Risk for UCITS (CESR/10-788)
  - Cover rule: please refer to our response Q24
  - VaR: the authorization of the VaR model for the calculation of the global exposure is only made by the NCA (and not also by an internal or external auditor or by an external service provider independent of the building process[20]). In addition, the result of the back testing is automatically reflected in the reduction of the VaR limit[21].

Tabella 1 Esposizione complessiva

Numero di scostamenti	Metodo del VaR relativo (rapporto dei VaR)	Metodo del VaR assoluto
meno di 5	VaR 200%	VaR massimo (Max 20%)
5	VaR 160%	VaR massimo -20% (16%)
6	VaR 150%	VaR massimo -25% (15%)
7	VaR 135%	VaR massimo -32,5% (14%)
8	VaR 125%	VaR massimo -37,5% (13%)
9	VaR 115%	VaR massimo -42,5% (12%)
10 o più	VaR 100%	VaR massimo -50% (10%)

State, by its local authorities, by a third country or by a public international body to which one or more Member States belong."

[20] CESR's Guidelines on Risk Measurement and the Calculation of Global Exposure and Counterparty Risk for UCITS – CESR/10-788. 3.7 Var Approach: Qualitative Requirements. Point 72. "The validation of the VaR model following its initial development can be conducted for example by a relevant competent authority, by an internal or external auditor or by an external service provider independent of the building process."

[21] CESR's Guidelines on Risk Measurement and the Calculation of Global Exposure and Counterparty Risk for UCITS – CESR/10-788. 3.6.4. Back testing. Box 18, point 6. " The UCITS senior management should be informed at least on a quarterly basis (and where applicable the UCITS competent authority should be informed on a semi-annual basis), if the number of overshootings for each UCITS for the most recent 250 business days exceeds 4 in the case of a 99% confidence interval. This information should contain an analysis and explanation of the sources of 'overshootings' and a statement of what measures if any were taken to improve the accuracy of the model. The competent authority may take measures and apply stricter criteria to the use of VaR if the 'overshootings' exceed an unacceptable number."