ASSOGESTIONI
associazione del risparmio gestito

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ESMA Discussion Paper – Share classes of UCITS (ESMA/2014/1577)

Assogestioni[1], the Italian Fund and Asset Management Association, welcomes the opportunity to respond to ESMA Discussion on Paper on a common understanding/definition of share classes according to the UCITS directive (ESMA/2014/1577).

Q1: What are the drivers for creating different share classes?

As a preliminary note, Assogestioni believes that the creation of share classes can benefit both investors and the asset managers.
As far as the first ones are concerned, the creation of different share classes of a UCITS allow a customisation of the UCITS product to be achieved, on the basis of different parameters which meet investors preferences, such as the type of investor (retail or institutional), minimum investment amounts and fees levied (subscription/redemption, management and performance fees), currency denomination, revenue distribution (capitalisation or distribution). In addition, another advantage from an investor's perspective stems from the benefits coming from the economies of scale that can be achieved by managing larger underlying pools. Furthermore, the bigger a fund, with different share classes offered to attract different type of investors, the lesser the risk of investors' concentration.

[1] Assogestioni is the trade body for Italian asset management industry and represents the interests of members who manage funds and discretionary mandates around € 1.700 bn (as of February 2015).

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As for the asset managers, the drivers for creating different share classes, can be found in the mutualisation of costs, deriving from the creation of economies of scales: instead of launching different funds, each customised to meet investors' preference, more efficiencies can be obtained by enabling different investors into one fund with different customised share classes.

Q2: Why do certain UCITS decide to create share classes instead of setting up a new UCITS?

As already mentioned in our response to Q1, the possibility to reach economies of scale, with a mutualisation of costs (such as administrative costs) can be seen as an important driver for the decision to create share classes instead of setting up a new UCITS. Moreover, the creation of share classes allows asset managers to benefit for operational simplification, as the creation of share classes does not require the prior authorization by competent authorities, and may only require the preparation of a new KIID. Furthermore there is a reduction in the time to market: it is easier and less expensive to activate additional share classes, already included in the prospectus, than launching new funds.

Q3: What are the costs of creating and operating a new share class compared to the cost of creating and operating a separate UCITS?

As already indicated in our replies to Q1 and Q2, the creation of new share classes requires lower operational and capital costs compared to the set up of a new fund. This firstly derives from the regulatory requirements which need to be complied with when a new share class is created, compared to those relating to the set up of a new fund: the activation of a new share class would not require an update of the prospectus where this already foresees that one share class, but merely the preparation of the relevant KIID, where necessary. Differently, the creation of a separate UCITS fund (or compartment) will require a new prospectus in addition to the class-specific KIID.
As for an asset manager, share classes usually permit a significantly smaller initial asset base (or seed capital).
Moreover, it is also useful to remember that the liquidation costs of a UCITS are higher than deactivating an individual share class.

Q4: What are the different types of share class that currently exist?

Up to now, Italian domiciled funds do not use mainly share classes; nevertheless different types of share classes, also used by our members in Luxembourg/Irish fund can be identified. We provide hereafter a non-exhaustive list of types of share classes. These types may differ in terms of: (i) different minimum investment amounts; (ii) the type of investors; (iii) the types of charges and fees that may be levied and their amount (on-going charges, subscription and redemption fees,

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performance-related fees); (iv) currency denomination; (v) currency hedging, (vi) revenue distribution (capitalisation or distribution).

Q5: How would you define a share class?

Share classes are not separate and segregated assets from a UCITS. They are categories of shares that belong to a same UCITS (or compartment) and allow sub-sets of investors in a UCITS to achieve some level of customisation which meets their specific needs.
In any case, as stated by ESMA in the first bullet point of paragraph 6 of the Discussion Paper, the level of customisation shall not infringe the principle according to which share classes of the same UCITS should have the same investment strategy. Moreover, as indicated in the second bullet point of paragraph 6 by ESMA, the features that are specific to one share class should not have a potential (or actual) adverse impact on other share classes of the same UCITS. Disclosure obligations are also necessary, as stressed out in the third bullet point of paragraph 6 by ESMA.

Q6: Do you agree that share classes of the same UCITS should all share the same investment strategy? If not, please justify your position.

We share ESMA's view that different share classes shall have the same investment strategy. More in particular, Assogestioni agrees with ESMA's indication that share classes that provide currency hedging, when share classes are denominated in different currencies from the base currency, could be considered as compatible with the principle of a common investment strategy. The investment in such a hedged class may have a different return/risk profile, due to the currency, although the fund's strategy - as for example the criteria used to select the different asset classes or the single instruments in the same asset class - remains unchanged. We believe that such principle may be applied also for the creation of share classes which foresee other hedging than the currency one as, in particular, share classes that offer differing degrees of protection against some market risks such as interest rate risk or volatility risk (please also refer to our replies to Q9 and Q10).

Q8: Do you agree that the types of share class set out in paragraph 8 are compatible with the principle of having the same investment strategy? In particular do you agree that currency hedging that is described in paragraph 8 complies with that principle? If not, please justify your position.

Assogestioni shares ESMA's view that all the types of share classes, as indicated in paragraph 8 of ESMA's Discussion paper are compatible with the principle of having the same investment strategy.
In particular, share classes that provide currency hedging are compatible with such a principle, as they are intended to ensure that investors receive as nearly as possible

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the same results of the investment strategy even though their exposure is obtained through a different currency.

Q9: Do you believe that other types of share class that comply with the principle of having the same investment strategy exist (or could exist) and should be allowed? If yes, please give examples.

Assogestioni believes that, in addition to the share classes that are considered by ESMA in paragraph 8 compatible with the principle of having the same investment strategy, other share classes should be considered as compatible with that principle. We refer to those share classes (indicated in paragraph 10) that offer differing degrees of protection against some market risks such as interest rate risk or volatility risk. We believe that where the hedging strategy is implemented separately from the investment strategy and applied systematically (even if dynamically) to hedge defined types of risk (such as currency hedging), with no discretion by the manager in determining whether or not to apply the strategy hedging, also other risks, different from the currency one, may be hedged.
Differently from what stated by ESMA in paragraph 11 of the Discussion paper, interest rate and volatility risk hedging share classes are not incompatible with the principle mentioned above: indeed, such hedging mitigates the effect of rate/market changes without the inconvenience for investors to have to invest into a new fund vehicle for this purpose.

Q10: Do you agree that the types of share class set out in paragraph 10 above do not comply with the principle of having the same investment strategy? If not, please justify your position.

As already indicated in our reply to Q9, Assogestioni does not share ESMA's view that all the types of share classes set out in paragraph 10 of the Discussion Paper are not compliant with the principle of having the same investment strategy. Share classes that realize interest rate or volatility risk hedging are compatible with such a principle.

Q12: Do you see merit in ESMA clarifying how regulatory ratios such as the counterparty risk limit should be calculated (e.g. at the level of the UCITS or share classes)?

No, we do not see merit in clarifying how regulatory ratios should be calculated. We believe that prudential rules set in UCITS Directive should be calculated at the level of the funds or sub-fund and not at the level of share classes: each UCITS compartment has a single pool of assets with no segregation of these assets between share classes.

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Q13: Do potential and current investors get adequate information about the characteristics, risks and return of different classes in the same UCITS? If not, what else should be provided to them?

Assogestioni believes that adequate information is already available to investors, both under the relevant Level 1 Directive, as well as under its Level 2 implementing measures. More specifically, this is achieved under the disclosure requirements concerning share classes according to Article 78(7)(b)(ii) of the Level 1 text (as recast) and Article 25 of the Level 2 Regulation 583/2010. We consider the aforementioned disclosure requirements as appropriate for investors to understand the main characteristics of the different share classes, alongside their relevant risks, return profile and their related costs.

Q14: Do you agree that ESMA should develop a common position on this issue? If not, please justify your position.

Assogestioni agrees with ESMA's proposition to develop a shared position relating to UCITS share classes which could lead to a harmonized and common definition of what constitutes a "share class" according to the UCITS directive. We are also in favor of a more flexible approach to be taken, in order to allow other types of share classes than those indicated in paragraph 8 of ESMA's Discussion Paper to be considered admissible, as long as the principle of having a same investment strategy is not infringed (please, refer to our replies to Q9 and Q10).

The Director General

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