European Securities and Markets Authority

Questions and Answers

Application of the UCITS Directive

25 May 2018 | ESMA34-43-392

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Contents

I. Background

1. The Undertakings for Collective Investment in Transferable Securities (UCITS) Directive puts in place a comprehensive framework for the regulation of harmonised investment funds within Europe. The extensive requirements with which UCITS must comply are designed to ensure that these products can be sold on a cross-border basis. The most recent version of the Directive (as amended by Directive 2014/91/EU, so called 'UCITS V') introduces rules on remuneration policies and sanctions and strengthens the depositary regime.

2. The UCITS framework is made up of the following EU legislation:

    a. Directive 2009/65/EC, which was adopted in 2009. It is a 'framework' Level 1 Directive which has been supplemented by technical implementing measures (see the Level 2 legislation in b. below).

    b. Directive 2007/16/EC[1]; Directive 2010/43/EU[2]; Regulation No 583/2010[3]; Directive 2010/42/EU[4]; Regulation No 584/2010[5]; and Regulation (EU) 2016/1212[6].

3. ESMA is required to play an active role in building a common supervisory culture by promoting common supervisory approaches and practices. In this regard, the Authority develops Q&As as and when appropriate to elaborate on the provisions of certain EU legislation or ESMA guidelines.

II. Purpose

4. The purpose of this document is to promote common supervisory approaches and practices in the application of the UCITS Directive and its implementing measures. It does this by providing responses to questions posed by the general public and competent authorities in relation to the practical application of the UCITS framework.

5. The content of this document is aimed at competent authorities under UCITS to ensure that in their supervisory activities their actions are converging along the lines of the

[1] COMMISSION DIRECTIVE 2007/16/EC of 19 March 2007 implementing Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards the clarification of certain definitions.

[2] COMMISSION DIRECTIVE 2010/43/EU of 1 July 2010 implementing Directive 2009/65/EC of the European Parliament and of the Council as regards organisational requirements, conflicts of interest, conduct of business, risk management and content of the agreement between a depositary and a management company.

[3] COMMISSION REGULATION (EU) No 583/2010 of 1 July 2010 implementing Directive 2009/65/EC of the European Parliament and of the Council as regards key investor information and conditions to be met when providing key investor information or the prospectus in a durable medium other than paper or by means of a website.

[4] COMMISSION DIRECTIVE 2010/42/EU of 1 July 2010 implementing Directive 2009/65/EC of the European Parliament and of the Council as regards certain provisions concerning fund mergers, master-feeder structures and notification procedure.

[5] COMMISSION REGULATION (EU) No 584/2010 of 1 July 2010 implementing Directive 2009/65/EC of the European Parliament and of the Council as regards the form and content of the standard notification letter and UCITS attestation, the use of electronic communication between competent authorities for the purpose of notification, and procedures for on-the-spot verifications and investigations and the exchange of information between competent authorities.

[6] Commission Implementing Regulation (EU) 2016/1212 of 25 July 2016 laying down implementing technical standards with regard to standard procedures and forms for submitting information in accordance with Directive 2009/65/EC of the European Parliament and of the Council

responses adopted by ESMA. However, the answers are also intended to help UCITS management companies by providing clarity as to the content of the UCITS Directive rules, rather than creating an extra layer of requirements.

6. This document consolidates into a single document all Q&As relating to the UCITS Directive previously issued by ESMA i.e. the Q&As on:

   a. the Key Investor Information Document (KIID) for UCITS (2015/ESMA/631);

   b. ESMA's guidelines on ETFs and other UCITS issues (ESMA/2015/12);

   c. Notification of UCITS and exchange of information between competent authorities (ESMA/2012/428); and

   d. Risk Measurement and Calculation of Global Exposure and Counterparty Risk for UCITS (ESMA/2013/1950).

   These four Q&As are hereby repealed and replaced by this document.

III. Status

7. The Q&A mechanism is a practical convergence tool used to promote common supervisory approaches and practices under Article 29(2) of the ESMA Regulation.[7]

8. Therefore, due to the nature of Q&As, formal consultation on the draft answers is considered unnecessary. However, even if they are not formally consulted on, ESMA may check them with representatives of ESMA's Securities and Markets Stakeholder Group, the relevant Standing Committee's Consultative Working Group or, where specific expertise is needed, with other external parties.

9. ESMA will review these questions and answers on a regular basis to identify if, in a certain area, there is a need to convert some of the material into ESMA guidelines. In such cases, the procedures foreseen under Article 16 of the ESMA Regulation will be followed.

IV. Questions and Answers

10. This document is intended to be continually edited and updated as and when new questions are received. The date each question was last amended is included after each question for ease of reference.

[7] Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC Regulation, 15.12.2010, L331/84.

Section I – General

Question 1: Directive 2014/91/EU (UCITS V) – update of documentation

Date last updated: February 2016

Question 1a [last update 1 February 2016]: UCITS V requires (i) the KIID to include a prescribed statement in relation to remuneration policy and (ii) the prospectus to include some remuneration-related information. UCITS are required to make an updated KIID available within 35 days of 31 December each year, while the 'essential elements' of the prospectus must be kept up to date at all times. Will UCITS be required to issue a further KIID and a revised prospectus on 18 March 2016 to reflect the UCITS V requirement?

Answer 1a: No: except where a UCITS is subject to national laws and regulations in its home Member State that require updates to be made by 18 March 2016, the UCITS will be allowed to update the KIID with this information at the next annual update after 18 March 2016, or on the first occasion after 18 March 2016 on which the KIID is revised or replaced for another purpose, if the information is available at that point in time. Similarly, a UCITS will be allowed to add the relevant information to the prospectus at the next occasion it is revised for another purpose or in any event by 18 March 2017 at the latest.

In the meantime, UCITS management companies should make available on a relevant website the additional information about the management company's remuneration arrangements as soon as it becomes available.

Question 1b [last update 1 February 2016]: UCITS V requires the annual report to include some remuneration-related information. The annual report shall be published within four months from the end of the period to which it relates. Does the UCITS V requirement apply to all annual reports published on or after 18 March 2016?

Answer 1b: No, it is not necessary to include the remuneration-related information in any annual report relating to a period that ended before 18 March 2016. For annual reports relating to periods that end on or after 18 March 2016, but before the UCITS management company has completed its first annual performance period in which it has to comply with articles 14a and 14b of the Directive, the UCITS management company should include the remuneration-related information in the report on a best efforts basis and to the extent possible, explaining the basis for any omission.

Question 1c [last update 1 February 2016]: When must existing UCITS depositary contracts be updated in order to meet the requirements under Directive 2014/91/EU (UCITS V)?

Answer 1c: UCITS V will start to apply on 18 March 2016. Under Article 22(2) of the UCITS Directive, introduced by UCITS V, the appointment of the depositary shall be evidenced by written contract, while the delegated acts required under Article 26b will set out the particulars that need to be included in that written contract. UCITS depositary contracts should be revised promptly in accordance with any transitional arrangements outlined in the delegated acts.

UCITS V contains provisions which prescribe in law the liability of depositaries. While there is no requirement to include those liability provisions in depositary contracts, in practice existing depositary contracts will contain liability provisions which will not be consistent with the depositary liability provisions set out in UCITS V. In accordance with Article 24(4), those provisions of a contract which set out the parties' agreement on depositary liability and which conflict with the UCITS V depositary liability provisions will be void with effect from 18 March 2016. The UCITS V depositary liability provisions will apply instead. The liability provisions in existing depositary contracts should be amended to reflect the UCITS V depositary liability provisions when those depositary contracts are revised to comply with the delegated acts.

Question 2: Master-feeder structures

Date last updated: April 2016

Question 2a [last update 1 April 2016]: Can a UCITS invest in a UCITS feeder fund?

Answer 2a: No. As UCITS feeder funds have to invest at least 85% of their net assets in their UCITS master fund, another UCITS cannot invest in a UCITS feeder fund. According to Article 50(1)(e)(iv) of the UCITS Directive, a UCITS can only invest in other UCITS if "no more than 10 % of the assets of the UCITS or of the other collective investment undertakings, whose acquisition is contemplated, can, according to their fund rules or instruments of incorporation, be invested in aggregate in units of other UCITS or other collective investment undertakings".

Question 3: Regulated markets under the UCITS Directive

Date last updated: October 2016

Question 3a [last update 12 October 2016]: 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 Directive[8], 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.

[8] Commission Directive 2007/16/EC of 19 March 2007 implementing Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards the clarification of certain definitions ("Eligible Assets Directive")

Question 4: Investment limits

Date last updated: November 2016

Question 4a [last update 21 November 2016]: Pursuant to Article 56(2)(c) of the UCITS Directive, a UCITS may acquire no more than 25% of the units of any single UCITS or other collective investment undertaking. Where the underlying UCITS or other collective investment undertaking is an umbrella fund, should this limit be applied at the level of the umbrella or at the level of the individual sub-funds within the umbrella?

Answer 4a: The limit set out in Article 56(2)(c) should be applied at the level of the individual sub-funds in the UCITS or collective investment undertaking of which the units are to be acquired, to ensure the principle of risk-spreading within the investing UCITS. Where an investment company or a management company is currently applying a different interpretation of this limit, it must at the earliest convenience adjust the funds' portfolios whilst acting with due skill, care and diligence in the best interest of the UCITS it manages.

Question 4b [last update 21 November 2016]: Pursuant to Article 55(1) of the UCITS Directive, a UCITS may acquire the units of UCITS or other collective investment undertakings referred to in Article 50(1)(e), provided that no more that 10% of its assets are invested in units of a single UCITS of other collective investment undertaking. Where the underlying UCITS or other collective investment undertaking is an umbrella fund, should this limit be applied at the level of the umbrella or at the level of the individual sub-funds within the umbrella?

Answer 4b: The limit set out in Article 55(1) applies at the level of the individual sub-funds in the UCITS or collective investment undertaking of which the units are to be acquired. Where an investment company or a management company is currently applying a different interpretation of this limit, it must at the earliest convenience adjust the funds' portfolios whilst acting with due skill, care and diligence in the best interest of the UCITS it manages.

Question 5: Issuer concentration

Date last updated: July 2017

Question 5a: Does the 40% limit set out in Article 52(2) of the UCITS Directive apply to index-tracking UCITS that are subject to Article 53 of the UCITS Directive?

Answer 5a: No. The 40% limit set out in Article 52(2) does not apply to index-tracking UCITS that comply with the requirements set out in Article 53.

Section II – Key Investor Information Document (KIID) for UCITS[9]

Question 1: Preparation of KIID by UCITS that are no longer marketed to the public or by UCITS in liquidation

Date last updated: September 2012

Question 1a: Where an existing UCITS is no longer marketed to the public, should it be required to prepare a KIID?

Answer 1a: In accordance with Article 82 of the UCITS Directive a UCITS is required to keep the essential elements of key investor information up-to-date. In accordance with Article 23 of Commission Regulation (EU) No 583/2010, a KIID with duly revised presentation of past performance of the UCITS shall be made available no later than 35 business days after 31 December each year. Notwithstanding that a UCITS is no longer marketed to the public, an up-to-date version of the KIID should be available to the existing investors.

Question 1b: Similarly, should there be an obligation to prepare a KIID for a UCITS that is in liquidation?

Answer 1b: When a UCITS is in liquidation there can be no obligation to prepare a KIID as the liquidator may have assumed many of the powers of the UCITS management company.

Question 1c: For a structured UCITS, as defined in Article 36 of Commission Regulation (EU) No 583/2010 that is no longer marketed to the public, should there be an obligation to update the KIID?

Answer 1c: Yes. A structured UCITS, as defined in Article 36 of Commission Regulation (EU) No 583/2010, needs to keep its KIID up to date.

Question 2: Communication of KIID to investors

Date last updated: September 2012

Question 2a: Should existing investors within a UCITS be provided with a KIID in the case of additional investments?

Answer 2a: Yes. Existing investors should be provided with a KIID in the case of additional investments, on the basis that the KIID is a pre-contractual document and each additional subscription is a new contract. However, where unit holders in a UCITS invest through a regular savings plan, a KIID is not required in relation to the periodic subscriptions, unless a

[9] This section mirrors the content of the old Q&A on the Key Investor Information Document (KIID) for UCITS (2015/ESMA/631), which is replaced by the present document.

change is made to the subscription arrangements, for example, increases or decreases in the subscription amount, which would require a new subscription form.

Question 2b: Should existing investors within a UCITS umbrella fund, who switch or exchange units in one sub-fund for units in another, be provided with the KIID for the sub-fund in which they are going into?

Answer 2b: Yes. As a pre-contractual document, the investor must receive the KIID for the sub-fund they are going into including where this investment arises from switching from another sub-fund within the umbrella.

Question 2c: Should an amended KIID be provided to existing investors within the UCITS?

Answer 2c: No. In accordance with Article 79 of the UCITS Directive, key investor information shall constitute pre-contractual information. A KIID does not need to be provided to existing investors unless they are making additional subscriptions. Investors always have the right to be provided with the KIID on request.

Question 2d: Must professional investors be provided with a KIID?

Answer 2d: Yes. All prospective investors must be provided with a KIID.

Question 3: Treatment of UCITS with share or unit classes

Date last updated: September 2012

Question: Should individual KIIDs be prepared for each class of units or shares within a UCITS?

Answer: In accordance with Article 26 of Commission Regulation (EU) No 583/2010 a separate KIID shall be produced for each individual share class. However, information relevant to two or more share classes may be combined into a single KIID provided the resulting KIID complies in full with all KIID requirements (including the limit on length). Also, a UCITS may select a class to represent one or more other classes of the UCITS provided the information in the KIID is fair, clear and not misleading to prospective investors in those other classes. Where charging structures differ between classes, the share class with the highest overall charge is the most appropriate representative share class to avoid the risk of understating charges. However, it is the responsibility of the UCITS to select the most appropriate representative share class having regard to the characteristics of the UCITS, the natures of the differences between share classes in the UCITS and the range of choices on offer to each investor.

Question 4: Past performance

Date last updated: 26 March 2015

Question 4a: If a UCITS does not yet have performance data for one complete calendar year (and is not a UCITS which may provide simulated data for past performance), how should this position be disclosed in the KIID?

Answer 4a: In accordance with Article 15(4) of Commission Regulation (EU) No 583/2010 a statement that there is insufficient data to provide a useful indication of past performance should be included in the KIID. There is no need to accompany that statement with a blank performance chart.

Question 4b: Where a UCITS refers to an index in its investment objectives and policies as a benchmark and will measure the performance against this but does not intend to track that index, is it necessary to show the performance of the benchmark index in the past performance section of the KIID?

Answer 4b: Yes, in accordance with Article 18(1) of Commission Regulation (EU) No 583/2010, a bar showing the performance of the benchmark index must be included in the bar chart alongside each bar showing the UCITS past performance. It should be made clear in the past performance section of the KIID that the performance is not tracking the index.

Question 4c: Where a UCITS refers to an index in its investment objectives and policies (for example as an indication of the universe from which investments may be selected) but does not intend to measure performance against that index, is it necessary to show the performance of the index in the past performance section of the KIID?

Answer 4c: No, in this case it is not necessary to refer to the index in the past performance section of the KIID.

Question 4d: What should be displayed in the bar chart for years when there is no data?

Answer 4d: Pursuant to Article 15, paragraph 3 of Regulation 583/2010, when there is no data available, the year shall be shown as blank with no annotation other than the date.

Question 4e: If the benchmark is changed, how should the chart of past performance be displayed for the period preceding the change?

Answer 4e: Pursuant to Article 17 of Regulation 583/2010, where a material change occurs to a UCITS' objectives and investment policy during the period displayed in the bar chart, the UCITS' past performance prior to that material change shall continue to be shown. Therefore, if the benchmark is modified, the bar chart should display the performance of the previous benchmark for the period preceding the change. A statement indicating this change should also be included in the past performance section.

Question 4f: When several versions of a benchmark are available which differ in the approach taken to reinvestment of revenues, which version should be used in the past performance chart?

Answer 4f: Pursuant to Article 16 of Regulation 583/2010, past performance figures shall be calculated on the basis that any distributable income of the fund has been reinvested. Therefore, where available the performance of the benchmark with reinvestment of revenues should be used in the bar chart alongside the UCITS' past performance. Where such a benchmark does not exist, an appropriate disclosure highlighting that the benchmark does not take into account the reinvestment of revenues should be included in the KIID.

Question 4g: Article 19(4) of Commission Regulation (EU) No 583/2010 states that "In the case of mergers referred to in Article 2(1)(p)(i) and (iii) of Directive 2009/65/EC, only the past performance of the receiving UCITS shall be maintained in the key investor information document." Article 19(4) applies in cases where a receiving UCITS has a performance history. How should Article 19(4) be interpreted in cases where the receiving UCITS is a newly established UCITS with no performance history and is in effect a continuation of the merging UCITS?

Answer 4g: In the case of a merger where the receiving UCITS is a newly established UCITS with no performance history, UCITS should use the past performance of the merging UCITS in the KIID of the receiving UCITS if the competent authority of the receiving UCITS reasonably assesses that the merger does not impact the UCITS' performance. ESMA expects the performance of the UCITS to be impacted if there is, inter alia, a change to the investment policy or to the entities involved in the investment management. It should also be made clear in the KIID of the receiving UCITS that the performance is that of the merging UCITS.

Question 5: Clear language

Date last updated: September 2012

Question 5a: Is it possible to signpost to a glossary?

Answer 5a: Yes. However, as provided by the guide to clear language and layout for the Key Investor Information document (ref. CESR/10-1320), the use of a glossary should not result in too numerous cross-references.

Question 5b: Is it possible to show the complete name of the fund when first mentioned and then simply refer it as "the Fund" after in the KIID.

Answer 5b: Yes and the same approach can be taken for share classes of funds with a reference to "the share class of the fund" in the KIID.

Question 6: Identification of the UCITS

Date last updated: September 2012

Question: Should the name of the investment manager(s) of the UCITS, if any, be disclosed in the KIID?

Answer: No. Only the name of the UCITS management company should be disclosed.

Question 7: Translation requirements in relation to the remuneration disclosure

Date last updated: October 2016

Question 7 [last update 12 October 2016]: Article 78(4), second sub-paragraph of the UCITS Directive requires the KIID to include a statement to the effect that the details of the up-to-date remuneration policy are available by means of a website and that a paper copy will be made available free of charge upon request. Does this mean that, in case of cross-border distribution of a UCITS, the information on the remuneration policy which has to be made available on a website (and the paper copy of it to be made available on request) needs to be translated into the same language as the one into which the KIID has to be translated?

Answer 7: No. The information on the remuneration policy which has to be made available on a website (and the paper copy of it to be made available on request) should fall under Article 94(1)(c) of the UCITS Directive relating to information or documents other than the KIID. Therefore, this information should be translated, at the choice of the UCITS, into one of the following:

a) the official language, or one of the official languages, of the UCITS host Member State,

b) a language approved by the competent authorities of that Member State, or

c) a language customary in the sphere of international finance.

Section III – ESMA's guidelines on ETFs and other UCITS issues[10]

Question 1: Information to be inserted in the prospectus

Date last updated: 11 July 2013

Question 1a: Can the prospectus of an index-tracking UCITS mention both replication methodologies (physical and synthetic replication)?

Answer 1a: Yes. If the UCITS intends to use both replication methodologies either at the same time or alternatively, this should be reflected in the prospectus.

Question 1b: Do the provisions on Index-tracking UCITS also apply to UCITS ETFs?

Answer 1b: Yes, to the extent that the UCITS ETF is tracking an index or indices.

Question 2: UCITS ETF label

Date last updated: 15 March 2013

Question 2: In the case of umbrella UCITS, does the requirement to use the label "UCITS ETF" apply to both the umbrella level and the sub-fund level?

Answer 2: If all the sub-funds are UCITS ETFs, the labelling requirement applies to the sub-fund level and the UCITS may decide to apply it to the umbrella level as well. However, if not all the sub-funds are UCITS ETFs, the labelling requirement only applies to the relevant sub-funds.

Question 3: Secondary market

Date last updated: 11 July 2013

Question 3a: If a UCITS ETF is open for direct redemption for secondary market investors, what should be the redemption price?

Answer 3a: If secondary market investors are given the possibility to redeem directly at the level of the UCITS ETF, the redemption price should be the Net Asset Value (NAV) from which costs may be deducted. According to paragraph 24 of the guidelines the costs of direct redemptions should not be excessive.

[10] This section mirrors the content of the old Q&A on ESMA's guidelines on ETFs and other UCITS issues (ESMA/2015/12), which is replaced by the present document.

Question 3b: When the UCITS ETF is open for direct redemptions, should UCITS management companies arrange the redemptions directly with secondary market investor of the UCITS ETF?

Answer 3b: In most cases, UCITS ETFs do not have a direct relationship with secondary market investors of UCITS ETFs. Therefore, UCITS management companies are not required to be directly in contact with the secondary market investors of the UCITS ETF but should make sure that appropriate processes are in place in order to allow direct redemptions when needed. In this context, the reference to unit-holders in Article 92 of the UCITS Directive should be understood as including secondary market investors of UCITS ETFs.

Question 4: Efficient portfolio management techniques

Date last updated: 15 March 2013

Question 4a: According to the guidelines, all revenues arising from efficient portfolio management techniques, net of direct and indirect operational costs, should be returned to the UCITS. Does this mean that securities lending agents should not be paid for their services?

Answer 4a: No. The guidelines do not prohibit the deduction from gross revenues arising from efficient portfolio management techniques of fees paid to securities lending agents as a normal compensation for their services in the context of such techniques. However, pursuant to paragraph 35 of the guidelines, the annual report of the UCITS should contain details on the revenues arising from efficient portfolio management techniques for the entire reporting period together with the direct and indirect operational costs and fees incurred.

Question 4b: In some jurisdictions, UCITS management companies may also act as securities lending agents. In this case, what information should be provided to investors?

Answer 4b: First, pursuant to paragraph 28 of the guidelines, it should be disclosed to investors that the UCITS management company acts a securities lending agent. Also, according to paragraph 35 of the guidelines, the annual report of the UCITS should provide investors with details on the amount of fees paid to the UCITS management company that may be deducted from the gross revenues arising from efficient portfolio management techniques.

Question 4c: According to paragraph 28 of the guidelines, UCITS should disclose the identity of the entity(ies) to which the direct and indirect costs and fees are paid and indicate if these are related parties to the UCITS management company or the depositary. Where should this information be disclosed?

Answer 4c: UCITS management companies may disclose this information in the prospectus of the UCITS or in the annual report of the UCITS.

Question 5: Financial derivative instruments

Date last updated: 9 January 2015

Question 5a: When a UCITS enters into an unfunded swap, should the exposure swapped into the UCITS be considered in combination with the assets that are swapped out to assess the compliance with investment limits laid down in Article 52, 53, 54, 55 and 56 of the UCITS Directive?

Answer 5a: No. If the UCITS swaps the performance of its assets against the performance of another portfolio of assets, the UCITS should not combine both the assets swapped out and the exposure swapped into the UCITS when assessing the investment limits laid down in Articles 52, 53, 54, 55, 56 of the UCITS Directive because the ultimate exposure of the UCITS is not a combination of the two portfolios.

However, pursuant to paragraphs 36 and 37 of the guidelines, when a UCITS enters into an unfunded swap, both the UCITS' investment portfolio that is swapped out and the portfolio that is swapped into the UCITS should comply with the investment limits laid down in Articles 52, 53, 54, 55 and 56 of the UCITS Directive.

Question 5b: Section XI of the guidelines on financial derivative instruments refers to total return swaps or other financial derivative instruments with similar characteristics. What types of instrument are covered here?

Answer 5b: First of all, the purpose of paragraphs 36 and 37 is to clarify that total return swaps should be treated like any other financial derivative instrument. This means that, in accordance with Article 51(3) of the UCITS Directive, the UCITS' investment portfolio as well as the final exposure of the UCITS resulting from the investment in financial derivative instruments should comply with the UCITS investment limits laid down in Articles 52, 53, 54, 55 and 56 of the UCITS Directive.

As far as paragraph 36 is concerned, ESMA's intention is to make sure that the guidelines are not circumvented via the use of financial derivative instruments that are not total return swaps but that have similar characteristics.

Question 5c: What is the scope of application of paragraphs 37, 39 and 40 of the guidelines?

Answer 5c: Paragraphs 37, 39 and 40 of the guidelines apply to any financial derivative instrument by which UCITS gain exposure to an asset.

Question 5d: For the purposes of paragraph 39 of the guidelines, would the counterparty to a financial derivative instrument be considered as having discretion over the composition of the underlying of the financial derivative instrument under the following arrangement? The counterparty to the financial derivative instrument can decide on the composition of the underlying of the financial derivative instrument or the UCITS investment portfolio without the prior consent of the UCITS management company.

Answer 5d: Yes, because the counterparty to the financial derivative instrument has discretion over the composition of the underlying of the financial derivative instrument or the UCITS' investment portfolio.

Question 5e: For the purposes of paragraph 39 of the guidelines, would the counterparty to a financial derivative instrument be considered as having discretion over the composition of the underlying of the financial derivative instrument under the following arrangement? The counterparty to the financial derivative instrument offers advice to the UCITS management company on the composition of the underlying of the financial derivative instrument or the UCITS' investment portfolio but any investment decision must be approved by the UCITS management company.

Answer 5e: No, provided that the UCITS management company expressly approves any investment decision in advance.

Question 5f: For the purpose of paragraph 39 of the guidelines, would the counterparty to a financial derivative instrument be considered as having discretion over the composition of the underlying assets of the financial derivative instrument under the following arrangement? The role of the counterparty only involves implementing a set of rules and this set of rules is agreed in advance with the UCITS management company and does not allow the exercise of any discretion by the counterparty.

Answer 5f: No, in such circumstances the counterparty to the financial derivative instrument will not be considered as having any discretion over the composition of the underlying assets of the financial derivative instrument.

Question 6: Collateral management

Date last updated: October 2016

Question 6a: Do the requirements on collateral only apply to the fraction of assets that reduces the counterparty risk of the UCITS to the limit imposed by the UCITS Directive?

Answer 6a: No. The requirements on collateral apply to all the assets received in the context of OTC financial derivative transactions and efficient portfolio management (EPM) techniques to cover counterparty risk. This means that assets received in excess (i.e. after the application of haircuts) should also comply with the same requirements.

Question 6b: Should re-invested cash collateral comply with the 20% issuer limit of paragraph 43 (e)?

Answer 6b: Yes. According to paragraph 44 of the guidelines, re-invested cash collateral should be diversified in accordance with the diversification requirements applicable to non-cash collateral. This means that the 20% issuer limit applies to:

- entities prescribed in Article 50(f) of the UCITS Directive at which UCITS may place cash collateral;

- high-quality government bonds and Short-Term Money Market Funds in which cash collateral may be reinvested;

If UCITS reinvest cash collateral in reverse repo transactions, the reverse repo transactions should comply with sections X and XII of the guidelines on efficient portfolio management techniques and collateral management.

Question 6c: Which types of asset do not comply with the requirement of correlation of paragraph 43 (d) of the guidelines?

Answer 6c: According to paragraph 43 (d) of the guidelines, collateral received by the UCITS should be issued by an entity that is independent from the counterparty and is expected not to display a high correlation with the performance of the counterparty. Therefore, collateral issued or guaranteed by the counterparty of an OTC financial derivative transaction or EPM technique or by one of its subsidiaries or by a parent company, or more generally by an entity belonging to the same issuer group should not be considered compliant with paragraph 40 (d) of the guidelines.

Question 6d: Are tripartite agreements for collateral management in the context of efficient portfolio management techniques and OTC financial derivative transactions forbidden by paragraph 40(g) of the guidelines?

Answer 6d: No. Tripartite agreements are possible under paragraph 40(g) as long as there is no title transfer and the collateral is held by a third party custodian subject to prudential supervision and that is unrelated to the provider of the collateral.

Question 6e: When there is transfer of title, can the collateral be held by a custodian that is not the depositary of the UCITS?

Answer 6e: Yes, but only if the UCITS' depositary has delegated the custody of the collateral to a sub-custodian and the depositary remains liable if the collateral is lost by the sub-custodian.

Question 6f: Paragraph 43(e) refers to "a basket of collateral with a maximum exposure to a given issuer of 20% of its net asset value". Does this diversification requirement refer to the basket of collateral or to the net asset value of the UCITS?

Answer 6f: The diversification refers to the net asset value of the UCITS. Therefore, collateral received should be diversified so that exposure to any issuer does not exceed 20% of the net asset value of the UCITS. This means that where the amount of collateral received by a UCITS does not exceed 20% of its net asset value, the collateral can be issued by a single issuer.

Question 6g: In the case of government bonds, can the 20% limit be deemed to apply to each different issue of bonds of the same issuer?

Answer 6g: No. The limit applies to the issuers and not to the issue. Accordingly, exposure to any one government issuer, or any individual issuer, is limited to 20% of the net asset value of the UCITS.

Question 6h: Do the ESMA guidelines require that counterparty risk exposures be aggregated across both financial derivative instruments and efficient portfolio management techniques?

Answer 6h: Yes. According to paragraph 41 of the ESMA guidelines, both exposures should be combined when calculating the counterparty risk limits of Article 52 of the UCITS Directive.

Question 6i: Are government bonds exempt from the provisions laid down in paragraphs 43(a) and paragraphs 43 (e) of the guidelines?

Answer 6i: No, paragraphs 43(a) and 43 (e) apply to all types of collateral received by the UCITS in the context of over-the-counter financial derivative transactions and efficient portfolio management techniques.

Question 6j: Can cash collateral received by UCITS in the context of EPM techniques or OTC financial derivative transactions be used by UCITS for clearing obligations under EMIR?

Answer 6j: No. Cash collateral received by UCITS can only be placed or invested in the assets listed in paragraph 43(j) of the guidelines.

Question 6k: When assessing the diversification of the collateral, should re-invested cash collateral be aggregated with non-cash collateral?

Answer 6k: Yes. UCITS should aggregate non-cash collateral and re-invested cash collateral when assessing the diversification requirements of collateral received by UCITS.

Question 6l: According to paragraph 43(g), where there is title transfer, the collateral received should be held by the depositary of the UCITS. Where there is title transfer and where the provider is also the depositary of the UCITS, should the collateral be held by the depositary of the UCITS?

Answer 6l: Yes. However, the depositary should have functionally and hierarchically separated the performance of its depositary tasks from its activity of collateral provider vis-à-vis the UCITS in order to address potential conflicts of interest.

Question 6m: When UCITS reinvest cash collateral, should the reinvested cash collateral be taken into account for the calculation of the issuer concentration limits laid down in the UCITS Directive?

Answer 6m: Yes, in accordance with paragraph 2 of Box 27 of the guidelines on Risk Measurement and Calculation of Global Exposure and Counterparty Risk for UCITS (Ref. CESR/10-788) the reinvested cash collateral should be taken into account for the calculation of the investment restrictions applicable to UCITS. For example, this means that if a UCITS has already placed 10% of its assets on deposits with a given issuer, it should not reinvest cash collateral for more than 10% of its assets in deposits with the same issuer in order to comply with the 20% limit of Article 52(1)(b) of the UCITS Directive.

In addition, the reinvested cash collateral has to comply with the diversification requirement laid down in paragraph 44 of the ESMA guidelines on ETFs and other UCITS issues.

Question 6n: When a UCITS reinvests cash collateral in short-term money market funds pursuant to paragraph 43 (j) of the guidelines, should the short-term money market funds comply with the requirements of Article 50(1)(e)(iv) of the UCITS Directive (i.e. the short-term money market funds should not invest more than 10% of their assets in aggregate in other money market funds)?

Answer 6n: Yes, the requirement of Article 50(1)(e)(iv) of the UCITS Directive also applies to short-term money market funds in which UCITS may reinvest cash collateral.

Question 6o [last update 12 October 2016]: A UCITS has a clause in its fund rules limiting investment in units of other funds to 10%, in line with Article 50(1)(e)(iv) of the UCITS Directive. If, in accordance with paragraph 43 of the ESMA Guidelines on ETFs and other UCITS issues, this fund re-invests cash collateral in short-term money market funds, should this investment be included in the calculation when calculating the 10% limit?

Answer 6o: Yes. Investment of cash collateral in short-term money market funds should be treated in the same way as any other investment made by the UCITS in units of other UCITS or other collective investment undertakings and should be compliant with all the requirements of the UCITS Directive.

Question 7: Financial indices

Date last updated: 24 March 2014

Question 7a: Do the guidelines on financial indices also apply to UCITS that only use financial indices as performance benchmark?

Answer 7a: No. The guidelines on financial indices apply only to UCITS that are using any indices for investment purposes.

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.

Question 7c: Paragraph 56 of the guidelines recommends that all levels of an index should be subject to transparency requirements. What does this mean?

Answer 7c: This means that if a financial index is comprised of other financial indices, the transparency requirements also apply to the underlying indices.

Question 7d: According to the guidelines, index components' weightings should be published after each re-balancing on a retrospective basis. What is the timetable for such publication?

Answer 7d: Weightings of index components should be published before the next rebalancing of the index. For example, if an index rebalances on a monthly basis, information on the weightings of the index components should be provided as soon as possible after the rebalancing but within one month of the rebalancing.

Question 7e: Paragraph 54 of the guidelines prohibits investment in financial indices which rebalance on an intra-day or daily basis but notes that technical adjustments made to financial indices (such as leveraged indices) according to publicly available criteria should not be considered as rebalancing in the context of the guidelines. What is meant by "technical adjustments"?

Answer 7e: Technical adjustments in the context of the guidelines are adjustments which:

- are based solely on algorithmic non-subjective frameworks;
- are generally published on an ex-ante basis;
- draw on publicly available criteria (or data); and

- do not rely on the judgement of the index-provider, for example, indices which follow mechanical rebalancing formulae.

Question 7f: Are financial indices of indices permitted?

Answer 7f: Yes.

Question 7g: Should underlying financial indices composing financial indices in which UCITS invest comply with the guidelines on financial indices?

Answer 7g: Underlying financial indices should comply with section XIII of the guidelines except paragraphs 48, 49, 50 and 53 of the guidelines. This means that underlying financial indices do not need to satisfy the diversification requirements laid down in Article 9 of the Eligible Assets Directive.

However, to fulfil the guidelines of paragraphs 53, UCITS that invest in indices of indices should take into account the rebalancing frequency of the underlying indices.

Question 7h: Paragraph 61 of the guidelines recommends that financial indices in which UCITS invest should be subject to independent valuation. Does this mean that UCITS should not invest in financial indices for which the valuation is performed by the index provider itself?

Answer 7h: No. If the valuation is performed by an entity independent from the index provider, the criterion of independent valuation is considered to be fulfilled. However, UCITS can invest in financial indices for which the valuation is performed by the index provider, insofar as the unit in charge of the valuation of the index is functionally independent from the unit responsible for the design of the index and the UCITS itself carries out its own due diligence. Also, the remuneration of the staff responsible for the valuation of the index should not be linked to the performance of the financial index.

Question 7i: According to paragraph 59 of the guidelines, UCITS should not invest in financial indices whose methodologies permit retrospective changes to previously published index values (‘backfilling’). Does this provision cover calculation mistakes?

Answer 7i: No. Calculation mistakes are not covered by paragraph 59 of the guidelines.

Question 7j: According to paragraph 55 of the guidelines, UCITS should not invest in financial indices for which the full calculation methodology to, inter alia, enable investors to replicate the financial index, is not disclosed by the index provider. Such information should be easily accessible, free of charge. What is meant by disclosed, easily accessible and free of charge in the context of the guidelines?

Answer 7j: The information to be disclosed and provided must be publicly available to investors and prospective investors, and published in such a way that direct access to this information is possible. Such information may be so accessed, for example, as a direct publication or via a source which directly links to a public website or other public forum which is not password protected, encrypted or in any way hinders or impedes immediate and direct access.

Question 7k: Paragraph 50 of the guidelines prohibits investment by UCITS in commodity indices that do not consist of different commodities and applies a correlation factor to be considered in this regard. Can UCITS invest in a commodity index for which a particular commodity component does not have 5 years of price history available for the purposes of the correlation observation?

Answer 7k: Yes, provided that a similar asset serves as an adequate proxy. The basis for such an asset being considered as an adequate proxy needs to be supported by both qualitative and quantitative data. Those qualitative and quantitative data should be documented by UCITS management companies. The proxy asset cannot constitute more than 3 years of the 5 years of data for the purposes of the calculation. The proxy must be a single commodity (rather than a component of a basket or other amalgam/hybrid product) asset. However, this asset could include a financial index which complies with section XIII of the guidelines.

Question 8: Transitional provisions

Date last updated: 15 March 2013

Question 8a: From when are the requirements set out in paragraphs 43, 44, 45 and 46 of the guidelines applicable for UCITS existing before the guidelines apply?

Answer 8a: UCITS existing before the guidelines apply should comply with the provisions of paragraphs 41, 43, 44, 45 and 46 within 12 months of the date of application of the guidelines. However, pursuant to paragraph 65 of the guidelines, any new reinvestment of cash collateral made by UCITS existing before the guidelines apply should comply with the guidelines immediately.

Question 8b: With respect to the tracking error, what type of information should existing UCITS provide for accounting periods that end within 12 months of the date of application of the guidelines if the prospectus has not been amended according to the guidelines?

Answer 8b: In this situation, existing UCITS only need to provide information on the realised tracking error; information on the anticipated tracking error and any difference between the two can be reported as from the next accounting period.

Question 8c: Are EPM techniques concluded by UCITS before the date of application of the guidelines subject to transitional provisions?

Answer 8c: UCITS that exist before the date of application of the guidelines should amend the agreements governing EPM techniques in accordance with Sections X and XII of the guidelines as soon as possible. At the latest, 12 months after the date of application of the guidelines any EPM techniques should comply with the provisions of Section X and XII of the guidelines.

Question 8d: Are structured UCITS created after the entry into force of the guidelines and which are compartments of an umbrella UCITS created before the guidelines take effect subject to the grandfathering rule set out in paragraph 64 of the guidelines.

Answer 8d: No. The transitional provisions apply to compartments of umbrella UCITS and not to umbrella UCITS themselves.

Section IV – Notification of UCITS and UCITS management companies; exchange of information between competent authorities[11]

Question 1: Notification of new investment compartments

Date last updated: July 2012

Question 1a: Should UCITS that wish to market new investment compartments in a Member State where they are already notified for marketing for other existing investment compartments undertake a new notification procedure via their competent authority?

Answer 1a: Yes. According to Article 91(4) of Directive 2009/65/EC, the notification procedure as referred in to Article 93 of that Directive also applies to investment compartments of UCITS.

Question 1b: Should UCITS that wish to market several investment compartments of the same UCITS undertake different notification procedures via their competent authority?

Answer 1b: No. UCITS can undertake a single notification procedure via their competent authority when they wish to market several investment compartments of the same UCITS in a Member State. Indeed, according to the Annex I of the Commission Regulation 584/2010, UCITS may indicate names of different investment compartments in the notification letter they transmit to their competent authority pursuant to Article 93(1) of Directive 2009/65/EC.

Question 1c: If the UCITS attestation transmitted to the competent authority of the home Member State lists all the existing investment compartments of a UCITS, should the UCITS undertake a notification procedure for all the investment compartments it intends to market in a Member State?

Answer 1c: Yes. Even if the UCITS attestation lists all the existing investment compartments of a UCITS, the marketing of these investment compartments in a Member State is possible only if the competent authority of the host Member State has been duly notified by the competent authority of the home Member State.

[11] This section mirrors the content of the old Q&A on Notification of UCITS and exchange of information between competent authorities (ESMA/2012/428), which is replaced by the present document.

Question 2: Amendments and updates of documents referred to in Article 93(2) of Directive 2009/65/EC

Date last updated: July 2012

Question 2a: Should notifications to the competent authorities of the host Member States of amendments to the documents referred to in Article 93(2) of Directive 2009/65/EC (i.e. fund rules or instruments of incorporation, prospectus, latest annual report and half-yearly report by the UCITS) be accompanied by an attestation letter?

Answer 2a: No. The attestation letter should only be transmitted to the competent authority of the host Member State by the competent authority of the home Member State at the time of the original notification of marketing.

Question 2b: Should notification by the UCITS to the competent authorities of the host Member States of a change in the name of the UCITS or in one of its investment compartments be accompanied by an attestation letter?

Answer 2b: No. When UCITS notify the competent authorities of home Member States of a change in the name of the UCITS or in one of its investment compartments, no UCITS attestation should be transmitted.

Question 2c*:* Should a UCITS follow a new notification procedure via its competent authority when it notifies updates of documents referred to in Article 93(2) to competent authorities of host Member States?

Answer 2c: No. When UCITS notify updates of documents to the competent authority of the host Member State they should not undertake a new notification procedure via their competent authority.

Question 2d: Should all the documents referred in to Article 93(2) of Directive 2009/65/EC be transmitted when UCITS send updates of documents to the competent authorities of the host Member States pursuant to Article 32(2) of Directive 2010/42/EU?

Answer 2d: No. Only the documents which have been modified should be transmitted to the competent authority of the host Member State.

Question 3: UCITS host Member State's access to documents

Date last updated: July 2012

Question 3a: When a UCITS is notified for the first time for marketing in a Member State, when should the UCITS make available on a website an electronic copy of each document referred to in Article 93(2)?

Answer 3a: In order to satisfy the obligation of Article 31(1) of Directive 2010/42/EU, UCITS should make available on a website an electronic copy of each document referred to in Article 93(2) as soon as possible after they receive confirmation from their national competent authorities that the notification of marketing has been transmitted to the competent authority of the host Member State.

Question 3b: When complying with the obligation of access to documents as required by Article 31(1) of Directive 2010/42/EU, can UCITS use password-protected documents?

Answer 3b: No. The use of password-protected documents by UCITS is not permitted.

Question 4: Part A of the notification letter

Date last updated: July 2012

Question: If the UCITS is a self-managed investment company, what information should be provided under the heading 'details of contact person at the management company' in Part A of the notification letter?

Answer: If the UCITS is a self-managed investment company, the details of the contact person at the self-managed investment company and the relevant contact information should be provided.

Question 5: Exchange of information between competent authorities in the context of establishment of a branch of a UCITS management company

Date last updated: July 2012

Question: In the context of establishment of a branch by a UCITS management company in a different Member State, in which language should competent authorities of home Member States send the relevant information to competent authorities of host Member States?

Answer: The information should be sent in a language customary in the sphere of international finance, unless the competent authorities of the UCITS home and host Member States agree to that information being provided in an official language of both Member States.

Question 6: Attestation of payment of notification fees

Date last updated: July 2012

Question: Under Part B of the model notification letter set out in Annex I of Regulation 584/2010, the UCITS' host Member State may require evidence of payment of notification fees. How should this evidence of payment be provided?

Answer: There should be evidence that the notification fee has been transferred e.g. by a scan of the transfer form. The evidence should be attached to the notification as proof of payment.

Question 7: Advance notification of provision of services

Date last updated: April 2017

Question: A UCITS management company wishes to pursue cross-border activities (MiFID services, collective portfolio management of UCITS) by way of the UCITS management company passport (Articles 16 to 21 of the UCITS Directive). Does the management company have to identify a specific UCITS, in respect of which it wants to pursue said activities, in the notification letter?

Answer: No. The management company can notify cross-border activities without having to identify a specific UCITS. When the management company, at a later point in time, has identified a UCITS that it wants to manage on a cross-border basis, it has to notify the competent authorities in the home Member State of the UCITS in accordance with Article 20 of the UCITS Directive.

Section V – Risk Measurement and Calculation of Global Exposure and Counterparty Risk for UCITS[12]

Question 1: Hedging strategies

Date last updated: July 2012

Question 1a: Can the following strategy be qualified as a hedging strategy as defined in CESR's guidelines?

A portfolio management practice which only aims to reduce the interest rate risk of a corporate bond portfolio by entering into a short position on bond future contracts (or an interest rate swap) in the same currency and with a similar interest rate duration. Note that in this case the portfolio credit risk would remain un-hedged.

Answer 1a: Yes. This strategy could be considered as a hedging arrangement as defined in CESR's guidelines as it is in line with the example set out in paragraph 33(a) of the guidelines.

Question 1b: Can the following strategy be qualified as a hedging strategy as defined in CESR's guidelines?

A portfolio management practice which aims to reduce the credit risk of a corporate or government bond portfolio through purchased Credit Default Swaps (CDS). Note that in this case the portfolio interest rate risk would remain un-hedged.

Answer 1b: Yes, but only if the corporate or government bond and the purchased CDS relate to the same issuer.

Question 1c: When calculating the global exposure according to the Commitment Approach, can UCITS that invest in other funds make use of hedging arrangements?

Answer 1c: According to Box 8 of CESR's guidelines, for the purpose of calculating global exposure under the Commitment Approach, hedging arrangements may only be taken into account if they relate to the same asset class. Therefore, hedging arrangements for UCITS funds of funds are possible provided that the management company of the investing UCITS has full knowledge of the underlying investments of the target funds.

[12] This section mirrors the content of the old Q&A on Risk Measurement and Calculation of Global Exposure and Counterparty Risk for UCITS (ESMA/2013/1950), which is replaced by the present document.

Question 2: Disclosure of leverage by UCITS

Date last updated: July 2012

Question 2a: For UCITS using VaR to calculate global exposure, can the required disclosure of leverage be made on a net basis i.e. leverage calculated after netting/hedging arrangements are taken into account?

Answer 2a: No. In accordance with Boxes 24 and 25 of CESR's guidelines, leverage should be calculated as the sum of the notionals of the derivatives used.

Question 2b: Could UCITS using the VaR approach to calculate global exposure disclose leverage based on the Commitment Approach?

Answer 2b: Yes. However, the leverage should be disclosed based on both the 'sum of the notionals' as provided by CESR's guidelines and the Commitment Approach.

Question 3: Concentration rules

Date last updated: July 2012

Question: Article 54 of Directive 2009/65/EC permits competent authorities to authorise UCITS to invest up to 100% of their assets in transferable securities issued by certain issuers e.g. sovereigns. In such cases the UCITS must hold securities from at least six different issues and securities from any single issue shall not exceed 30% of its total assets.

Should this diversification rule apply on the basis of the net assets of the UCITS or on a gross basis?

Answer: The 100% diversification limit of Article 54 should be applied on the net assets (i.e. exposure to assets referred to in this article is limited to 100% of the net asset value) as all investment restrictions applicable to UCITS, including the diversification limits of Article 54, have to be applied with reference to their net assets and because any exposure beyond 100% to a sovereign issuer cannot be considered as 'equivalent protection' with regard to Article 52.

Furthermore, it is explicitly clarified that any exposure taken to assets referred to in Article 54, including through derivatives (e.g. bond future contracts such as Euro. Bund Future, 10 Year US T-Note future) and any efficient portfolio management techniques (e.g. reinvestment of cash collateral) must be included when calculating the limit of 100% according to Article 54.

Question 4: Calculation of global exposure for fund of funds

Date last updated: July 2012

Question: Is the look-through approach compulsory for the calculation of global exposure when UCITS invest in other funds?

Answer: No. For the purpose of calculating global exposure, a look-through approach is not compulsory when UCITS invest in other funds. As an alternative, UCITS may treat the NAV of the target fund as an equity and use it as a substitute in the calculation of global exposure, in particular when the VaR Approach is used.

This method may only be used if the risk management function can prove and document that this approach does not lead to an inaccurate picture of the fund of funds. In addition, UCITS fund of funds structures have to comply with all due diligence and risk management requirements laid down in the UCITS framework (Directive 2009/65/EC, Directive 2010/43/EU and the CESR guidelines on Risk Management principles for UCITS[13]). Finally, the method chosen by the UCITS should be disclosed in the prospectus.

Question 5: Calculation of counterparty risk for exchange-traded derivatives and centrally-cleared OTC transactions

Date last updated: December 2013

Question: How should UCITS calculate their counterparty risk for exchange-traded derivatives and OTC transactions that are centrally cleared under the European Market Infrastructure Regulation (EMIR)?

Answer: When calculating the counterparty risk for exchange-traded derivatives and OTC transactions that are centrally cleared, UCITS should look at the clearing model used to determine the existence of counterparty risk and, if any, where the counterparty risk is located. When analysing the clearing model used, UCITS should have regard to the existence of segregation arrangements of the assets and the treatment of claims on these assets in the event of bankruptcy of the clearing member or central counterparty.[14]

[13] CESR guidelines on Risk Management principles for UCITS – Ref. CESR/09-178, https://www.esma.europa.eu/sites/default/files/library/2015/11/09_178.pdf

[14] Since this question was last updated, ESMA has issued an opinion to the European institutions on the Impact of Regulation 648/2012 on Articles 50(1)(g) (iii) and 52 and of Directive 2009/65/EC for over-the-counter financial derivative transactions that are centrally cleared (ESMA/2015/880)

Section VI – Impact of Regulation (EU) 648/2012 (EMIR)[15] on the UCITS Directive

Question 1: Valuation of OTC derivatives

Date last updated: July 2016

Question [last update 19 July 2016]: For OTC financial derivative transactions that are centrally cleared and subject to the reporting obligation of EMIR, can UCITS management companies rely on the valuation provided by the central counterparty (CCP)?

Answer: No. The UCITS framework requires UCITS management companies to have in place a process for accurate and independent verification of the value of the OTC financial derivative transactions, even if they are centrally cleared. The valuation provided by the CCP can only serve as a point of reference for the verification performed by the UCITS management company. Nevertheless, the UCITS management company should be able to justify any deviation from the valuation provided by the CCP.

Question 2: Application to UCITS of the exemption for intra-group transactions under EMIR

Date last updated: 24 May 2017

Question: Where a UCITS is subject to the clearing obligation of Article 4(1) of EMIR, can it make use of the exemption for intragroup transactions (Article 4(2) of EMIR)?

Answer: ESMA is of the view that in the case of UCITS the exemption for intragroup transactions should be construed narrowly, and that in most cases it will not be possible for the exemption to be used. A UCITS can only make use of the exemption for intragroup transactions if it has been established to form part of the same group (as defined in Article 2(16) of EMIR) as the counterparty to the OTC derivative contract and if it fulfils all the criteria for intragroup transactions set out in Article 3(2)(a)(i)-(iv), (b), or (d) of EMIR.

Article 3(2)(a)(iii) of EMIR requires both counterparties to be included in the same consolidation on a full basis. In addition, they have to be subject to appropriate centralised risk evaluation, measurement and control procedures, as well as fulfil other specific requirements set out in Article 3(2) of EMIR.

An exemption to the clearing obligation based on Article 4(2) of EMIR can only be granted after a thorough case-by-case assessment, which will have to take into account whether the UCITS has been established to form part of the same group as the counterparty to the OTC derivative

[15] Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories ("European Markets Infrastructure Regulation")

contract and whether the UCITS fulfils all the criteria set out in Article 3(2)(a), (b), or (d) of EMIR.

Where a UCITS is granted an intragroup exemption for the clearing obligation, it follows that the UCITS will not be considered a distinct entity and will not be treated separately for other purposes under EMIR either, in particular for the purpose of the bilateral margining thresholds calculation. Therefore, the aggregate month-end average notional amount referred in Article 28(1) of Commission Delegated Regulation (EU) 2016/2251 shall be calculated at the group level (including the relevant UCITS).

Section VII – Impact of Regulation (EU) 2015/2365 (SFTR)[16] on the UCITS Directive

Question 1: Commencement of reporting under SFTR

Date last updated: October 2016

Question 1a [last update 12 October 2016]: Article 13 of Regulation (EU) 2015/2365 on transparency of securities financing transactions and of reuse and amending Regulation (EU) No 648/2012, requires UCITS management companies, UCITS investment companies, and AIFMs to provide information to investors on the use made of SFTs and total return swaps in the annual report of each UCITS/AIF under management, as well as in each half-yearly report for UCITS. As Article 13 applies from 13 January 2017, which report should be the first to include this disclosure?

Answer: The information should be included in the next annual or half-yearly report to be published after 13 January 2017 which may relate to a reporting period beginning before that date.

Question 2: Periodic reporting under Article 13 of SFTR for UCITS and AIFs

Date last updated: 5 October 2017

Question 2a [last update 5 October 2017]: Pursuant to Article 13 of SFTR, UCITS management companies, UCITS investment companies, and AIFMs ("UCITS/AIF managers") shall inform investors on the use they make of SFTs and total return swaps in annual (UCITS and AIFs) and half-yearly (UCITS only) reports. The information on SFTs and total return swaps shall include the data provided for in Section A of the Annex to SFTR.

Should this data be reported as aggregate data (with respect to the whole of the reporting period) or based on a snapshot (taken at the end of the reporting period)?

Answer: The table below explains how each data item in Section A of the Annex to the SFTR should be reported. All data items should be reported as a snapshot, with the exception of the following:

- Data on reuse of collateral
    - Cash collateral reinvestment returns to the collective investment undertaking.
- Data on return and cost for each type of SFTs and total return swaps
    - broken down between the collective investment undertaking, the manager of the collective investment undertaking and third parties (e.g. agent lender) in

[16] Regulation (EU) 2015/2365 of the European Parliament and of the Council of 25 November 2015 on transparency of securities financing transactions and of reuse and amending Regulation (EU) No 648/2012

absolute terms and as a percentage of overall returns generated by that type of SFTs and total return swaps

For each of the data items firms should not artificially alter their practices in a way that would lead to the reporting being misleading.

The guidance provided by this Q&A is without prejudice to further work that ESMA intends to carry out in relation to the disclosure obligations for UCITS and AIFs under SFTR.

Heading	**Sub-item**	**How to report**
Global data	The amount of securities and commodities on loan as a proportion of total lendable assets defined as excluding cash and cash equivalents	Snapshot
	The amount of assets engaged in each type of SFTs and total return swaps expressed as an absolute amount (in the collective investment undertaking's currency) and as a proportion of the collective investment undertaking's assets under management (AUM).	Snapshot
Concentration data	Ten largest collateral issuers across all SFTs and total return swaps (break down of volumes of the collateral securities and commodities received per issuer's name);	Snapshot
	Top 10 counterparties of each type of SFTs and total return swaps separately (Name of counterparty and gross volume of outstanding transactions).	Snapshot
Aggregate transaction data for each type of SFTs and total return	Type and quality of collateral;	Snapshot

swaps separately to be broken down according to the below categories		
	Maturity tenor of the collateral broken down in the following maturity buckets: less than one day, one day to one week, one week to one month, one to three months, three months to one year, above one year, open maturity;	Snapshot. All outstanding/existing collateral at the end of the reporting period should be aggregated according to their maturity tenor. That aggregation should be broken down in the mentioned maturity buckets.
	Currency of the collateral;	Snapshot. Currency of the existing collateral at the end of the reporting period.
	Maturity tenor of the SFTs and total return swaps broken down in the following maturity buckets: less than one day, one day to one week, one week to one month, one to three months, three months to one year, above one year, open transactions;	Snapshot. All outstanding/existing SFTs at the end of the reporting period should be aggregated according to their maturity tenor. That aggregation should be broken down in the mentioned maturity buckets.
	Country in which the counterparties are established;	Snapshot. Country where the counterparties of existing SFTs as of the end of the reporting period are established.
	Settlement and clearing (e.g., tri-party, Central Counterparty, bilateral).	Snapshot
Data on reuse of collateral	Share of collateral received that is reused, compared to the maximum amount specified in the prospectus or in the disclosure to investors;	Snapshot

	Cash collateral reinvestment returns to the collective investment undertaking.	See explanation below table
Safekeeping of collateral received by the collective investment undertaking as part of SFTs and total return swaps	Number and names of custodians and the amount of collateral assets safe-kept by each of the custodians	Snapshot
Safekeeping of collateral granted by the collective investment undertaking as part of SFTs and total return swaps	The proportion of collateral held in segregated accounts or in pooled accounts, or in any other accounts	Snapshot
Data on return and cost for each type of SFTs and total return swaps	broken down between the collective investment undertaking, the manager of the collective investment undertaking and third parties (e.g. agent lender) in absolute terms and as a percentage of overall returns generated by that type of SFTs and total return swaps	See explanation below table

Regarding the field "Cash collateral reinvestment returns to the collective investment undertaking", during the year the fund receives a certain amount of cash as collateral for SFTs which is invested and produces a return. All SFTs have a given duration (normally short term) and there may be several SFTs that are carried out on a number of occasions with repeated investments and divestments of cash. Due to the possible concatenation of the operations, there may be a certain amount of cash collateral which is constantly invested for the whole year and produces a return. One interpretation is that the SFTR requires managers to disclose at least the overall sum of the returns earned by the fund from all the investment operations made during the year with cash collateral. This sum may only be an income flow that covers the whole year and therefore the distinction between aggregate vs snapshot (i.e. flow vs stock data) is not meaningful, because it could be calculated in only one way. One alternative would be to state that this is "aggregate" by definition. Another alternative would be to require the disclosure of the cash collateral investment return, calculated as the sum of the cash flows received for the investment of SFTs cash collateral over the yearly average amount of cash collateral investments.

The same reasoning applies to the field “Data on return and cost for each type of SFTs and total return swaps/broken down between the collective investment undertaking, the manager of the collective investment undertaking and third parties (e.g. agent lender) in absolute terms and as a percentage of overall returns generated by that type of SFTs and total return swaps”. The manager has to sum the inflows and outflows generated by all the operations during the year and disclose the two total amounts; again, there appears to be only one way to calculate the data required and the disclosure of rate of returns (gross and net of cost) could be required if deemed more appropriate.

Section VIII – Independence of management boards and supervisory functions

Question 1: Group links, independence and cooling-off periods

Date last updated: July 2017

Question: Where a group link exists for the purpose of Article 24 of the Commission Delegated Regulation (EU) 2016/438 ("UCITS V Level 2"), does a person who served in the management body or supervisory body of an entity within the group or was otherwise employed by such an entity fulfil the independence requirement under Article 24(2) of the UCITS V Level 2 where the person has ceased any function within the entity?

Answer: A person who served in the management body or supervisory body of an entity or was otherwise employed by such an entity should be deemed to fulfil the independence requirement only after an appropriate cooling-off period following the termination of his/her relationship with the relevant entity. That period should start from the final payment of any outstanding remuneration due to him/her which entails a margin of discretion from the entity (e.g. in case of any portion of variable remuneration which is deferred and still subject to contraction, including through malus or clawback arrangements) and is linked to his/her previous employment or other relationship with that entity. Non-discretionary outstanding payments from the entity to the person should not be taken into account for this purpose.

Without prejudice to any requirements established under the relevant national corporate governance rules or codes, the cooling-off period should be proportionate to the length of the employment or other relationship that the individual had with any of the companies within the group and to the type of functions performed within such company(ies).

Section IX – Remuneration

Question 1: Application of disclosure requirements on remuneration to delegates

Date last updated: May 2018

*** NEW *** **Question 1 [last update 25 May 2018]:** Do the remuneration-related disclosure requirements under Article 69(3)(a) of the UCITS Directive also apply to the staff of the delegate of a management company to whom investment management functions (including risk management) have been delegated?

Answer: Yes. In line with the approach followed under the UCITS Remuneration Guidelines[17], management companies can ensure compliance in one of the following two ways:

i) where the delegate is subject to regulatory requirements on remuneration disclosure for its staff to whom investment management (including risk management) activities have been delegated that are equally as effective as those

[17] See paragraph 16 of the UCITS Remuneration Guidelines.

under Article 69(3)(a) of the UCITS Directive, the management company should use the information disclosed by the delegate for the purposes of fulfilling its obligations under Article 69(3)(a) of the UCITS Directive; or

ii) in other cases, appropriate contractual arrangements should be put in place with the delegate allowing the management company to receive (and disclose in the annual report for the relevant UCITS that it manages) at least information on the total amount of remuneration for the financial year, split into fixed and variable remuneration, paid by the management company, the investment company and, where relevant the UCITS itself to the identified staff of the delegate – and number of beneficiaries, and, where relevant, performance fee – which is linked to the delegated portfolio. This means that the disclosure should be done on a prorated basis for the part of the UCITS' assets which are managed by the identified staff within the delegate.

In both situations set out above, the disclosure may be provided on an aggregate basis i.e. by means of a total amount for all the delegates of the management company in relation to the relevant UCITS.