

# Communication

March 2017

## New ESMA opinion on share classes

On 30 January 2017, the European Securities and Markets Authority (“ESMA”) published an opinion ([Link](#) to the ESMA opinion) on UCITS share classes detailing the four high-level principles a UCITS must follow when setting up different share classes and the share class hedging techniques which comply with such principles. As a consequence existing non-compliant share classes may continue to operate but will need to be closed for new subscriptions before 30 July 2017 and for subsequent subscriptions before 30 July 2018. The CSSF communicated in a press release from 13 February 2017 that they expect UCITS to take the necessary measures to comply with the transitional provisions set forth in the ESMA Opinion.

### Four high-level principles:

- **Common investment objective:**
  - ESMA considers that hedging arrangements at share class level are not compatible with the requirement for a fund to have a common investment objective. As an exception ESMA is however of the view that currency risk hedging at the level of a share class is compatible with the principle of a common investment objective
  - Share classes could be classified as “technical share classes” or as “overlay share classes” if they benefit from a derivatives-based currency hedging arrangement.
- **Non-contagion:**
  - Due to the lack of asset segregation between share classes, the derivatives used in the overlay of a given share class become part of the common pool of assets. Therefore there is a potential counterparty and operational risk for all investors in the sub-fund
  - Any additional risk and cost introduced through the use of a derivative overlay should only be borne by the investors in the respective share class
  - Accounting methodology: profit and loss (realised and unrealised) of the derivative assets used for hedging purposes in an overlay share class are only applied to the respective share class.



In the regard of contagion risk, ESMA recommends that:

- Derivatives should not lead to a payment or delivery obligation which is greater than the value of the relevant share class
- The UCITS management company should put in place operational and accounting segregation to identify the assets and liabilities of each share class on an ongoing basis
- Share classes should be subject to stress tests to quantify the impact of losses on all investor classes of a fund that are due to losses relating to share class specific assets that exceed the value of the respective share class
- The derivative overlay should be implemented in accordance with a detailed, pre-defined and transparent hedging strategy.

For share classes with a derivative overlay:

- The exposure to a counterparty (to be calculated in respect to the net asset value of the share class) comply with the limits laid down in Article 52 of the UCITS Directive
- Over-hedged positions do not exceed 105% of the share class NAV
- Under-hedged positions do not fall short of 95% of the share class currency exposure
- The UCITS keep hedged positions under review on an ongoing basis
- The UCITS put in place procedures to rebalance hedging arrangements on a regular basis to ensure compliance with permitted levels.

#### ■ Pre-determination

All features of a share class should be pre-determined before the share class is set up.

#### ■ Transparency

- The list and features of sub-fund share classes should be disclosed in the fund prospectus including the possible contagion risks when one of the share classes is using a derivative overlay for currency risk hedging
- The stress test results should be made available to national regulators on request.

### What the Management Company could already consider

- Identification of the share classes in / out of scope
- Amendment of the prospectus (list of share classes and description of their features, description of the hedging methodology, risks related to hedging)
- Ensure that the appropriate wording is / will be inserted in the KIIDs (share classes features and associated risks)
- Ensure that the appropriate wording is / will be inserted in the financial reports (share classes features and list, collateral information)



## How EFA can help you

- Assist in the identification process to determine the in / out of scope status of the share classes
- Confirm the segregation of the assets and P/L for the hedged share classes
- Monitor the hedged positions, through the use of EFA's investment compliance services, to ensure that the hedged share classes are / remain compliant
- Implement stress testing solutions
- Amend the financial reports and KIDs.

EFA will also keep you informed on the ALFI (Association Luxembourgeoise des Fonds d'Investissements) working group outcome on the share classes subject, focusing on the interpretation of requirements in relation to RM topics and on the CSSF expectations in relation thereto.

Your Client Relationship Manager remains at your disposal to give you more information on how EFA will help you comply with the ESMA principles on share classes.

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