

UCITS share class - new key focus area for management companies

1 February 2017

In brief

Within the same fund, the UCITS framework allows the creation of investment compartments having their own investment strategy. These compartments may in turn offer different share class to investors with different rights or features thus allowing a high level of customisation. However, the UCITS framework is mute on what constitutes a UCITS share class and on the ways share classes of the same UCITS may differ one from another. In a recent opinion ESMA developed some guidance putting once again regulatory compliance at the top of boardroom agendas.

In detail

On 30 January 2017, ESMA has adopted an opinion on share classes of UCITS¹. In this opinion addressed to national regulators, ESMA is outlining 4 high-level principles to define the concept of “UCITS share class” and set the boundary between share class and compartment. In this context, ESMA is of the view that share classes of a UCITS shall have all the following features:

Common investment objective

As a rule, share classes of the same fund shall share a common pool of assets. Technical share class which differentiate between groups of investors or means of investments will be considered as sharing a common investment objective. **However, ESMA is of the opinion that hedging arrangements at share class level, other than currency risk hedging, are not compatible with this principle.** Thus, share classes with derivative overlays that are not linked to FX hedging will need to be set-up as separate sub-funds.

Non-contagion principle

Where a fund offers different share classes to investors, ESMA identifies a risk of contagion between currency-hedged and other share classes due to the lack of segregation between share classes. ESMA introduces minimum operational procedures to be implemented by management companies in order to mitigate such spill-over risks and ensure that additional risk linked to the derivative overlay in a share class are only borne by investors in that share class. Management companies will in particular need to conduct **stress test** and **monitor hedged positions on an ongoing basis** in order to ensure that **(i) over-hedged positions do not exceed 105% and (ii) under-hedged positions do not fall short of 95% of the NAV** of the share class hedged against currency risk. This is significantly changing the controls level at the fund administration.

¹ https://www.esma.europa.eu/sites/default/files/library/opinion_on_ucits_share_classes.pdf

Pre-determination

All features of a UCITS share class should be **pre-determined before it is set up**, including currency risks in share classes with hedging arrangements.

Transparency

ESMA further introduces minimum transparency requirements vis-à-vis investors. In this context, information on the different share classes including contagion risks should be **disclosed in the UCITS' prospectus**. In addition, the results of stress tests (as referred to above) will need to be made available to national regulators.

What's next?

UCITS established before 30 January 2017 that do not comply with the above principles may continue to operate to the extent that they be closed for new subscriptions before **30 July 2017** and for additional investments by existing investors before **30 July 2018**. ESMA's opinion is however not binding until it is endorsed by a national authority and/or upgraded into a legislative act.

Let's talk

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