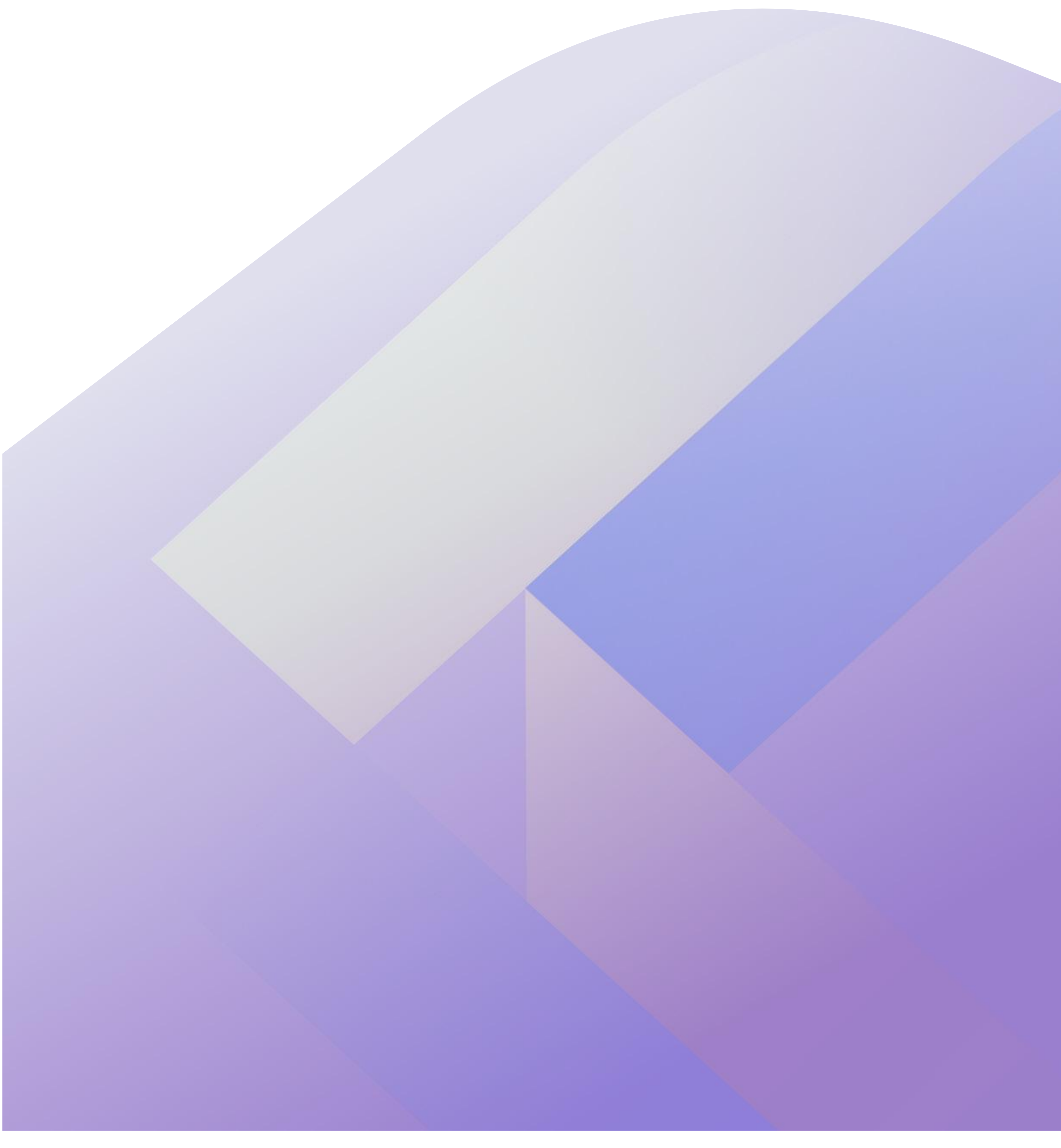
European Securities and Markets Authority

7 May 2024
ESMA 34-1270380148-1033

Reply form

On the review of the UCITS Eligible Assets Directive



Responding to this paper

ESMA invites comments on all matters in this paper and in particular on the specific questions summarised in Annex 1. Comments are most helpful if they:

- respond to the question stated;
- indicate the specific question to which the comment relates;
- contain a clear rationale; and
- describe any alternatives ESMA should consider.

ESMA will consider all comments received by **Wednesday 7 August 2024.**

All contributions should be submitted online at www.esma.europa.eu under the heading 'Your input - Consultations'.

Instructions

In order to facilitate analysis of responses to the Call for Evidence, respondents are requested to follow the below steps when preparing and submitting their response:

- Insert your responses to the questions in the Call for Evidence in this reply form.
- Please do not remove tags of the type < ESMA_QUESTION_EADC_0>. Your response to each question has to be framed by the two tags corresponding to the question.
- If you do not wish to respond to a given question, please do not delete it but simply leave the text "TYPE YOUR TEXT HERE" between the tags.
- When you have drafted your responses, save the reply form according to the following convention: ESMA_CP1_EADC_nameofrespondent.

  For example, for a respondent named ABCD, the reply form would be saved with the following name: ESMA_CP1_EADC _ABCD.
- Upload the Word reply form containing your responses to ESMA's website (**pdf documents will not be considered except for annexes**). All contributions should be submitted online at https://www.esma.europa.eu/press-news/consultations/call-evidence-review-ucits-eligible-assets-directive under the heading *'Your input - Consultations'.*

Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publicly disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA's rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA's Board of Appeal and the European Ombudsman.

Data protection

Information on data protection can be found at www.esma.europa.eu under the heading 'Data protection'.

Who should read this paper?

This Call for Evidence is of particular interest for investors and consumer groups interested in retail investment products, management companies of Undertakings for Collective Investment in Transferable Securities (UCITS), self-managed UCITS investment companies, depositaries of UCITS and trade associations.

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1 General information about respondent

Name of the company / organisation	Deutsche Börse Group
Activity	Exchange & market infrastructure
Country / Region	Germany

2 Questions

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

<ESMA_QUESTION_EADC_1>

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Q2 Have you experienced any recurring or significant issues with the interpretation or consistent application of UCITS EAD rules with respect to financial indices? If so, please describe any recurring or significant issues that you have experienced and how you would propose to amend the UCITS EAD to improve investor protection, clarity and supervisory convergence. Where relevant, please specify what indices this relates to and what were the specific characteristics of those indices that raised doubts or concerns. Where possible, please provide data to substantiate the materiality of the issue.

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Q3 Have you experienced any recurring or significant issues with the interpretation or consistent application of UCITS EAD rules with respect to money market instruments? If so, please describe the issues you have experienced and how you would propose to amend the UCITS EAD to improve investor protection, clarity and supervisory convergence. Where relevant, please describe the specific characteristics of the money market instruments that raised doubts or concerns.

<ESMA_QUESTION_EADC_3>

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Q4 Have you experienced any recurring or significant issues with the interpretation or consistent application of UCITS EAD provisions using the notions of « liquidity » or « liquid financial assets »? If so, please describe the issues you have experienced and how you would propose to amend the UCITS EAD to better specify these notions with a view to improving investor protection, clarity and supervisory convergence. Where relevant, please explain any differences to be made between the liquidity of different asset.

<ESMA_QUESTION_EADC_4>

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Q5 The 2020 ESMA CSA on UCITS liquidity risk management identified issues with respect to the presumption of liquidity and negotiability set out in UCITS EAD. In light of the changed market conditions since 2007, do you consider such a presumption of liquidity and negotiability still appropriate? Where possible, please provide views, data or estimates on the possible impact of removing the presumption of liquidity and negotiability set out in the UCITS EAD.

<ESMA_QUESTION_EADC_5>

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Q6 Please explain your understanding of the notion of ancillary liquid assets and any recurring or significant issues that you might have experienced in this context. Please clarify if these are held as bank deposits at sight and what else is used as ancillary liquid assets. Where relevant, please distinguish between ancillary liquid assets denominated in (1) the base currency of the fund and (2) foreign currencies.

<ESMA_QUESTION_EADC_6>

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Q7 Beyond holding currency for liquidity purposes, do you think UCITS should be permitted to acquire or hold foreign currency also for investment purposes, taking into account the high volatility and devaluation/depreciation of some currencies? Where relevant, please distinguish between direct and indirect investments.

<ESMA_QUESTION_EADC_7>

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<ESMA_QUESTION_EADC_7>

Q8 Have you observed any recurring or significant issues with the interpretation or consistent application of the 10% limit set out in the UCITS Directive for investments in transferable securities and money market instruments other than those referred to in Article 50(1) of the UCITS Directive? If so, please explain the issues and how you would propose to address them in the UCITS EAD with a view to improving investor protection, clarity and supervisory convergence.

<ESMA_QUESTION_EADC_8>

Deutsche Börse Group (DBG) welcomes the discussion around the limits set out in the UCITS

Directive and would like to use the question regarding the application of the 10% limit according to Art. 50(1) to provide insights on issues associated with the “5/10/40-percent-rule” for investments in transferable securities and money market instruments under Article 52. The idea of the UCITS Directive to create a simple and accessible investment opportunity for retail investors in the EU is a success story. However, this success is impeded by the weak developments of European financial markets in recent years. According to the ESMA Position Paper ‘Building more effective and attractive capital markets in the EU’ published in May this year, “a large portion of European savings migrate to other global markets. […] While European stocks accounted for 51% of the total assets of UCITS equity funds in 2015, that portion fell to only 35% in 2022, while in parallel, the share of US stocks increased from 27% to 42%. In a free global market, capital will inevitably flow to where it can most efficiently make optimal returns for investors. To attract more funding for European companies, measures should be considered to make investing in EU markets a more appealing choice […]”.

The investment limits, particularly the rigid “5/10/40-percent-rule” for actively managed UCITS funds for investing in individual stocks, can have a negative impact on the performance of shares, as, for example, positive price developments can lead to the limit being exceeded and the fund is forced to sell the well-performing share in order to comply with the limits. These sales can have a negative impact on prices, as in various investment vehicles exceeding the 10% limit inevitably leads to a limitation of share purchases, which is an artificial intervention in the stock market that has led to general selling pressure, increased volatility and a falling market capitalization of the share and the affected indices. The rigid investment limits therefore burden the attractiveness of the German and European capital markets for issuers and investors. On the other side, higher limits can have positive impacts on market capitalisation and do not impair market attractiveness as investors are primarily interested in securities with strong performance and high market capitalization. The situation is similar with the so-called "5/40-percent-rule”, whereby individual stocks that are weighted more than 5% may not make up more than 40% of the fund in total. This also restricts actively managed UCITS funds, where well-performing stocks have to be sold in order to comply with the limits. From the perspective of an actively managed UCITS fund, the “5/10/40-percent-rule” prevents the fund from participating in the rise of national companies that are positioning themselves internationally and outgrowing their original market.

In contrast, purely passively managed UCITS funds (replicating index funds) are not bound by the "5/10/40-percent-rule" (Article 53 of the UCITS Directive, according to which a single security may account for up to 20% or 35% of a portfolio under certain conditions). It can also be observed that passive index-tracking ETFs often show a better risk-return ratio, because, on the one hand, they can be managed at lower costs and, on the other hand – compared to actively managed funds – they can give greater weight to individual stocks with higher market capitalization and higher growth than the overall market.

This discrepancy raises the question of whether it is appropriate to impose stricter restrictions on active managers in their portfolio selection than on managers of passive UCITS funds. From

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the DBG's perspective, there are no plausible reasons why the limits should not be further developed in the direction of the "20/35-percent-rule" (Article 53). The investment limits were introduced in 1985 and have remained unchanged since then but should be reviewed and adjusted in light of current market developments and regulatory changes since the adoption of the UCITS Directive. From the DBG's perspective, this alone means that there is a need for action to consider increasing the 10% limit or at least regularly reviewing them. Furthermore, an increase in the limits does not mean an obligation to use higher portfolio weightings, it is simply an additional option for fund managers.

We agree that limits for both portfolio weighting and stock indices are basically necessary to ensure diversification and to reduce risks and portfolio concentration. The idea of indices and funds is, on the one hand, to achieve a broad representation of a target market and, on the other hand, to enable investors to invest in a large basket of securities in order to benefit from strong performing securities as well as to reduce risks compared to buying individual stocks. However, there is no clear evidence that higher weightings of single securities lead to increasing risks in a portfolio. There are also indications that there might be no relation between concentration and performance, that cap-weighted portfolios are not efficient and that equally weighted portfolios exhibit higher risks and lower returns than the capitalization-weighted portfolios.

The delisting of Linde plc from the Frankfurt Stock Exchange underlines the need for action. At the time of the decision, Linde was the largest issuer in the DAX by market capitalization. Linde has decided against continuing its dual listing and is now only listed on the NYSE. The board justified the move by saying that the dual listing had limited the share valuation due to European restrictions and increasing complexity. In other words, they opted for the market with higher liquidity and fewer regulatory requirements. As the operator of the Frankfurt Stock Exchange, the DBG has welcomed the adjustment of the DAX capping limit from 10% to 15% to take market demands into account. However, the fundamental problem of the "5/10/40-percent-rule" remains unsolved and thus a further competitive disadvantage compared to financial centres outside EU jurisdictions.

A further point we would like to raise, concerns the UCITS capping limits of transferable securities or money market instruments issued by the same body (Art. 52 para. 5 sentence 3). While we agree that classes of shares of the same company should be considered as one issuer, listed group companies with different business models should be considered as separate companies in the context of UCITS capping limits. This could otherwise lead to companies with different business models having to be sold due to group affiliation and the capping limit in order to comply with the limits.

Therefore, we propose that **ESMA, in its technical advice, recommends conducting a review of the UCITS Directive at Level 1** and assessing potential adjustments of the limits set out in the UCITS Directive, particularly in Articles 51, 52 and 53 to enhance competitiveness of the European financial markets and to provide a clear and attractive framework for UCITS

management companies that finally delivers the best outcome for retail investors. It should be discussed whether the investment limits are still up to date in terms of the overarching goals to strengthen the participation of retail investors and to increase the market capitalization of European stock indices providing for deeper liquidity pools. The rules for passive investment funds in Article 53 UCITS Directive, according to which a single security may account for up to 20% of a portfolio, should also apply as a basis for actively managed UCITS funds, i.e. **the current "5/10/40-percent-rule" in Article 52 paragraphs 1 and 2 of the UCITS Directive should be developed further in the direction of a new "20/40-percent-rule"**.

<ESMA_QUESTION_EADC_8>

Q9 Are the 'transferable security' criteria set out in the UCITS EAD adequate and clear enough? If not, please describe any recurring or significant issues that you have observed and how you would propose to amend the UCITS EAD to improve investor protection, clarity and supervisory convergence.

<ESMA_QUESTION_EADC_9>

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Q10 How are the valuation and risk management-related criteria set out in the UCITS EAD interpreted and applied in practice, in particular the need for (1) risks to be "adequately captured" by the risk management process and (2) having "reliable" valuation/prices. Please describe any recurring or significant issues that you have observed with the interpretation or consistent application of these criteria and how you would propose to amend the UCITS EAD to improve investor protection, clarity and supervisory convergence.

<ESMA_QUESTION_EADC_10>

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Q11 Are the UCITS EAD provisions on investments in financial instruments backed by, or linked to the performance of assets other than those listed in Article 50(1) of the UCITS Directive adequate and clear enough? Please describe any recurring or significant issues that you have observed in this respect and how you would propose to amend the UCITS EAD to improve investor protection, clarity and supervisory convergence.

<ESMA_QUESTION_EADC_11>

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<ESMA_QUESTION_EADC_11>

Q12 Is the concept of « embedded » derivatives set out in the UCITS EAD adequate and clear enough? Please describe any recurring or significant issues that you have observed with the interpretation or consistent application of this concept and how you would propose to amend UCITS EAD to improve investor protection, clarity and supervisory convergence.

<ESMA_QUESTION_EADC_12>

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<ESMA_QUESTION_EADC_12>

Q13 Linked to Q11 and Q12, ESMA is aware of diverging interpretations on the treatment of delta-one instruments under the EAD, taking into account that they might provide UCITS with exposures to asset classes that are not eligible for direct investment (see also Section 3.2). How would you propose to amend the UCITS EAD to improve investor protection, clarity and supervisory convergence? Please provide details on the assessment of the eligibility of different types of delta-one instruments, identify the issues per product and provide data to support the reasoning.

<ESMA_QUESTION_EADC_13>

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Q14 Have you observed any recurring or significant issues with the interpretation or consistent application of the rules on UCITS investments in other UCITS and alternative investment funds (AIFs)? In this context, have you observed any issues in terms of the clarity, interaction and logical consistency between (1) the rules on investments in UCITS and other open-ended funds set out in the UCITS Directive and (2) the provisions on UCITS investments in closed ended funds set out in the UCITS EAD? Please describe any recurring or significant issues that you have observed in this respect and how you would propose to amend the relevant rules to improve investor protection, clarity and supervisory convergence. Where relevant, please distinguish between different types of AIFs (e.g. closed-ended, open-ended), investment strategies (real estate, hedge fund, private equity, venture capital etc.) and location (e.g. EU, non-EU, specific countries). In this context, please also share views on whether there is a need to update the legal wording used in the UCITS EAD and UCITS Directive given the fact that e.g. they refer to 'open-ended' and 'closed ended funds', whereas it might seem preferable to use the notion of 'AIFs' by now given the subsequent introduction of the AIFMD in 2011.

<ESMA_QUESTION_EADC_14>

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Q15 More specifically, have you observed any recurring or significant issues with the interpretation or consistent application of the rules on UCITS investments in (1) EU ETFs and (2) non-EU ETFs? Please describe any issues that you have observed in this respect and how you would propose to amend the relevant rules to improve investor protection, clarity and supervisory convergence.

<ESMA_QUESTION_EADC_15>

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Q16 How would you propose to amend the UCITS EAD to improve investor protection, clarity and supervisory convergence with respect to the Efficient Portfolio Management (EPM)-related issues identified in the following ESMA reports: (1) Peer Review on the ESMA Guidelines on ETFs and other UCITS issues; (2) Follow-up Peer Review on the ETF Guidelines; and (3) CSA on costs and fees. In this context, ESMA is interested in also gathering evidence and views on how to best address the uneven market practices with respect to securities lending fees described in the aforementioned ESMA reports with a view to better protect investors from being overcharged.

<ESMA_QUESTION_EADC_16>

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<ESMA_QUESTION_EADC_16>

Q17 Would you see merit in linking or replacing the notion of EPM techniques set out in the UCITS Directive and UCITS EAD with the notion of securities financing transaction (SFT) set out in the SFTR? Beyond the notions of EPM and SFT, are there any other notions or issues raising concerns in terms of transversal consistency between the UCITS and SFTR frameworks?

<ESMA_QUESTION_EADC_17>

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<ESMA_QUESTION_EADC_17>

Q18 Apart from the definitions and concepts covered above, are there any other definitions, notions or concepts used in the UCITS EAD that may require updates, further clarification or better consistency with definitions and concepts used in other pieces of EU financial legislation, e.g. MiFID II, EMIR, Benchmark Regulation and MMFR? If so, please provide details on the issues you have observed and how you would propose to clarify or link the relevant definitions or concepts.

<ESMA_QUESTION_EADC_18>

For more than 20 years, European financial institutions have voluntarily cleared securities

financing transactions (SFTs such as repurchase agreements (repo)) in order to reduce counterparty risk, improve settlement efficiency and lower capital costs. The continuous level of debt issuance and subsequent growth of repo markets in Europe puts pressure on the intermediation capacities of banks which have to operate and serve their clients with a limited balance sheet capacity subject to a variety of constraining ratios such as counterparty ratio. When facing such constraints, there is a risk that certain types of clients, and in this context, buy-side firms, struggle to find adequate intermediation capacity from banks in a tensed market, and banks themselves struggle to serve the entirety of their client base safely and adequately in similar market conditions. In response to these constraints, CCPs have designed new membership models for the voluntary clearing of SFTs – models that offer a new balance of responsibilities between banks and their clients. The aim of these new models is to provide an additional option for buy-side firms to access liquidity and for banks additional capacity to serve their clients in a less resource intensive manner. This additional option also represents an opportunity to re-use collateral and to allow funds to participate in certain types of transactions or strategies that could benefit investors and provides margin efficiencies.

Whilst banking regulation has enshrined clear rules on the treatment of exposures of a bank towards the CCP in a traditional clearing model, funds regulation has not applied similar rules for other types of market participants when facing a CCP. As a result, there are **inconsistencies between banking, clearing and EU funds regulation, unintentionally disincentivizing buy-side entities to make use of central clearing, notably for SFTs, and to benefit more from the new access models that were specifically developed to meet the needs of the buy-sid**e. **While EMIR 3.0 provides some welcomed reliefs to counterparty and cash limits in the MMFR and UCITS Directive**, more holistic changes to address those inconsistencies and to recognize the specific risk-reducing nature of centrally cleared transactions and the efficiencies of access models have been deferred to the review of the UCITS framework.

To provide a viable option to all market participants to centrally clear SFTs and other financial instruments, **further targeted amendments to the UCITS and MMF frameworks could be helpful** and would ensure consistency with the European Commission's regulatory objectives in context of EMIR 3.0 to make the EU's clearing ecosystem more competitive, well-developed, and resilient. In particular, ensuring access to central clearing for a broad range of participants across financial instruments is key to support a balanced and efficient clearing ecosystem in the EU.

<u>Risk-adequate collateral concentration and diversification rules for centrally cleared repos</u>

The strict collateral concentration and diversification rules applied to UCITS could be further adapted risk-adequately for CCP cleared (reverse) repos. While those rules have been put in place with the intention to address funds' vulnerabilities and protecting them from risks associated with the OTC market, with its strong lines of defense, the CCP guarantees the

fulfilment of the contract so that the diversification of received collateral becomes insignificant for the safety of the MMF or UCITS fund. MMFs and UCITS currently need to receive at least 6 bond issues per issuer or can only own a certain percentage of a given issuer according to Art. 17(7) MMFR and Art. 52 UCITS Directive. However, there are no such regulatory requirements for OTC IRS, e.g., no need to diversify OTC IRS maturity profiles for MMF and UCITS.

In the context of CCP cleared transactions it might be instructive to also look at the banking regulation (CRR) which explicitly provides certain relief with regards to the "Large Exposure" limits applicable for CCP cleared securities financing and derivatives transactions.

Despite the welcomed changes to the MMFR and UCITS Directive via EMIR 3.0, the funds regulation still unintentionally disincentivize central clearing with respect to counterparty limits for centrally cleared SFTs. These provisions do not recognize that a CCP becomes the buyer and seller to all centrally cleared transactions and would thereby hit the limit much faster than in a bilateral context, despite the risk reducing nature of clearing. To ensure consistency with the recent changes that exempt centrally cleared derivatives transactions from counterparty limits in both MMFR and UCITS Directive and reflecting repos in the MMFR cash limits, targeted additions to Art. 17 MMFR and Art. 52 UCITS Directive could exclude **all centrally cleared transactions, including SFTs, from relevant concentration and diversification requirements, making the use of central clearing for the buy-side more attractive without restricting the use of bilateral markets**. Such an exclusion should apply to both direct and indirect clearing models.

<u>Easing constraints on the re-use of received collateral through SFTs for margin efficiencies</u>

Further, other regulatory constraints exist which equally impact the viability of centrally cleared transactions and efficient collateral management for the buy-side. **To facilitate more voluntary clearing and efficiencies for the buy-side for stronger EU capital markets, targeted changes to the UCITS Directive, the MMFR and ESMA Level 3 measures could be considered as well to ease the constraints on the re-use of received collateral through SFTs to meet CCP margin requirements**:

Specifically, in order to protect funds from risks associated with non-centrally cleared repos, they are currently restricted to pledge collateral received in a reverse repo transaction to meet CCP margin requirements, even if this collateral would be held bankruptcy remote from the pledge. Consequently, for CCP cleared transactions, additional assets would need to be sourced by the fund to meet the mandatory CCP margin requirements, making central clearing economically less attractive and keeping the buy-side locked in bilateral markets. Through a targeted amendment to Art. 15(2) MMFR and the related provisions in UCITS Guidelines, UCITS funds could be explicitly allowed to pledge securities to a CCP if received by the fund by way of a transfer of title in a cleared reverse repo transaction with that CCP.

Also, according to Article 14(b) MMFR as well as according to Q6J of the ESMA UCITS Q&A, funds are currently not explicitly permitted to raise or re-use cash collateral received through a repo transaction to meet mandatory CCP margin requirements. Through a targeted amendment to Art. 14(b) MMFR as well as Art. 52 UCITS Directive, it could be added that cash collateral received from centrally cleared securities financing transactions may be used by UCITS to meet CCP margin requirements. The respective ESMA Guidelines reinforcing the current restriction should be amended accordingly.

<ESMA_QUESTION_EADC_18>

Q19 Are there any national rules, guidance, definitions or concepts in national regulatory frameworks that go beyond ('gold-plating'), diverge or are more detailed than what is set out in the UCITS EAD? If so, please elaborate whether these are causing any recurring or significant practical issues or challenges.

<ESMA_QUESTION_EADC_19>

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Q20 Please fill in the table in the Annex to this document on the merits of allowing direct or indirect UCITS exposures to the asset classes listed therein, taking into account the instructions provided in the same Annex. Please assess and provide evidence on the merits of such exposures in light of their risks and benefits taking into account the characteristics of the underlying markets (e.g. availability of reliable valuation information, liquidity, safekeeping). To substantiate your position, please fill the table with any available data and evidence (e.g. on liquidity or valuation of the relevant asset classes and underlying markets). ESMA acknowledges that the availability of data on direct/indirect exposures to some of the asset classes listed in this table is limited and would welcome receiving any available data (whether on individual market participants and products or market-wide) and even rough estimates that help to understand the practical relevance of the relevant asset class for UCITS and the possible impact of any future policy measures.

<ESMA_QUESTION_EADC_20>

Asset class 8: Commodities and precious metals

Eurex – a derivatives exchange of DBG – sees merit in allowing both indirect UCITS exposures for commodities and precious metals and for exchange-traded commodities (ETCs). Exchange-traded products and associated derivatives offer investors indirect exposure to underlying commodities/precious metals in a safe, cost-effective, and reliable manner. ETF issuers have demonstrated considerable innovation in designing and streamlining products that offer access to commodities/precious metals in significant size and reliability. Such products offer all the investment benefits of this asset class (e.g., source of additional growth, hedging and diversification of overall investment), without the complexities of investing directly in the underlying commodities/precious metals. Investor assets are kept in reputable, safe custodians, at a fraction of the cost. Investors benefit from ease of trading, price tracking, flexibility, and reduced operational complexities.

As a case study we would like to take iShares Physical Gold ETC (IGLN), which offers targeted exposure to the gold spot price since April 2011, backed by secure and segregated gold bar allocation, responsibly sourced: 100% of bars meet LBMA (London Bullion Market Association) responsible gold criteria. It currently has almost $16bn in assets under management (AUM) with a Total Expense Ratio (TER) of only 0.12%. For comparison, UCITS eligible iShares MSCI Emerging Markets ETF has under $5bn in AUM at TER of 0.18%. ETCs like iShares Physical Gold ETC have made possible investment to previously inaccessible underlying like commodities/precious metals. Investors can access commodity exposure through trading and custody infrastructure typical for traditional financial products, i.e., without the need for physical delivery and storage. Constant growth in AUM demonstrates the merits of such investment products. On 14 July, iShares Physical Gold ETC (IGLN), traded a record $612m (18x its 3m ADV) since its inception, and it was the most traded security on LSE for the day.

As a result of market demand, Eurex launched in 2018 options contracts on iShares Physical Gold ETC. Since launch, an average of 3.5mn option contracts traded annually at Eurex. This is equivalent to over $10bn traded annually in the Eurex options alone. Most large dealers and electronic market makers are active in the product, ensuring investors get the most competitive execution price. Sophisticated sell side participants can source liquidity from a range of financial markets and instruments, incl. Futures & Options directly on underlying commodities/precious metals. In turn, this allows them to offer most competitive prices on indirect exposure via ETCs and derivatives. Exposure in Options on ETCs is managed by Eurex Clearing, who acts as counterparty which virtually removes any counterparty risk. Eurex is also responsible for daily publication of settlement prices and the final settlement price on expiry. The option can be exercised during its lifetime (i.e. American exercise) or held to expiry. In all cases, investors commit to deliver or receive the underlying ETC shares. Under no circumstances should the investor receive or deliver the physical commodity (in this example gold bars). There are numerous other product examples in the ETC market and on Eurex in form of options contracts that follow the same principles and offer similar benefits to investors. Therefore, these considerations should be included in the overall assessment.

Asset class 9: ETCs

As operator of Xetra and one of Europe's largest trading venues for exchange-traded products (ETPs), Deutsche Börse would like to highlight some key benefits for UCITS gaining indirect exposure to asset classes via exchange-traded commodities (ETCs) and exchange-traded notes (ETNs). One important aspect for ESMA to consider in its assessment of assets eligibility for UCITS is the trading environment of ETCs and ETNs. Since both product types are financial instruments listed on regulated markets, they are traded in a transparent trading environment that follows highest regulatory standards in line with frameworks such as MiFID II and CSDR. The tradability of ETPs in a MiFID II regulated environment can bring significant advantages to UCITS that may not be available if UCITS were to access the underlying markets directly. These advantages include a high degree of pre- and post-trade transparency, availability of intraday liquidity, availability of volume and spread data for best execution considerations, supervision of trading by a Trading Surveillance Office and central clearing services provided by a CCP. Some of these aspects can present a significant improvement over access and trading options in the underlying markets themselves. For example, directly accessing markets in crypto assets would require UCITS to either mandate a crypto service provider or operate a wallet and settlement infrastructure based on DLT technology themselves. In particular, the latter option can impose additional operational risks on UCITS when managed improperly and may thus warrant a more cautious assessment of assets eligibility. On the other hand, using ETPs to gain exposure to crypto markets effectively outsources the operational management of these risk factors to the issuers of such products, i.e. specialised service providers, while at the same time facilitating access for UCITS and other investors via a financial instrument that is tradable on traditional regulated markets and MTFs. Another beneficial aspect is the ETP product structure itself. Since ETPs are financial products admitted under the EU Prospectus Regulation, issuers must produce prospectuses and key information documents that enable investors to take informed investment decisions. The required disclosure of investment risks supports UCITS and other investors in conducting a full and accurate risk assessment before taking invest decisions. In addition, the standardised cost transparency allows investors to develop a full understanding of initial and ongoing costs built into the product structure. Such risk and cost disclosures may not be as readily available when transacting directly in the underlying markets of ETCs and ETNs. **For these reasons, ETCs and ETNs should retain their status as financial instruments eligible for investment by UCITS.**

Please refer to our feedback provided under asset class 8.

<ESMA_QUESTION_EADC_20>

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Q21 Please elaborate and provide evidence on how indirect exposures to the aforementioned asset classes (e.g. through delta-one instruments, ETNs, derivatives) increase or decrease costs and/or risks borne by UCITS and their investors compared to direct investments.

<ESMA_QUESTION_EADC_21>

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<ESMA_QUESTION_EADC_21>

Q22 Under the EAD, should a look-through approach be required to determine the eligibility of assets? Please explain your position taking into account the aforementioned risks and benefits of UCITS gaining exposures to asset classes that are not directly investible as well as the increased/decreased costs associated with such indirect investments. A look-through approach would aim to ensure that the list of eligible asset classes set out in the UCITS Level 1 Directive would be deemed exhaustive and reduce risk of circumvention by gaining indirect exposures to ineligible asset classes via instruments such as delta-one instruments, exchange-traded products or derivatives. Where possible, please provide views, data or estimates on the possible impact of such a possible policy measure.

<ESMA_QUESTION_EADC_22>

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<ESMA_QUESTION_EADC_22>

Q23 What are the risks and benefits of UCITS investments in securities issued by securitisation vehicles? Please share evidence and experiences on current market practices and views on a possible need for legislative clarifications or amendments.

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ESMA
European Securities and Markets Authority

Q24 What are the risks and benefits of permitting UCITS to build up short positions through the use of (embedded) derivatives, delta-one instruments or other instruments/tools? Please share evidence and experiences on current market practice and views on a possible need for legislative clarifications or amendments.

<ESMA_QUESTION_EADC_24>

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Q25 Apart from the topics covered in the above sections, have you observed any other issues with respect to the interpretation or consistent application of the UCITS EAD? If so, please describe the issues and how you would propose to revise the UCITS EAD or UCITS Directive with a view to improve investor protection, clarity and supervisory convergence.

<ESMA_QUESTION_EADC_25>

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