



FINANCIAL SERVICES

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# ESMA issues Opinion on UCITS Share Classes

by **lk-shields**

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17th February 2017 | by

On 30 January 2017, the European Securities and Markets Authority (ESMA) issued an opinion (the Opinion) addressed to national regulators which outlines four high-level principles which a UCITS must follow when setting up different share classes.

A copy of the Opinion can be found [here](#).

## Background

The UCITS Directive recognises that a UCITS may offer different share classes to investors, but it does not prescribe whether, and to what extent, share classes of a UCITS can differ from one another. ESMA has identified different national practices regarding the types of share classes that are permitted, which range from very simple share classes with different levels of fees, to much more sophisticated share classes which may potentially have different investment strategies.

While the UCITS Directive covers UCITS funds and compartments, it stays silent on the definition and scope of share classes, only recognising their existence in passing. Therefore, there is currently no common legal or regulatory framework for share classes throughout the EU. The requirements in relation to the establishment of share classes vary in each jurisdiction, both in regard to the features of share classes and whether they need to be pre-approved by national regulators.

## The Opinion

The four high-level principles which a UCITS must follow when setting up different share classes are outlined as follows:

### 1. Common Investment Objective

Share classes of the same fund should have a common investment objective reflected by a common pool of assets. ESMA considers that hedging arrangements at share class level, with the exception of currency risk hedging, are not compatible with the requirement for a fund to have a common investment objective. The implications of this are that share class hedging arrangements with overlays that are not linked to currency (such as interest rate risk, duration risk or volatility risk) are not compatible with this high-level principle and should be set up as separate funds.

### 2. Non-contagion

In order to ensure that any derivative overlay used to hedge currency risk in one share class does not lead to a risk to other share classes in the same fund, ESMA suggests that certain operational principles should be observed, the most significant of which are summarised as follows:

- The UCITS should put in place a level of operational and accounting segregation.
- The UCITS should implement stress tests to quantify the impact of losses on all of its share classes.

- The share class currency hedge should be implemented according to a detailed, predefined and transparent hedging strategy.

### **3. Pre-determination**

All features of the share class should be predetermined before it is set up. This will assist investors in getting a full overview on the rights and features of their investment.

### **4. Transparency**

Differences between share classes of the same fund should be disclosed to investors when they have a choice between two or more classes. Therefore, information about existing share classes should be provided to investors via a fund's prospectus.

## **Transitional Arrangements and Next Steps**

While the Opinion is not legally binding, it is expected that the principles in the Opinion will be observed by the Central Bank and that the current Central Bank guidance on UCITS share classes will be updated to incorporate the principles in the Opinion.

UCITS with currency hedged share classes will need to ensure that the four high-level principles outlined above are adhered to and, in particular, that operational and accounting segregation is achieved and that stress tests are carried out.

To mitigate any negative effects for investors in share classes which are impacted by the Opinion, ESMA has outlined the following transitional arrangements:

All share classes established before the publication of the Opinion that do not comply with the principles laid out in the Opinion should be closed to new investors from 30 July 2017.

All share classes established before the publication of the Opinion that do not comply with the principles laid out in the Opinion should be closed to additional investment by existing investors by 30 July 2018.

If you would like to discuss any matters in relation to the requirements of the Opinion, please contact David Williams at [dwilliams@lkshields.ie](mailto:dwilliams@lkshields.ie) or your usual LK Shields contact.

## About the Author