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# luxembourg newsflash

18 March 2013

## ESMA guidelines on ETFs and other UCITS issues: Q&A published

On 15 March 2013 ESMA published a set of questions and answers giving further details on the content of its guidelines on ETFs and other UCITS issues (ESMA/2012/832) which entered into force on 18 February 2013, subject to certain transitional provisions for existing UCITS.

The Q&A sheds light on a number of key points which are summarised below. Please click here to access a table reproducing the full text of the Q&A together with an extract of the relevant provisions of the guidelines. The full text of the Q&A is accessible here.

### UCITS ETFs and rights of secondary market investors

- The obligation to use the identifier 'UCITS ETF' in the fund rules, prospectus, KIID and marketing materials applies to umbrella funds on a sub-fund per sub-fund basis.
- Where secondary market investors are directly granted an exceptional redemption right in relation to the UCITS, the redemption price should be the NAV from which the costs of direct redemption may be deducted. These costs should not be excessive.

### Efficient portfolio management (EPM) techniques

- The guidelines do not prevent the deduction from gross revenues generated by EPM techniques of fees paid to agents as "normal compensation for their services in the context of such techniques". Details of gross revenues, costs and fees relating to EPM techniques should be included in the annual report.
- UCITS may disclose the identity of the entities to which costs and fees in relation to EPM techniques are paid either in the prospectus or the annual report.

### Financial derivative instruments

- Where a UCITS enters into an unfunded swap, the portfolio which is swapped out must comply with the UCITS investment limits. However, these assets do not have to be combined with the exposure acquired on the underlying of the swap.
- A counterparty that has discretion over the composition of the underlying of a derivative must be treated and disclosed as an investment manager, even if any changes made by the counterparty to the underlying must be agreed to by the UCITS.
- Disclosure requirements apply to all financial derivative instruments by which UCITS gain exposure to an asset.

### Collateral management for OTC derivative instruments and EPM techniques

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- The new collateral requirements apply to all collateral received in the context of OTC derivative instruments and EPM techniques, including overcollateralization.
- Collateral received under arrangements involving a transfer of title may be held by a custodian that is not the depositary of the UCITS provided that the custodian is a delegate of the depositary and that the depositary remains liable if the collateral is lost. Tripartite agreements remain possible subject to the new rules.
- The 20% limit per issuer for collateral received refers to the NAV of the UCITS, not the basket of collateral. Where government bonds are received as collateral, this limit applies to each government issuer, not each issue.
- Cash collateral received by UCITS cannot be used for clearing obligations under EMIR.

## Financial indices

- The guidelines apply to any UCITS investing in financial indices, not only index-tracking UCITS.
- If a financial index is comprised of other financial indices, the retrospective publication of components and weightings also applies to the underlying indices.
- The Q&A further defines the notion of "technical adjustments" not deemed to rebalance the index, which may therefore occur on a daily or intraday basis. In particular, these adjustments must be based on algorithmic non-subjective frameworks.

## Transitional provisions

- UCITS that existed before 18 February 2013 benefit from a 12-month transition period (ending on 18 February 2014) to amend their agreements in compliance with the provisions on EPM techniques and the related provisions on collateral management.
- Transitional provisions apply to umbrella funds on a sub-fund per sub-fund basis (i.e. only sub-funds existing before 18 February 2013 benefit from transitional provisions).

## Next steps

Existing UCITS should take advantage of the transition period, where applicable, to conduct an in-depth review of their current business model and investment strategies and assess whether any products need restructuring. Adjustments to disclosures and marketing documentation may also be required.

There are still a number of grey areas in the guidelines which may be further clarified and supplemented by ESMA in future Q&A. In Luxembourg, subject to further guidance being issued, questions on the practical implementation of the guidelines will be addressed by the CSSF on a case-by-case basis.

Please contact us should you require any further information.

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