UCITS – ESMA Developing a Common Understanding on Share Classes

On the 23rd of December 2014 the European Securities and Markets Authority ("ESMA") published a discussion paper on share classes of UCITS Funds with a view to developing a common understanding of what constitutes a share class of a UCITS Fund. This was spurred by the fact that whilst the UCITS Directive recognises the possibility for UCITS Funds to offer different share classes to investors, it does not define the term "Class" or the way one class can differ from another class. As a consequence, ESMA identified diverging national practices as to the types of share class that are permitted, ranging from very simple share classes to much more sophisticated share classes.

Share Class – The Principles

In the discussion paper ESMA identifies the following principles that should be used in assessing the legality of different share classes:

- Share classes of the same UCITS Fund should have the same investment strategy. It is ESMA's view that UCITS management companies which seek to offer different investment strategies to investors should create a separate sub-fund for each strategy;
- Features that are specific to one share class should not have a potential (or actual) adverse impact on other share classes of the same UCITS Fund; and
- Differences between share classes of the same UCITS Fund should be disclosed to investors when they have a choice between two or more classes.

Permitted Share Classes

In pursuance of the principles listed above, the discussion paper identifies the following non-exhaustive list of permitted types of share classes:

- Share classes that differ according to the maximum or minimum investment amounts, or values of holdings allowed to be retained;
- Share classes that differ in terms of the type of investor (e.g. institutional investors vs. retail investors);
- Share classes that differ according to the types of charges and fees that may be levied and their amount (on-going charges, subscription and redemption fees, performance-related fee);
- Share classes that differ according to the currency in which they are denominated;
- Share classes that differ according to the allocation of revenues to investors (by capitalisation or distribution, either subject to or exempt from withholding tax);
- Share classes that differ according to their characteristics: registered or bearer;
- Share classes that differ in terms of voting rights; and
- Share classes that provide currency hedging when share classes are denominated in different currencies from the base currency.

Non-Permissible Share Classes

Furthermore, it also identifies the following non-exhaustive list of types of share class that do not appear to be compatible with the said principles:

- Share classes that are exposed to different pools of underlying assets;
- Share classes whereby the same underlying portfolio is swapped against different portfolios of assets;
- Share classes that offer differing degrees of protection against some market risks such as interest rate risk or volatility risk;
- Share classes that are exposed to the same pool of assets but with different level of capital protection and/or payoff;
- Share classes that differ in terms of leverage.

What does this mean for Maltese UCITS Funds and UCITS Fund Managers?

Maltese open ended funds may, by means of their constitutional documents, be structured as umbrella funds ('multi-funds') having share classes which constitute separate licenced sub-funds to which they are allocated certain assets and liabilities. Investors hold units/shares in a particular sub-fund and thus participate in the investment strategy and assets and liabilities of that particular sub-fund. Here we note the satisfaction of the primary principle that share classes of the same UCITS Fund should have the same investment strategy.

However, there is no real segregation between the assets and liabilities of each sub-fund unless the multi-fund, through its constitutional documents, elects to have each sub-fund as a patrimony separate from the assets and liabilities of the other sub-fund. It is only by means of this election that the liabilities incurred in respect of a sub-fund of a multi-fund will be paid out of the assets forming part of the patrimony of the said sub-fund, and the creditors in respect thereof shall have no claim or right of action against the other assets of the company/other sub-funds. Unless there is such election, the second principle set out in the discussion paper (that are specific to one share class should not have a potential (or actual) adverse impact on other share classes of the same UCITS Funds) would not be satisfied.

Next Steps

The consultation on the discussion paper will run until the 27th March 2015 wherein ESMA will consider all comments received from stakeholders. Please forward any queries and/or feedback regarding this discussion paper or seek advice in connection with any of these activities to financialservices@csb-advocates.com.