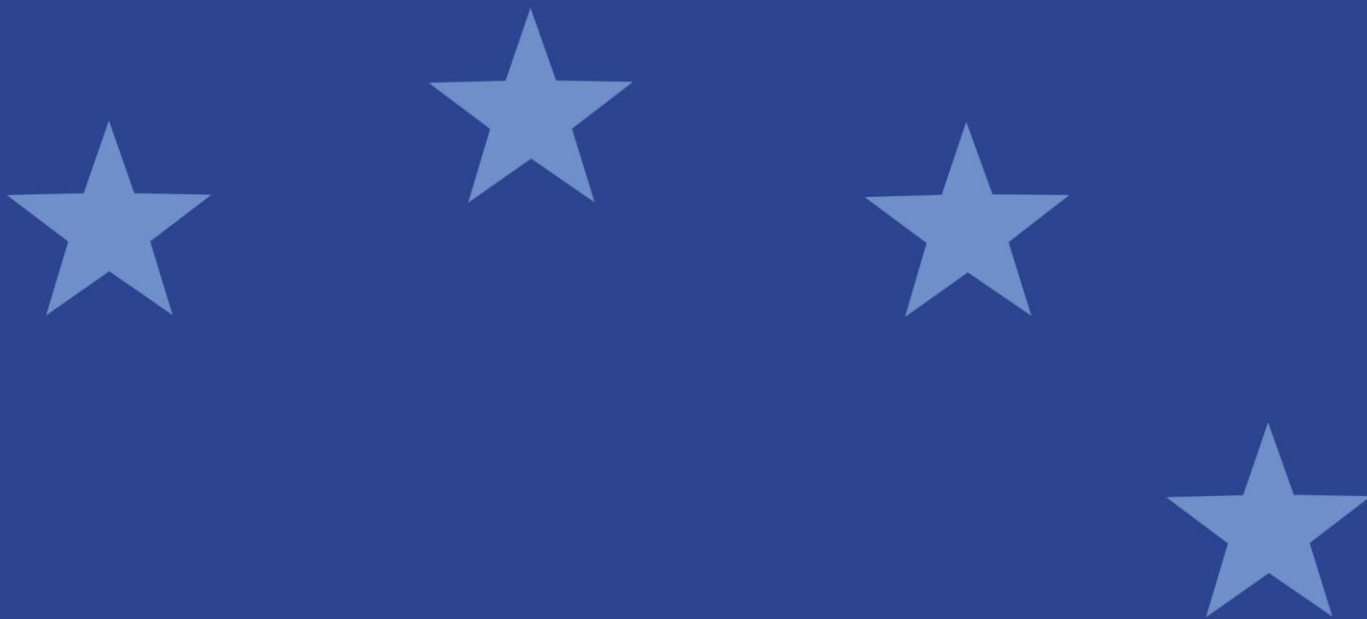




European Securities and  
Markets Authority

# Final Report

**Peer review on the Guidelines on ETFs and other UCITS issues**





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## List of Terms and Acronyms

AG	Assessment Group
AMF	Autorité des Marchés Financiers
Art.	Article
AuM	Assets under Management
BaFin	Bundesanstalt für Finanzdienstleistungsaufsicht
BoS	Board of Supervisors
CBol	Central Bank of Ireland
CCP	Central Counterparty
CIS	Collective Investment Scheme
COLL	FCA Collective Investment Schemes Sourcebook
CSSF	Commission de Surveillance du Secteur Financier
CSD	Central Securities Depository
DerivateV	Verordnung über Risikomanagement und Risikomessung beim Einsatz von Derivaten, Wertpapier-Darlehen und Pensionsgeschäften in Investmentvermögen nach dem Kapitalanlagegesetzbuch – Derivateverordnung (German Regulation on Derivatives)
EEA	European Economic Area
EFSA	Estonian Financial Supervision Authority
Eligible Assets Directive	Directive 2007/16/EC implementing Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards the clarification of certain definitions.
EPM	Efficient Portfolio Management Techniques and Instruments
ESA	European Supervisory Authority
ESMA	European Securities and Markets Authority
ESMA Regulation	Regulation (EU) 2010/1095 of the European Parliament and of the Council of 24 November 2010
ESMA Q&As	Questions & Answers on the Application of the UCITS Directive (ESMA34-43-392)
ETFs	Exchange Traded Funds
EU	European Union
FCA	Financial Conduct Authority
FDI	Financial Derivative Instruments
FTE	Full time equivalent



GMSLA	Global Master Securities Lending Agreement
Guidelines	ESMA Guidelines on ETFs and other UCITS issues (ESMA/2014/937)
ManCo	Management Company
Methodology	Review Panel Methodology (2013/ESMA/1709)
MMIF	Money Market and Investment Funds Return
MS	Member State
NAV	Net Asset Value
NCA	National Competent Authority
OTC	Over the Counter
para.	Paragraph
Q&As	Questions and Answers
Repo	Repurchase Agreement
Reverse Repo	Reverse Repurchase Agreement
RMP	Risk Management Process
SFTR	Regulation (EU) 2015/2365 of the European Parliament and of the Council of 25 November 2015 on transparency of securities financing transactions and of reuse and amending Regulation (EU) No 648/2012
SMSG	Securities and Markets Stakeholders Group
UCITS	Undertakings for Collective Investment in Transferable Securities
UCITS Directive	Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS)
UCITS V	Directive 2014/91/EU of the European Parliament and of the Council of 23 July 2014 amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions
UCITS Management Company	UCITS Management Companies, as defined in Article 2(1)(b) of the UCITS Directive, and self-managed investment companies that have not designated a UCITS Management Company in accordance with Chapter V of the UCITS Directive

## 1 Executive Summary

1. UCITS are a key financial instrument for retail investors in the EU, accounting for around 75% of all collective investments by retail investors in Europe<sup>1</sup>. These collective investment schemes benefit from a detailed regulatory framework that provides for a level-playing field and allows for managing and marketing UCITS in the Single Market. One of the central pillars of the UCITS framework is the comprehensive investment requirements that provide for an exhaustive list of assets that a UCITS can invest in.
2. The UCITS framework permits that efficient portfolio management techniques and instruments relating to transferable securities and money market instruments may be engaged in. The use of EPM may add to the complexity of UCITS and investors need to be informed accordingly in order to make an informed investment decision. To clarify the use of EPM in the interest of investor protection, ESMA's Guidelines on ETFs and other UCITS issues provide guidance on various areas relating to EPM, such as transparency and disclosure rules, operational requirements, as well as rules for risk and collateral management.
3. As the Guidelines address a number of issues regarding UCITS and not all of these issues are equally applicable to all kinds of UCITS<sup>2</sup>, the peer review focuses on a subsection of the Guidelines, in particular relating to requirements for UCITS when engaging in EPM. For the sake of comprehensibility, this report groups the requirements under the Guidelines in four main categories, these being (i) Disclosure to End-Investors of the UCITS; (ii) Internal Risk Management and Compliance with the Investment Mandate; (iii) Operational Aspects; and (iv) Collateral Management.
4. In order to assess the application and compliance with these Guidelines, ESMA's BoS agreed in the 2017 Supervisory Convergence Work Programme<sup>3</sup> that a peer review on the Guidelines would be launched, with a possible focus on EPM techniques. This peer review was launched in September 2017, identifying six NCAs to be assessed by the AG. The AG performed on-site visits to all six NCAs in order to get a full understanding of the practices of NCAs regarding UCITS supervision in relation to the Guidelines. In addition, the AG reached out to stakeholders in each MS that was visited, in total six UCITS ManCos and six UCITS depositaries, in order to complement the exercise with an understanding of the practical effects and ramifications of the Guidelines on the UCITS market.
5. In this report, the AG presents its findings regarding compliance of the assessed NCAs with the Guidelines, identifies good practices of supervisory tools and measures that may be of interest to other NCAs, and highlights areas where follow-up policy work may be considered by ESMA in order to take into account changes in the regulatory framework as well as address

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<sup>1</sup> Cf. [https://ec.europa.eu/info/business-economy-euro/growth-and-investment/investment-funds\\_en](https://ec.europa.eu/info/business-economy-euro/growth-and-investment/investment-funds_en).

<sup>2</sup> Most noticeably, the Guidelines carve out requirements and guidance for index-tracking UCITS, UCITS ETFs and UCITS engaging in EPM (not necessarily structured as either of the former kinds). The BoS decided to focus this peer review on the guidance in relation to EPM.

<sup>3</sup> ESMA42-397158525-448. Cf. [https://www.esma.europa.eu/sites/default/files/library/esma42-397158525-448\\_supervisory\\_convergence\\_work\\_programme\\_2017\\_0.pdf](https://www.esma.europa.eu/sites/default/files/library/esma42-397158525-448_supervisory_convergence_work_programme_2017_0.pdf).

open questions concerning the application of the Guidelines. This is to improve ESMA's guidance to NCAs and market participants and to strengthen the supervisory practices in place.

## Identification of NCAs to be assessed

6. In order to achieve an optimal focus for the peer review, the BoS decided that the peer review shall include a full assessment of six jurisdictions, i.e. Germany (DE), Estonia (EE), France (FR), Ireland (IE), Luxembourg (LU), and United Kingdom (UK). The mandate<sup>4</sup> identifies objective criteria for the selection of jurisdictions to be assessed. These criteria comprise (i) the relative significance of the UCITS market of the jurisdiction assessed in terms of the market size; (ii) the cross-border impact of the activity performed at national level<sup>5</sup>; and (iii) the fact that an NCA was never visited on-site in the course of a previous ESMA peer review.
7. Regarding the market size, assessed by the total net assets of UCITS domiciled in a MS, the top 5 jurisdictions in descending order are: LU, IE, UK, FR, DE. The same jurisdictions – however not necessarily in the same ranking – are among those with the highest number of UCITS with cross-border marketing activity.
8. Taking into account the third criterion, and work undertaken by the NCA with respect to the Guidelines, it was decided to include EE in the scope of this peer review.
9. All six jurisdictions that were identified to be assessed in the course of this peer review reported that they comply with the Guidelines.<sup>6</sup>

## Process of the Peer Review

10. As one main source of information on the supervisory approach and practices of the assessed NCAs, the AG developed a self-assessment questionnaire<sup>7</sup> to be completed by the six NCAs identified. To complement the findings of the analysis of the answers provided by the NCAs, the AG carried out on-site visits to all six NCAs.
11. Simultaneously to the self-assessment questionnaire, all NCAs were asked to provide background information on permissibility and legal constraints of EPM techniques for UCITS and on the collection of EPM data by NCAs (including – if such data is collected – the amount of

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<sup>4</sup> Cf. Annex 1.

<sup>5</sup> This criterion was assessed inter alia in the course of the [ESMA thematic study among National Competent Authorities on Notification frameworks and home-host responsibilities under UCITS and AIFMD \(ESMA34-43-340\)](#).

<sup>6</sup> Cf. Annex 1 bis.

<sup>7</sup> Cf. Annex 2.



EPM techniques for UCITS). This questionnaire<sup>8</sup> and the aggregated answers<sup>9</sup> to the collection of background information are annexed to this report.

## Compliance with the Guidelines

12. Regarding the general compliance of the assessed NCAs with the Guidelines, the level of compliance depends heavily on the individual topics covered by the Guidelines, meaning that some areas raise substantively more concern than others. For certain areas, the application of the Guidelines is mostly satisfactory, although room for improvement exists. This is true in particular for the categories of ‘Disclosures to end-investors’ and ‘Internal Risk Management and Compliance with the Investment Mandate’. However, regarding the two other sections – ‘Operational Aspects’ and ‘Collateral Management’ – the AG identified supervisory practices and arrangements in place at certain NCAs that raise specific concerns in relation to compliance with the Guidelines.
13. Regarding ‘Disclosures to end-Investors’ of the UCITS, the AG considers that the NCA’s approach regarding the general level of disclosure relating to EPM in the prospectus of UCITS does not ensure sufficient information for investors as required by the Guidelines. Disclosures do not necessarily provide a clear enough understanding of the intention to engage in EPM, as required by the Guidelines. Equally, the required disclosures concerning (i) the policies of UCITS regarding direct and indirect operational costs/fees arising from EPM that may be deducted from the revenue and (ii) information on collateral management leave room for improvements. The NCA’s assessments of the comprehensibility and substance of disclosures could be further improved in the interest of transparency and in order to ensure a better comparability of products for the end-investors. There is also scope to consider implementing a more systematic and formalised supervisory mechanism to ensuring the required disclosures relating to EPM are made in the prospectus and annual reports.
14. On the section ‘Internal Risk Management and Compliance with the Investment Mandate’, the AG found that overall most of the assessed NCAs have supervisory practices to systematically assess the UCITS ManCos’ RMP at the initial authorisation stage and/or ex post. Notwithstanding some room for improvement, together with adequate practices of ongoing supervision of UCITS, the level of compliance with the Guidelines is satisfactory.
15. Regarding ‘Operational Aspects’, the AG identified certain supervisory practices that are not in line with the requirements under the Guidelines aiming to ensure that investors receive the full revenue of EPM engagement, net of direct and indirect operational costs. Two NCAs [DE,

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<sup>8</sup> Cf. Annex 3.

<sup>9</sup> Cf. Annex 4.

LU] set regulatory thresholds of minimum revenues to be returned to the UCITS without having a standardised practice of questioning or challenging ManCos on their cost and fee structure, creating a risk that investors do not receive the full revenue of EPM engagement.

16. The Guidelines' requirement to ensure that all revenues net of direct and indirect operational costs are returned in full to the UCITS is crucial to safeguard the interests of investors of the UCITS. On aggregate, the split of revenues for EPM amounts to a significant figure for UCITS so the NCAs' practices to check compliance with this requirement can have a considerable effect on the return. For that reason, the AG puts a focus on these operational aspects. In addition to the findings in regard to the practices of the NCAs, the AG recommends that ESMA considers reviewing the Guidelines themselves, to ascertain whether any further work is required to enhance a consistent approach across jurisdictions, including in the interpretations of some key aspects such as 'operational costs', so that investors across the EU receive adequate protection.
17. Another divergence in the application of the Guidelines relates to 'Collateral Management'. The Guidelines do not provide for any exemptions regarding the requirement for a UCITS to receive collateral. Yet, the regulatory frameworks of two jurisdictions [DE, UK] assessed allow for such exemptions when EPM is engaged in via a securities lending programme maintained by CSDs. The other assessed NCAs do not grant such exemptions. In particular, the practice of granting such exemptions from the Guidelines when the securities lending programme of only one specific CSD (i.e. in UK this is Euroclear Bank SA/NV's Securities Lending and Borrowing Programme, and in DE this is Clearstream Banking) is used, is in contravention of the Guidelines and not consistent with a level-playing field for UCITS in the Single Market.
18. A summary table of the compliance level per jurisdiction and per category of the Guidelines assessed is set out below. Additional information on the individual findings on the categories is provided as well.

**Table 1: Summary table of the compliance level per jurisdiction and topic covered by the Guidelines**

NCA	Disclosure to end-investors	Internal Risk Management and Compliance with the Investment Mandate	Operational Aspects	Collateral Management
DE	fully compliant	fully compliant	insufficiently compliant	insufficiently compliant
EE	partially compliant	broadly compliant	broadly compliant	broadly compliant
FR	broadly compliant	fully compliant	fully compliant	fully compliant
IE	broadly compliant	broadly compliant	broadly compliant	fully compliant
LU	broadly compliant	fully compliant	partially compliant	fully compliant
UK	partially compliant	partially compliant	broadly compliant	insufficiently compliant

**Legend:**

fully compliant	fully compliant
broadly compliant	broadly compliant
partially compliant	partially compliant
insufficiently compliant	insufficiently compliant

**Findings on rules on disclosure to end-investors of the UCITS**

19. NCAs are expected to check that the end-investor receives clear information on the intention of the UCITS to engage in EPM. The Guidelines require further information on the risks of such engagement and conflicts of interest arising from these activities, as well as the policy of the UCITS regarding costs, fees and revenues to be included in the prospectus. Moreover, the prospectus should also clearly inform investors of the collateral policy of the UCITS. This should include permitted types of collateral, level of collateral required and haircut policy and, in the case of cash collateral, re-investment policy (including the risks arising from the re-investment policy). In addition, the Guidelines specify what elements are to be contained in the UCITS' annual report in relation to EPM. In this context, the AG assessed how NCAs have implemented appropriate supervisory practices in a systematic and consistent manner to check that the disclosures required by the Guidelines are contained in the prospectus and the annual report of UCITS.
20. While all NCAs have supervisory practices in place to check the disclosures of the prospectus in general, not all NCAs have sufficiently formalised supervisory practices and tools in place to review compliance with all disclosure requirements set out in the Guidelines. The AG reviewed a number of prospectuses and the internal guidance documents of NCAs relating to EPM (if any) and came to the conclusion that in a number of jurisdictions [DE, LU, UK] the supervisory practices in place do not ensure a formalised and systematic review of the comprehensibility and substance of the required disclosures. Thus, such practices allow for overly open or legalistic phrasings and disclosures often do not inform investors clearly enough

about elements such as the intention to engage in EPM, the risks involved, or the cost and fee policy concerning EPM.

21. In one NCA [EE], the AG found disclosures in a prospectus that were confusing (failing the requirement to be 'clear') in the context of intended EPM activity of UCITS. EE confirmed that such disclosures were in line with the expectations of the NCA. Similar observations were made with regard to the required disclosures of UCITS concerning costs/fees and revenues stemming from EPM as well as collateral management.
22. This leads to the AG's assessment that the majority of assessed NCAs do not check disclosures in the prospectus in a fully satisfactory manner. In the interest of transparency to end-investors, NCAs should reassess their supervisory procedures and tools regarding the disclosure requirements set out in the Guidelines.
23. As envisaged by the UCITS Directive, the accounting information in the annual report of the UCITS shall be audited by a statutory auditor. In some jurisdictions [DE, LU] the obligation of auditors extends to checking compliance with the Guidelines as well. Regarding the periodic disclosures in the annual reports, four NCAs [DE, FR, IE, LU] had some form of supervisory practices for reviewing annual reports of UCITS with regard to their compliance with the Guidelines. However, in most jurisdictions, more detailed reviews are performed only in cases where statutory auditors report issues or breaches to the NCA in the annual report [FR, IE, LU]. A number of NCAs rely more on different sources of information in this regard, such as reports of ManCos or depositaries on EPM data or breach reports.
24. No systematic and proactive reviews of annual reports are performed by NCAs, with the exception of one NCA [DE]. One NCA [EE] does not have a methodical form of reviewing annual reports. One NCA [UK] does not systematically review the compliance of annual reports with the Guidelines and generally does not utilise annual reports in the course of its supervisory work.
25. Therefore, the AG considers that the supervisory practices regarding disclosure requirements set out in the Guidelines could be further enhanced to ensure that end-investors receive clearer, more comprehensive and more detailed information on EPM and ensure supervisory convergence amongst NCAs.

## **Findings on internal risk management and compliance with the investment mandate**

26. The Guidelines require that EPM activities of UCITS should not result in a change of the investment objective or add substantial supplementary risk in comparison to the original risk policy of the UCITS as described in its sales documents. Moreover, the risk arising from EPM needs to be adequately captured by the RMP and taken into account for the liquidity risk management process.

27. Most of the assessed NCAs therefore apply processes to assess the RMP at the initial authorisation stage and/or review these documents ex-post on an on-going basis. Three of those NCAs [DE, FR, LU] apply sufficiently formalised and systematic supervisory practices to review the impact of EPM on the risk management. Some NCAs have dedicated risk management experts/units that are consulted by the relevant authorisation/supervision units in more complex cases relating to EPM [DE, EE, FR, IE, LU].
28. The process for assessing the RMP of UCITS of one NCA [IE] is designed in such a way that RMP are only submitted and reviewed where market participants make use of FDI. This approach leaves a gap regarding UCITS solely engaging in (Reverse) Repos and Securities Lending. One NCA [UK] does not systematically assess RMP of each applicant at the initial authorisation stage. Supervisory measures of some NCAs in this regard comprise on-site visits with the focus on the RMP, thematic reviews or cross-firm reviews, and the assessment of updates to these RMP.
29. Regarding one NCA [EE], due to the fact that UCITS in this jurisdiction generally do not engage in EPM, no additional internal or external guidance was drafted, due to its risk-based approach to supervision. The NCA confirmed that further guidance and practices would be developed should an increase of EPM activity by UCITS be observed.
30. On the topic of checking that the engagement in EPM does not result in a change of the declared investment objective of the UCITS (as required under the Guidelines), NCAs applied a number of supervisory practices. Data reporting that includes EPM [DE, IE, LU, UK] and portfolio analysis tools [EE] applied in some jurisdictions provide the NCAs with information on the activities of the UCITS to check the consistency of the investment objective of the UCITS with the assets held and techniques used by the UCITS.
31. In addition, regulatory practices of a number of NCAs [FR, IE, LU, UK] involve checks of compliance with the investment mandate of the UCITS, such as UCITS or umbrella fund deep dives, thematic reviews, model portfolios or on-site visits covering these topics. By applying such practices, NCAs can analyse in depth the way the UCITS has actually been managed, including via its employment of EPM, compared what is permitted under its investment objective and policy.
32. The AG considers that the NCA's overall level of compliance with the Guideline requirements regarding the internal risk management and compliance with the investment mandate is satisfactory. This report identifies points to further strengthen the individual approaches of NCAs in this regard.

## Findings on operational aspects

33. In relation to the operational aspects for the engagement in EPM, the Guidelines cover a number of issues. Most prominently, the Guidelines require that all the revenues arising from EPM should be returned to the UCITS, net of direct and indirect operational costs and that these costs should not include hidden revenues.
34. The AG noted that only one NCA [FR] provided for comprehensive internal and external guidance in applying these Guidelines that are fully in line with the requirements. The applied rules of this NCA ensure that the revenues are expressed in gross values and are based on the gross revenue earned from the counterparty (such as the ultimate borrower of the security), best execution principles and conflicts of interest management. This form of implementation communicates transparent information to the end-investors of the UCITS and operationally it allows for clear arrangements on the market.
35. The other assessed NCAs [DE, EE, IE, LU, UK] do not provide any additional internal and external guidance in applying the Guidelines, therefore, there is no clear information or set practice with regard to operational costs and fees of UCITS.
36. Two NCAs [IE, UK] conducted a thorough market analysis via a thematic review<sup>10</sup> on securities lending by UCITS. These thematic reviews analysed how securities lending is organised by the market, what operational costs and fees exist and how revenues earned are split between the UCITS and other parties (as part of the operational costs). One NCA [IE] performed a follow-up to the thematic review on revenue splits. While the AG acknowledges the work in this area, the AG concluded that without a formalised and systematic approach with regard to reviewing costs, fees and revenues relating to EPM, full adherence with the Guidelines is not ensured. In particular, the requirement not to levy hidden fees can only be assessed when clear internal and external guidance is put in place.
37. Two NCAs [DE, LU] stipulate in their regulatory framework minimum percentages of revenues to be returned to the UCITS, without providing further guidance on what constitutes permissible operational costs and fees or reviewing individual cases that are above this threshold in a standardised way.
38. One NCA [LU] applies a threshold of 51% to be returned to the UCITS on the basis of the gross revenue. This is an internal policy and the threshold serves as a backstop of minimal revenues to be returned to the UCITS. However, this NCA neither provides for additional internal or external guidance on cost, fees and revenues nor does it apply standardised checks of cost and fee policies. Further communication or interaction with applicants only occurs in

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<sup>10</sup> In the FCA's regulatory framework, 'thematic reviews' are clearly defined supervisory tools. The FCA's review on securities lending by UCITS was not such a thematic review. This report uses the term 'thematic review' in a broader context to cover the market analysis work done by the named NCAs.

cases where the case officer finds the operational set-up of the UCITS to be noticeably different.

39. The other NCA [DE] provides two options in their external guidance ('Muster-Kostenklauseln') on how cost and fee policies should be established and presented for UCITS to be permissible. While one option relates to a split of revenues on the basis of the gross revenues, the other option explicitly allows that at least 51% of the net revenue is to be returned to the UCITS, thus allowing a split of revenues after the direct and indirect operational costs were deducted.
40. The setting of a fixed threshold, either on a gross or on a net basis, without providing any additional guidance on costs, fees and revenues and standardised reviews and checks of market participants on the fee structure cannot fully prevent the levy of hidden revenues to the detriment of the UCITS. Furthermore, the option of splitting of revenues on a net basis is a breach of the Guidelines, which require all net revenue to be returned to the UCITS.
41. The AG considers that in relation to these two NCAs, this situation should be remedied to ensure a common application of the Guidelines and compliance with the same. This is a concerning divergence in the application of the Guidelines that ultimately does not ensure that investors receive the full revenue of EPM engagement. Furthermore, the option of splitting of revenues on a net basis is a breach of the Guidelines, which require all net revenue to be returned to the UCITS. Upon identification of this finding by the AG, one NCA [DE] confirmed it has changed its external guidance to market participants ('Muster-Kostenklauseln') to ensure compliance with the Guidelines. As these changes took effect after the review period, the AG did not review or assess its implementation.
42. Regarding the remaining NCA [EE], due to the fact that UCITS in this jurisdiction generally do not engage in EPM, no additional internal or external guidance was drafted, due to its risk-based approach to supervision.

## **Findings on collateral management**

43. Chapter XII of the Guidelines lays down the collateral management requirements when UCITS engage in EPM. The AG expects NCAs to review that all assets received by the UCITS in the context of EPM are considered as collateral in accordance with the Guidelines and that all collateral requirements are complied with, such as those on liquidity, valuation, diversification, and custody arrangements.
44. The AG observed that three NCAs [FR, IE, LU] presented robust supervisory practices to review the compliance of market participants with the Guidelines.



45. Regarding two NCAs [DE, UK], the AG is of the view that their regulatory framework with regard to collateral requirements is in breach with the Guidelines. Both regulatory frameworks allow for exemptions with respect to the collateral management requirements set out in the Guidelines in cases where EPM is engaged in via a securities lending programme maintained by CSDs. However, the Guidelines do not provide for any exemptions with regard to the collateral management requirements.
46. In one case [DE], UCITS using 'organised securities lending systems' are by law exempt from some of the collateral management requirements set out in the assessed Guidelines, provided that the 'interests of investors are safeguarded'. The potential exemptions in particular relate to para. 43 d), e) and h) as well as para. 46 of the Guidelines. Such partial exemptions have been granted to the securities lending program of one specific CSD, this being Clearstream Banking.
47. In the other case [UK], the national rules (COLL) provide for an exemption to the requirement to post collateral where securities lending is undertaken through the securities lending programme of one specific CSD, this being Euroclear Bank SA/NV. Thus, the UK framework fully exempts these EPM transactions carried out through Euroclear Bank SA/NV's Securities Lending and Borrowing Programme from the collateral management requirement set out in the Guidelines.
48. Both regulatory frameworks [UK, DE] are not in line with the Guidelines that do not provide for any type of exemptions with respect to the collateral management requirements. Therefore, both regulatory frameworks [UK, DE] are not in compliance with the Guidelines on this point.<sup>11</sup>
49. These exemptions from the Guidelines are not consistent with the objective of supervisory convergence in the Single Market for UCITS.

## Good practices

50. Following the analysis and the on-site visits, the AG has identified good practices with regard to the Guidelines. The most relevant practices are indicated below, more detail is provided in Chapter 3.
51. The AG observed in particular that several NCAs apply a more data-driven form of supervision to help identifying areas to concentrate resources on. Data analysis around general supervisory practices is becoming an increasingly important element in the supervisory process. Several NCAs introduced bespoke reporting tools of various granularity to provide support to and

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<sup>11</sup> In the course of this peer review, the AG did not assess in what way either CSD makes use of the exemptions granted by the regulatory frameworks. The AG did not assess whether collateral (if any is posted) for securities lending activities through the individual securities lending programme of the CSDs is in line with the requirements under the Guidelines.



augment oversight of UCITS and their adherence to the Guidelines. Depending on the approach of NCAs, these cover either the full UCITS market on an aggregate or asset-by-asset basis, or a sufficient number of UCITS to obtain an adequately broad overview to assess the current market profile and tailor the supervisory program accordingly.

52. Regarding the general approach to ESA Guidelines, the AG observed that one NCA had a clear practice of surveying the market once any ESA guidance is published to assess the level of activity of its supervised market in relation to such Guidelines and the expected impact of these provisions on its market. This kind of survey was also performed on the assessed Guidelines. The AG found that this practice helps shape the supervisory program in the context of setting priorities with limited resources and overall provides a thorough insight into market activities.
53. EPM activities of UCITS need to be adequately captured by the RMP of the relevant UCITS ManCo. Therefore, RMP of UCITS ManCos should be analysed in depth in view of EPM and its impact on the risk profile of the UCITS. This holds true for the authorisation stage as well as for on-going supervisory measures. In addition to this practice, some NCAs require that RMP are updated periodically and that they are informed of any changes made to these documents and processes. By doing so, NCAs can thus stay informed about the operations of UCITS ManCos and adapt the supervisory program accordingly. The analysis of RMP and updates thereof should be performed by specialised Risk Teams or subject matter experts. Some NCAs employ specialist risk assessment teams that review RMP, lending support both at the authorisation stage and later for ongoing supervision, onsite inspections and thematic reviews.
54. To facilitate the UCITS authorisation process and to ensure that end-investors benefit from a high level of transparency and consistency of disclosures including those regarding EPM, some NCAs introduced clear guidance tools to UCITS ManCos, such as model fund documents that offer templates for UCITS documentation with clear references to EPM engagement. The development of model fund documents can provide market participants with valuable guidance as to the required disclosures, improves consistency of disclosure and helps streamlining the authorisation process.
55. Another effective tool in the context of the UCITS authorisation process is the requirement for UCITS ManCos to submit model portfolios to evidence the investment strategy using actual examples. UCITS ManCos thus need to consider whether their EPM engagement is intended and reflect this in the model portfolio accordingly. These model portfolios can be assessed at the stage of authorisation and constitute the basis for a 'Meeting Investors Expectations Review' at a post-authorisation stage to check whether the UCITS' actual investment strategy is in line with what an end-investor can reasonably expect.

## On-site visits

56. The on-site visits to NCAs played an important role in enabling the AG to enhance its understanding of the NCAs' supervisory approaches. In order to gain a thorough understanding, the AG looked into supervisory practices in relation to the application of the Guidelines by NCAs and market participants in the context of the authorisation stage, day-to-day supervision and enforcement. The AG wishes to both stress that all visited NCAs engaged openly and constructively with the AG and express its gratitude for this.
57. The following practices and findings in relation to the Guidelines are presented in the order the on-site visits took place chronologically.

## EFSA (Estonia)

58. The MS's UCITS market is small. This is true both relative to the other MSs whose NCAs have been visited as part of this peer review, and also relative to other fund types supervised in the jurisdiction, such as pension funds. As such, the EPM activity of funds in the MS could only ever be very limited and any specific supervisory work undertaken on that activity proportionately limited. Further, the EFSA is required by national legislation to operate a risk-based approach to supervision. Consequently, less priority is assigned to supervision of UCITS and their ManCos compared to other funds. The EFSA therefore seeks its supervision of UCITS to be proportionate.
59. During the review period, the AG found only one UCITS which appeared to be using EPM. There were no specific supervisory checks undertaken by the EFSA on that UCITS applicable to the Guidelines. As such, the AG principally assessed: (i) whether the EPM use was in fact detected by the NCA during the review period, and what the result of that detection was; and (ii) in the case of no detection of EPM use, the likelihood that the EFSA's supervisory approach would detect any material employment of and/or material increase in EPM use.
60. In general, the AG found that there was scope for improvement of the EFSA's supervision of entities' compliance with the Guidelines, even allowing for the relatively lower supervisory resource allocated to this sector of the market. A number of supervisory practices are not documented in written policies and procedures, and therefore there is a risk that their application may not be consistent and/or is subject to key personnel risk.
61. The EFSA uses a portfolio analysis tool to assess whether UCITS are displaying characteristics which require a deeper supervisory review. This is in line with the EFSA's risk-based approach. The tool did not highlight any UCITS as requiring a follow-up review during the review period. Neither a ManCo nor a depositary were subject to an on-site inspection during the review period. The AG found that an inspection regime which consists of elements of

proactive supervision and not just being based on triggers could materially improve the supervisory oversight over either those entities employing EPM (ManCos) or those responsible for oversight of the UCITS (depositaries), or both. Given the AG's uncertainty of the effectiveness of the EFSA's tools to detect the EPM use, additional methods of selecting entities for further review would complement the EFSA's risk-based supervision.

62. In addition, the AG found that the EFSA's policy allowed for unclear disclosures to investors in the prospectus.
63. The AG found some good practices employed by the EFSA. After any ESA Guidelines is published, the EFSA surveys its market to establish (i) the level of activity relevant to the published Guidelines in its market and, (ii) the impact of the Guidelines on its market. In line with the risk-based approach to supervision the EFSA applies, it adjusts its supervisory programme accordingly. In addition, the EFSA requires that a ManCo notify it of any material change to its internal procedures. This could be a lead indicator of the ManCo commencing more risky activities. The NCA can then adjust its supervisory approach to the ManCo as appropriate. The EFSA's portfolio analysis tool allows for an asset-by-asset analysis of each fund in the MS. The data is used by the NCA to establish whether UCITS' holdings are in-line with limits set out in the UCITS' Investment Objective and Policy. This practice is granular enough to enable a level of confidence that UCITS' assets are in-line with their prospectuses, whilst the semi-automated nature of the practice allows for the NCA to employ human resources efficiently. The AG found that whilst this practice required further review, and may not be scalable for use by other larger NCAs, it was nevertheless an example of good practice.

## **FCA (United Kingdom)**

64. The FCA takes a sophisticated risk-based and proportionate approach to supervision. Overall, given this framework, the AG considers that the FCA has shown that it implements and supervises compliance with a number of the Guidelines in a satisfactory way, taking into account a number of relevant good practices that assist significantly in achieving this goal. However, the AG has made a number of findings that require follow-up action by the FCA.
65. The AG is in particular of the view that the FCA should further enhance its supervisory practices and tools to review disclosures required by the assessed Guidelines in a more formalised and systematic way. Similarly, the ManCo authorisation process should be reassessed to ensure that all essential policies and procedures (including RMP, collateral management and conflicts of interest policies) are reviewed in each case before granting a license to applicants.
66. In the area of fees and costs, the FCA carried out a (thematic) review on securities lending by authorised fund managers in 2015. However, there was no follow-up work in this area by the FCA. Moreover, the FCA does not provide any further guidance on fees, costs and revenues,

nor does it have an internal policy in this area to ensure adherence with the Guidelines in a consistent and systematic manner.

67. The aforementioned codified full exemption from the requirements of collateral management for a CSD is not in line with the assessed Guidelines that do not provide for any exemptions in this regard.
68. In addition, the AG considers that the FCA should assess carefully the possible need for additional human resources in its UCITS supervision team, notwithstanding the FCA's proportionate and risk-based approach to supervision. Although some flexibility is available in the allocation of staff within the department in times of increased workload, the current level of staffing of the UCITS supervision team (4 FTEs while an additional 0.5 FTE can be made available) is a potential cause for concern, given the large number of UCITS (2,658) and in light of the significant contribution of this team to work in related areas (e.g. supervision of depositaries and a large number of authorised AIFs).
69. The AG identified a number of good practices operated by the FCA. The FCA applies a sophisticated reporting tool to complement its supervisory approach. In particular the annual collection of data on the use of FDI by UCITS (Derivative Use Report) allows for a thorough analysis of the UCITS market regarding FDI and their risks, and the requirement for depositaries to submit monthly Depositary Breach Reports, containing all detected breaches, whether they are material, non-material, advertent or inadvertent, is a good practice and particularly appropriate in the UK environment. Furthermore, the FCA requests model portfolios to be submitted during the UCITS authorisation process, followed by a 'Meeting Investors Expectations Review' post-authorisation, to assess the UCITS' investment strategy and the implementation thereof once the UCITS is established.

### **CBol (Ireland)**

70. The CBol presented a well-structured and robust process around the use of EPM by UCITS regarding the ESMA Guidelines that are the subject of this peer review. The resourcing of the relevant units within the CBol seems to be for the better part adequate, with the possible exception of the Fund Supervision Team. This team was composed of just 4 individuals at the end of the review period, supervising a total of around 4,000 UCITS sub-funds. The structure and resourcing of the funds supervision teams (including the 'Derivatives Unit') are currently under review as part of a larger CBol wide conduct supervision project. It is expected that resources in funds supervision will increase as a result.
71. In terms of potential improvements, the AG has identified a small number of areas. The 'Probability Risk and Impact System (PRISM)' model for risk-based supervision existing during the review period classifies all UCITS as low risk, meaning that the minimum level of supervisory engagement is reactive, trigger-based with regular thematic reviews. The AG considers that

this approach could be enhanced to allow for a classification that identifies UCITS employing more complex strategies, including EPM, so that they can receive more targeted supervision.

72. Another area of potential focus is the requirement of the Guidelines in relation to fees, costs and revenues. On the basis of the thematic review of the CBol on securities lending and the follow-up to this review, the AG sees merit in formalising a systematic approach on reviewing costs, fees and revenues relating to EPM to prevent the risk of hidden revenues.
73. Finally, the Derivatives Unit could take a more prominent role in assessing the risks connected to securities lending, repos and reverse repos, as currently, the process of evaluating the RMP of UCITS is designed in such a way that RMP are only reviewed in relation to EPM where market participants make use of FDI.
74. A number of good practices have been identified by the AG. These include the full transposition of the Guidelines into domestic law, the issuance of Guidance and Q&As, and the adoption of an UCITS application form that explicitly addresses the use of EPM. Full reviews of the Derivatives Risk Management Procedures and the generation and follow-up of alerts are also considered as good practices.

### **CSSF (Luxembourg)**

75. The CSSF presented a well-structured supervisory approach during both the authorisation process and the on-going supervision process of UCITS and UCITS Management Companies with regard to the use of EPM. For the most part, the AG considers that the CSSF has shown that it incorporated the Guidelines and supervises compliance with the majority of the assessed Guidelines in a satisfactory way.
76. The AG identified findings where the CSSF may wish to consider strengthening their supervisory approach in relation to the Guidelines.
77. The AG sees merit in further improving the supervisory practices for reviewing disclosure requirements for UCITS relating to the engagement in EPM by clarifying areas of ambiguity regarding the intention to engage in EPM and related policies.
78. Moreover, the CSSF should develop additional supervisory practices to assess compliance with the requirements on fees, costs and revenues. The CSSF requires that at least 51% of the gross revenue is returned to the UCITS. This is an internal policy and the threshold serves as a backstop of minimal revenues to be returned to the UCITS. However, the CSSF neither provides for additional internal or external guidance on cost, fees and revenues nor does it apply standardised checks of cost and fee policies. Further communication or interaction with applicants on this topic only occurs in cases where the operational set-up of the UCITS stands

out as noticeably different. On this point, the AG encourages the CSSF to develop clear internal and external guidance on the topic of fees, costs and revenues to ensure that the UCITS's policies regarding direct and indirect operational costs and fees are clearly disclosed in the prospectus and annual reports and that no hidden revenues are included in these positions.

79. The AG found some good practices employed by the NCA. The CSSF applies a bespoke UCITS Risk Reporting tool that provides a detailed insight into the dealings of UCITS, including their EPM engagement. In addition, the annual updates on RMP provide an overview of changes and evolutions of the ManCos' use of EPM.

### **BaFin (Germany)**

80. The AG identified areas where BaFin's supervisory practices do not ensure compliance with the assessed Guidelines. This relates in particular to the assessed Guidelines relating to fees, cost and revenues generated from EPM techniques. In this regard, BaFin merely requires that at least 51% of the net revenue (after deduction of expenses for the agent and other costs) are to be returned to the UCITS. The setting of a fixed threshold, be it on a net or gross basis, without further reviewing and challenging market participants on the fee structure cannot fully prevent the levy of hidden revenues to the detriment of the UCITS. Furthermore, the option of splitting of revenues on a net basis is a breach of the Guidelines, which require all net revenue to be returned to the UCITS.
81. Moreover, the aforementioned collateral management requirements set out in the German legislation include several exemptions for 'organised securities lending systems' which includes CSDs. The potential exemptions in particular relate to para. 43 d), e) and h) as well as para. 46 of the ESMA Guidelines. This is contrary to the Guidelines that do not provide for any exemptions in this regard.
82. In addition, supervisory tools such as checklists encompassing the disclosure requirements set out in the assessed Guidelines could help to further enhance BaFin's systematic and formalised process in order to ensure compliance with all disclosure requirements laid down in the Guidelines and improve consistency of its supervisory checks.
83. Regarding good practices, BaFin has developed model fund documents ("Muster-Anlagebedingungen" and "Muster-Kostenklauseln") which provide market participants with helpful guidance as to BaFin's expectations concerning different types of required disclosures and their granularity. These documents help streamlining the UCITS authorisation process and are therefore to be seen as a valuable supervisory tool. It is also worth mentioning that additional reporting requirements pursuant to DerivateV provide for a good overview of the use of EPM by UCITS and related collateral management arrangements.



## **AMF (France)**

84. The AMF responses to the self-assessment questionnaire and the on-site visit, including both supporting documentation and answers by the AMF staff to questions asked by the AG, enabled the AG to gain a sufficiently comprehensive understanding of the supervisory approach taken by the AMF in relation to the application of the Guidelines. This was considered in the context of the authorisation, day-to-day supervision and enforcement processes in relation to ManCos, UCITS, depositaries, and other related third parties involved in the EPM activity of UCITS, such as lending agents. It also allowed the AG to identify key findings and good practices.
85. The AG found the AMF to have a comprehensive framework and well established procedures in place to implement and supervise compliance with the Guidelines. In addition, the AG considers that the AMF has made a considerable effort in order to promote and enhance a good understanding of the Guidelines across the industry.
86. Concerning potential improvements, the AMF should consider implementing means to systematically and regularly review annual reports for UCITS in addition to its existing supervisory approach and programme.

## **Follow-up actions with NCAs**

87. In accordance with the Peer Review Methodology, a follow up will take place regarding the points of insufficient compliance and partial compliance with the relevant NCAs.

## **Recommendations for ESMA policy work**

88. The AG identified a number of potentially diverging interpretations of the Guidelines as well as inconsistencies between the Guidelines and the UCITS Directive. The AG wishes to highlight these in the general report and suggest to ESMA to follow-up on them accordingly. The AG identified several practices of NCAs relating to the application of the Guidelines that might need to be considered under new or altered regulatory requirements. The AG wishes to highlight these points and sees merit in giving further consideration as to whether additional clarifications would be beneficial in order to improve the common understanding and application of the Guidelines.

89. First, a mutual understanding of what constitutes EPM is essential to ensure a common approach regarding these activities. While certain techniques and activities are generally considered to be EPM, such as securities lending activities or (reverse) repurchase agreements, no such clear understanding can be found regarding other techniques (e.g. sell/buy backs and buy/sell backs). Moreover, UCITS may invest in FDI for investment purposes or for the purposes of EPM. This differentiation may lead to operational and interpretational challenges for both market participants and NCAs. One NCA [FR] does not consider FDI to be EPM in principle. However, it requires compliance of UCITS investing in FDI with all relevant requirements set out in the Guidelines. In addition, with the entry into force and application of the SFTR, the legal framework for UCITS engaging in securities financing transactions or total return swaps has changed, specifically regarding disclosure and reporting requirements. These changes could be taken into account in the context of a potential follow-up concerning the Guidelines.
90. Second, in the context of collateral management, there may be an inconsistency between the Guidelines and Art. 22(7) of the UCITS Directive which was introduced by the UCITS V Directive. While the Guidelines refer to 'title transfer' and 'other types of collateral arrangement' (such as pledging arrangements) to be permissible for collateral received by the UCITS for its EPM, the text of Art. 22(7) stipulates that the assets held in custody by the depositary are allowed to be reused only where the transaction is covered by high-quality and liquid collateral received by the UCITS under a title transfer arrangement.
91. Third, further clarifications concerning the Guidelines on fees, costs and revenues could help to improve supervisory convergence amongst NCAs and ensure that all market participants have a common understanding of these issues. Such clarifications may cover the question what basis should be taken into account to express the direct and indirect operational costs and fees to be deducted from the revenue to the UCITS.
92. Finally, further clarifications concerning the interpretation of para. 33 of the Guidelines could help to improve supervisory convergence. In this regard, the Guidelines set out that fixed-term repurchase and reverse repurchase agreements that do not exceed seven days should be considered as arrangements on terms that allow the assets to be recalled at any time by the UCITS. The AG observed that the interpretation of this para. seemed to vary in some MS as further explained under Section 3.2.3.2 below.



## 2 Introduction

1. The ESMA Supervisory Convergence Work Programme 2017 provided that a peer review on the Guidelines was to be initiated in order to assess compliance by the national competent authorities with the Guidelines, identify good practices and potential areas for improvement.
2. This peer review was conducted in accordance with Article 30 Regulation (EU) No. 1095/2010 of the European Parliament and of the Council of 24 November 2010 (ESMA Regulation) and the Review Panel Methodology (ESMA/2013/1709) (Methodology).
3. In accordance with ESMA Regulation and the Methodology, the peer review is required to include a review of the NCAs' capacity to achieve high quality supervisory outcomes, including the adequacy of resources and governance and the effective application of the Guidelines, the capacity of the NCAs to respond to market developments, the degree of convergence in the application of law and supervisory practices, and the extent to which the practices achieve the objectives. The mandate<sup>12</sup> was approved by the BoS in September 2017 and revised in November 2017 to accommodate a change of experts within the AG.
4. In accordance with the Methodology, the peer review was carried out by an independent group of experts, the AG. The mandate identifies the experts that were named as members of the AG.
5. This peer review is a focused one. The reasons for this approach are mainly twofold. First, the Guidelines cover a great variety of topics relating to UCITS supervision. These topics are not necessarily interrelated. For the sake of efficiency and taking into account the need to allocate scarce resources in the best possible way, restricting the peer review's scope to a particular subsection of the Guidelines seems appropriate and would allow a more informative and thorough review. Second, UCITS account for the vast majority of collective investment schemes held by retail investors in the Union and EPM techniques may add to the complexity of these vehicles.
6. This peer review therefore aims at assessing the level of compliance and supervisory convergence between NCAs in the area of supervision of EPM techniques in order to ensure that the use of EPM techniques complies with the Guidelines, that robust risk management processes and collateral management processes are applied for UCITS in relation to EPM techniques, and that investors understand the strategy behind the use of the EPM techniques applied for the UCITS they invest in. Therefore, the BoS put into scope Chapter X, para. 25-35, and Chapter XII, para. 42-44 and 47-48, of the Guidelines.
7. Furthermore, the BoS decided to focus the peer review on a number of jurisdictions to be assessed by this peer review, i.e. DE, EE, FR, IE, LU, UK. Only the six NCAs identified in the

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<sup>12</sup> Cf. Annex 1.

mandate were required to submit their answers to a self-assessment questionnaire<sup>13</sup> and were visited on-site by members of the AG.

**Table 2: Country codes and acronyms of NCAs assessed in the peer review**

Country Code	Country	Competent Authority	Acronym
DE	Germany	Bundesanstalt für Finanzdienstleistungsaufsicht	BaFin
EE	Estonia	Finantsinspektsioon	EFSA
FR	France	Autorité des Marchés Financiers	AMF
IE	Ireland	Central Bank of Ireland	CBol
LU	Luxembourg	Commission de Surveillance du Secteur Financier	CSSF
UK	United Kingdom	Financial Conduct Authority	FCA

8. All 31 NCAs, not only the six identified ones, were required to submit background information<sup>14</sup> on permissibility and legal constraints of EPM techniques for UCITS and on the collection of EPM data by NCAs (including – if such data is collected – the amount of EPM techniques for UCITS). This data is annexed to this report<sup>15</sup>.
9. The period under review covers the application of the requirements in relation to EPM under the Guidelines from 1 July 2015 to 30 June 2017.
10. In order to ensure a clear structure of the report and a comprehensive assessment of compliance by the NCAs, the report structures the assessment of the NCAs by material categories that are addressed by the Guidelines. For that, four areas are identified, i.e. (i) Disclosure to end-investors of the UCITS; (ii) Internal Risk Management and Compliance with the Investment Mandate; (iii) Operational Aspects; and (iv) Collateral Management.
11. A number of Guidelines are subsumed under each category. These categories cover such Guidelines that generally address similar topics or that from a regulatory perspective are usually supervised at the same stage of the process.

<sup>13</sup> Cf. Annex 2.

<sup>14</sup> Cf. Annex 3.

<sup>15</sup> Cf. Annex 4.

12. Compliance of the six NCAs with the Guidelines is assessed on the basis of these four categories. However, each corresponding section of the report relates to the full list of Guidelines covered to ensure a holistic assessment. This approach allows a more practical assessment of compliance with the Guidelines while any deficiency of compliance with individual Guidelines can still be outlined.

**Table 3: Categories for assessment and Guidelines covered**

Category	Guidelines subsumed	Section
Disclosure to end-investors of the UCITS	Chapter X para. 25, 28, 35; Chapter XII para. 43(e) [partly], 47, 48	3.2.1
Internal Risk Management and Compliance with the Investment Mandate	Chapter X para. 26, 27, 34	3.2.2
Operational Aspects	Chapter X para. 29 - 33	3.2.3
Collateral Management	Chapter XII para. 42-44	3.2.4

13. NCAs usually supervise EPM engagements as part of broader supervisory processes, such as UCITS ManCo and UCITS authorisation or daily supervision. The AG therefore aimed at assessing compliance with the Guidelines by covering such supervisory processes and complementing this with elements of supervision of relevant third parties, such as depositaries and auditors. This is to ensure that the individual supervisory approaches of NCAs are duly considered and put in perspective when assessing compliance with the Guidelines.

### 3 Peer Review Assessment

1. In this Section, this report identifies findings in relation to the four categories of the Guidelines and assesses the compliance of the assessed NCAs with these requirements. For that, the AG applies four levels of compliance, these being (i) full compliance; (ii) broad compliance; (iii) partial compliance; and (iv) insufficient compliance.
2. First, to provide a concise overview, Section 3.1 lays out the main findings (Table 4) and good practices (Table 5) in relation to the Guidelines for each NCA, reflecting the overall assessment of the AG. Section 3.2 then provides detailed information on the findings of the AG and its analysis of the same.

#### 3.1 Overview

**Table 4: Assessment table**

<b>Rules on Disclosure to end-investors of the UCITS</b>	
<p>Clear disclosures in the prospectus on the intention to engage in EPM, the risks of such engagement and conflicts of interest arising from these activities the policy of the UCITS regarding related costs, fees and revenues and the collateral policy.</p> <p>Complete disclosures contained in the UCITS' annual report in relation to EPM and collateral received.</p>	<b>Full Compliance:</b>
	<p><b>Broad Compliance: DE, FR, IE, LU</b></p> <p><b>DE:</b> Checklists to review prospectuses of UCITS do not include the Guidelines  <b>FR:</b> No systematic and proactive regular review of annual reports apart from trigger-based checks  <b>IE:</b> No systematic and proactive regular review of annual reports apart from trigger-based checks  <b>LU:</b> No systematic and proactive regular review of annual reports apart from trigger-based checks; Supervisory practices should be improved on clarity and substance of disclosures in the prospectus</p>
	<p><b>Partial Compliance: EE, UK</b></p> <p><b>EE:</b> Supervisory practices on comprehensibility and substance of disclosures in the prospectus allow for confusing wording  <b>UK:</b> Supervisory practices should be improved on clarity and substance of disclosures in the prospectus; Annual reports are generally not reviewed</p>
	<b>Insufficient Compliance:</b>

Internal Risk Management and Compliance with the Investment Mandate	
<p>EPM are adequately captured by the RMP</p> <p>EPM do not result in a change of the declared investment objectives of the UCITS</p> <p>EPM do not add substantial supplementary risks in comparison to the original risk policy of the UCITS</p> <p>EPM are taken into account in the liquidity risk management process</p>	<b>Full Compliance: DE, FR, LU</b>
	<p><b>Broad Compliance: EE, IE</b></p> <p><b>EE:</b> Supervisory practices were not proven to act on detection of engagement in FDI  <b>IE:</b> RMP are not reviewed when they solely engage in other EPM than FDI (such as reverse repos, repos and securities lending). Limited coverage of umbrella deep dives</p>
	<p><b>Partial Compliance: UK</b></p> <p><b>UK:</b> No systematic assessment of RMP at authorisation stage. Lack of adequately written procedures for UCITS ManCo authorisation. Limited participation of the FCA in depositary bank supervision despite the strong reliance placed on their oversight function in this regard</p>
	<b>Insufficient Compliance:</b>
Operational Aspects	
<p>All revenues arising from EPM, net of direct and indirect operational costs, are returned to the UCITS</p> <p>The costs and fees do not include hidden revenue</p> <p>All lent out securities are recallable and all securities lending agreements and (reverse) repurchase agreements can be terminated at any time</p>	<b>Full Compliance: FR</b>
	<p><b>Broad Compliance: EE, IE, UK</b></p> <p><b>EE:</b> Supervisory practices were not proven to act on detection of engagement in FDI  <b>IE:</b> A thorough market analysis via a thematic review and a follow-up on revenue splits have been performed. However, no sufficiently formalised and documented approach on revenues, fees and costs of EPM is applied.  <b>UK:</b> A thorough market analysis via a (thematic) review has been performed and UCITS applicants are challenged on their EPM engagement. However, no sufficiently formalised and documented approach on revenues, fees and costs of EPM.</p>
	<p><b>Partial Compliance: LU</b></p> <p><b>LU:</b> No sufficiently formalised and documented approach on revenues, fees and costs of EPM. Insufficient threshold-based approach on minimum gross revenue to be returned to the UCITS with reviews occurring only when the operational set-up of the UCITS stands out as noticeably different.</p>

	<b>Insufficient Compliance: DE</b>  <b>DE:</b> No sufficiently formalised and documented approach on revenues, fees and costs of EPM. Insufficient threshold-based approach on minimum net revenue to be returned to the UCITS; no additional reviews or challenging of UCITS ManCos
<b>Collateral Management</b>	
All collateral received for EPM engagement complies at all times with (i) Liquidity, (ii) Valuation, (iii) Issuer Credit Quality, (iv) Correlation, (v) Diversification, (vi) Risk Management, (vii) Title Transfer, (viii) Enforceability, and (ix) Investment criteria	<b>Full Compliance: FR, IE, LU</b>
	<b>Broad Compliance: EE</b>  <b>EE:</b> Supervisory practices were not proven to act on detection of engagement in FDI
	<b>Partial Compliance:</b>
	<b>Insufficient Compliance: DE, UK</b>  <b>DE:</b> ‘Organised securities lending schemes’ are exempted from a subset of collateral management requirements; such exemptions have been granted to Clearstream <b>UK:</b> Euroclear Bank’s Securities Lending Programme is fully exempted from the collateral management requirements

3. The assessment table provides an overview on NCAs’ compliance, broad compliance, partial compliance or insufficient compliance with the key topics identified under the assessed Guidelines. The detailed assessment for each topic and NCA is available in the analysis of findings below.

**Table 5: Table of good practices**

Area	Good practice
General	Following the publication of any new Guidelines by an ESA , surveying the market on (i) the level of market activity relevant to the published Guidelines, and (ii) the impact of the Guidelines on its market.  The result of this survey impacts the supervisory program accordingly.

<p>Disclosure to end-investors of the UCITS</p>	<p>Developing tools to help streamlining the UCITS authorisation process, for example by introducing complete and comprehensive model fund documents which provide valuable guidance to market participants on acceptable wordings of the required disclosures in the fund documents.</p>
<p>Internal Risk Management and Compliance with the Investment Mandate</p>	<p>Applying a data reporting and portfolio analysis mechanism allowing for an asset-by-asset analysis of each UCITS.</p> <p>The data can be used to establish whether UCITS' holdings are in-line with the limits set out in the UCITS' investment objective and policy and allow for the detection of changes of the investment mandate or the investment in other asset classes.</p>
<p>Internal Risk Management and Compliance with the Investment Mandate</p>	<p>Applying an appropriate reporting tool to assess the UCITS activities including data on the use of FDI and EPM techniques, including</p> <ul style="list-style-type: none"> <li>(i) volumes per EPM type (minimum, maximum, average, and semester-end values);</li> <li>(ii) overall net counterparty exposure arising from EPM techniques;</li> <li>(iii) collateral received in the context of EPM techniques; and</li> <li>(iv) leverage arising from the use of EPM techniques.</li> </ul> <p>This reporting tools may set thresholds on the AuM and the leverage of individual UCITS to determine the amount and depth of data to be provided to ensure a sufficiently good overview of the market without causing disproportionate regulatory burden.</p>
<p>Internal Risk Management and Compliance with the Investment Mandate</p>	<p>On an on-going basis, requiring updates to the RMP of UCITS ManCos, either by requiring</p> <ul style="list-style-type: none"> <li>(i) periodical (annual) updates to the RMP to assess any changes, or</li> <li>(ii) ad-hoc notifications of any (material) change to the internal procedures.</li> </ul> <p>This analysis is performed by specialised Risk Teams or subject matter experts. This practice ensures that NCAs keep informed about the operations of UCITS ManCos and that the supervisory program considers this information accordingly.</p>
<p>Internal Risk Management and Compliance with the Investment Mandate</p>	<p>Developing tools to help streamlining the UCITS authorisation process, for example by requiring and analysing model portfolios in the UCITS authorisation process, followed by a 'Meeting Investors Expectations Review' post-authorisation.</p> <p>By assessing the UCITS's investment strategy at the stage of authorisation, combined with a systematic review after implementation once the UCITS is set up, the NCA can ensure a more effective supervision of the UCITS.</p>

4. The table of good practices aims at enhancing supervisory convergence among NCAs by identifying practices that may be considered of benefit to all or a number of NCAs in strengthening their supervisory approach regarding the supervision of UCITS in the context of EPM. The AG does not rank these good practices in any way or prioritise any examples, as they may directly relate to the specific supervisory approach chosen by this very NCA and thus be appropriate only in this context. NCAs may however wish to make use of this information by considering whether some good practices could improve their own supervisory work.
5. All NCAs that were assessed in the course of this peer review apply variants of a risk-based approach towards supervision. In order to ensure that supervisory resources and attention are appropriately allocated to sectors and entities that are identified by the risk assessment, NCAs make use of and rely to a significant degree on data generated internally as well as data provided by market participants via reporting tools or other sources of market-sided data, such as data providers.
6. Thus, the good practices in the context of the Guidelines that were identified by the AG that relate to data collection and data analysis should be considered carefully by NCAs in the context of data-driven supervision and whether an adaptation of the risk-based approach is desirable.

## **3.2 Peer Review Findings**

### **3.2.1 Disclosure to end-investors of the UCITS**

7. The Guidelines require that UCITS should inform investors clearly in the prospectus of the intention to use EPM techniques. The Guidelines require, inter alia, that UCITS provide information to investors on (i) risks associated with the use of such techniques, (ii) potential conflicts of interest arising from the use of such techniques, (iii) the impact on the UCITS' performance, (iv) the policy regarding direct and indirect operational costs/fees arising that may be deducted from the revenue delivered to the UCITS from the use of such techniques and (v) collateral policy including permitted types of collateral, level of collateral required and haircut policy and, in the case of cash collateral, re-investment policy and the risks arising from the re-investment policy.
8. Furthermore, Guidelines expectations are that the UCITS specify in the UCITS' annual report information in relation to (i) revenues generated as well as direct and indirect operational costs and fees incurred, (ii) collateral received, (iii) the identity of counterparties and (iv) exposures obtained through such techniques.
9. In this context, the AG assessed how NCAs have implemented appropriate supervisory practices in a systematic and consistent manner to check that the disclosures required by the Guidelines are contained in the prospectus and the annual report of UCITS.



### 3.2.1.1 – Disclosures in the UCITS Prospectus

#### Findings

10. All assessed NCAs have some form of internal procedures, such as checklists, mind maps or other internal guidance documents, in place to check disclosures in the prospectus in general. However, in relation to EPM, not all of these internal procedures are sufficiently formalised so as to ensure supervisory practices to review compliance with all of the Guidelines' disclosure requirements are consistent and complete.
11. Several NCAs use standardised checklists at the authorisation stage of a UCITS [DE, FR, IE] while one NCA [LU] applies a mind-map that formalises a less stringent form of checks of disclosures, giving room for discretion to the case officer where to focus on. Regarding these guidance documents, three NCAs [FR, IE, LU] include direct reference to the Guidelines, one NCA [DE] does refer to the disclosure requirements under SFTR, whereby the requirements of the Guidelines were subsumed into SFTR for the purposes of authorisation of the UCITS.
12. Two NCAs [EE, UK] do not apply checklists or formalised internal procedures at the authorisation stage of a UCITS that cover the Guidelines.
13. Notwithstanding the given references to the Guidelines in the guidance documents of some NCAs, not all NCAs had a clear set of rules on how the intention to use EPM or the required policies on costs, fees, revenues and collateral should be disclosed clearly to the end-investors, as required under the Guidelines.
14. The internal guidance of four NCAs [DE, EE, LU, UK] generally allows for open and in some cases legalistic wordings in such a way that engagement in EPM was solely disclosed as a possibility or option. Similarly, the required disclosures of the policies on costs, fees, revenues and collateral in many cases lacked the required substance. In one instance [EE], the permissible disclosures were found to be even confusing and not only very openly worded.

#### Analysis

15. The AG observed that although relevant UCITS prospectuses did disclose the possibility to use EPM, there were distinct differences across NCAs with regard to comprehensibility and substance of disclosures. The required level of clarity and detail of the disclosures vary to a distinct degree between the assessed NCAs.
16. While the Guidelines require that a UCITS should inform investors clearly in the prospectus of its intention to use EPM, the AG observed in many cases open and in some cases legalistic wordings in such a way that engagement in EPM was solely disclosed as a possibility or option rather than an intention. Therefore, some of the required disclosures were provided in a manner that did not allow (retail) investors to fully understand the engagement in EPM and

relevant risks and policies of the UCITS in relation to EPM. In some cases, the information on the risks involved, such as a detailed description of the counterparty risk and potential conflicts of interest, and policies relating to EPM, such as the policy regarding direct and indirect operational costs and fees arising from EPM, did not provide sufficient detail to allow a complete understanding.

17. Differences were also observed among NCAs with respect to whether certain disclosure requirements could be met through reporting in the annual report rather than through the prospectus. In this regard, one NCA [LU] expressed the view that those cases met the Guideline requirements as the actual details concerning the use of EPM had been included in the annual reports. Moreover, only two NCAs [FR, IE] had clear rules on how the intention to use EPM should be disclosed clearly to investors and in this context.
18. Two NCAs [FR, UK] demonstrated to the AG a practice of challenging UCITS ManCos at the authorisation stage of a UCITS regarding their intention to engage in EPM techniques or otherwise requesting deletion of the related clauses.
19. As stated above, the supervisory approach of four NCAs [DE, EE, LU, UK] regarding disclosures in the prospectus give way to open wordings. The AG considers that such open wordings are not sufficiently reflecting the intention to engage in EPM and the relating policies lack comprehensibility and substance. The supervisory approaches of these NCAs are therefore not fully compliant with the Guidelines. The AG considered the permissible disclosures of one NCA [EE] would likely confuse investors as to the use of EPM. In this case, the disclosures assessed do not put the investor in a position to reach an informed decision regarding intended EPM engagement by the UCITS.
20. The AG considers that NCAs' oversight of the requirements regarding rules on prospectus disclosures to investors of the UCITS should be strengthened to ensure that investors receive clear and complete information that is checked and challenged by the NCA.

### 3.2.1.2 – Disclosures in the Annual Report

#### **Findings**

21. The AG found that the majority of NCAs had some form of internal procedures to assess and analyse UCITS' annual reports as part of the supervisory process. However, the assessments of most NCAs are usually performed only in cases where an issue is flagged to the NCA, for example in the annual report, or as part of a broader assessment of the UCITS. The majority of NCAs however do not assess audited annual reports in a systematic and proactive manner as part of a formalised supervisory activity in relation to UCITS but only once triggers are set off.

22. With the exception of one NCA [DE], no systematic and proactive reviews of annual reports are performed by NCAs in addition to trigger-based assessments [FR, IE, LU]. None of the NCAs had internal procedures to systematically and proactively assess and analyse UCITS' annual reports specifically with regard to their compliance with the Guidelines.
23. Two NCAs [EE, UK] do not have a methodical form of reviewing annual reports. One NCA [UK] does not systematically review the compliance of annual reports with the Guidelines and generally does not utilise annual reports in the course of its supervisory work.

## Analysis

24. The AG found that the majority of NCA's [DE, FR, IE, LU] had internal procedures to assess and analyse UCITS' annual reports as part of the supervisory process. However, these assessments are usually performed in cases where an issue is flagged to the NCA, for example in the audited annual report or as part of a broader assessment of the UCITS [FR, IE, LU]. Only one NCA [DE] had a practice of systematically reviewing annual reports.
25. In three jurisdictions, more detailed reviews of annual reports are generally performed only in cases where statutory auditors report issues or breaches to the NCA in the audited annual report [FR, IE, LU]. In this context, it is worth noting that statutory auditors in two of these jurisdictions [FR, IE] are not required by law to check compliance with the Guidelines on disclosures in the annual reports. Regulatory obligations for statutory auditors to check compliance of UCITS and UCITS ManCos with a broad range of legal requirements including most aspects of the Guidelines (such as disclosure requirements) exist in only two MS [DE, LU].
26. Two NCAs [EE, UK] do not have a methodical form of reviewing annual reports. One NCA [UK] does not systematically review the compliance of annual reports with the Guidelines and generally does not utilise annual reports in the course of its supervisory work.
27. The AG found that in order to ensure that end investors of UCITS receive complete EPM related information covered by the Guidelines in the annual reports, five NCAs [EE, FR, IE, LU, UK] should consider implementing appropriate means to ensure regular reviews of annual reports for UCITS on at least a sample check or random basis to complement the existing approach on UCITS supervision.
28. The AG considers that NCA requirements regarding rules on disclosure to investors contained in the annual reports of the UCITS could be strengthened to ensure the information presented is complete and accurate. As part of the supervisory process compliance with the Guidelines' disclosures in the annual report should be assessed and challenged. Where complete coverage is not achievable, a level of randomness regarding the assessment and analysis might enhance supervisory practices and compliment the general approach of UCITS supervision by NCAs.

### 3.2.1.3 – Good Practices in the context of Disclosures

29. One NCA [DE] outlines the development of Model Fund Documents which provide valuable guidance to market participants and help streamline the authorisation process. Such Model Fund Documents may provide a means by which NCA's can fashion clearer disclosures to investors and facilitate the application process for UCITS ManCos alike.

## 3.2.2 Internal Risk Management and Compliance with the Investment Mandate

30. The Guidelines require that EPM engagement should not result in a change of the investment objective or add substantial risks in comparison to the original risk policy of the UCITS as described in its sales documents. Moreover, the risks arising from EPM engagement need to be adequately captured by the risk management process and taken into account for the liquidity risk management process.

### 3.2.2.1 – Risk Assessment Procedures

#### Findings

31. The AG found that the visited NCAs apply processes to assess the UCITS RMP at the initial authorisation stage or ex post. Robust challenges of these processes are made, particularly around the use of FDI, less in relation to securities lending or repos and reverse repos. The majority of NCAs had processes in place to check that the risks arising from the engagement in EPM is duly reflected by the risk management processes of the UCITS ManCo. Other supervisory measures of some NCAs in this regard comprise on-site inspections with the focus on RMP, thematic or cross-firm reviews, and the assessment of updates to these RMP.
32. Five NCAs [DE, EE, IE, FR, LU] require that a UCITS ManCo submits its RMP prior to authorisation, otherwise authorisation cannot be granted. All of those NCAs make use of dedicated risk management experts/units that review RMP on behalf of the authorisation/supervision units on a case-by-case basis, e.g. when the relevant authorisation/supervision units request input or reviews in more complex cases.
33. The process for assessing RMP of one NCA [IE] arranges for engagement of the authorisation team with internal risk management experts in case FDI are permissible assets for the UCITS. In such cases, the 'Derivatives Unit' is involved in the assessment of consistency of the prospectus with the set-up of the UCITS. However, the 'Derivatives Unit' is not involved in the assessment of the RMP of UCITS that exclude FDI but provide for the engagement in other

EPM, such as (Reverse) Repos and Securities Lending on an unleveraged basis. Such UCITS are not required to submit a RMP at authorisation.

34. One NCA [UK] does not systematically assess RMP of each UCITS ManCo applicant at the initial authorisation stage. While the authorisation unit assesses all documents received by the applicant, there is no requirement for case officers to ensure that the RMP is part of the case file. It lies in the discretion of the case officer to request RMP, if not initially sent by the applicant. In the course of other supervisory measures, such as cross firm reviews or thematic reviews, RMP can be assessed post authorisation.
35. In the context of FDI, the distinction around the use of FDI for EPM purposes or investment purposes was not always homogenously understood by market participants and NCAs. This was reflected in the way NCAs accessed the use of FDI at authorisation of the UCITS and ongoing supervision. As the distinction was unclear and to avoid regulatory issues, stakeholders confirmed that they apply the requirements of the Guidelines to all FDI activity, while also incorporating all FDI activity, regardless of purpose, into the general risk management process. This practice facilitated the operation aspects of investing in FDI.
36. For one NCA [EE], due to the fact that UCITS in this jurisdiction do generally not engage in EPM to a substantive extent, no additional internal or external guidance was drafted. The NCA confirmed that guidance and practices would be developed should an increase of EPM activity by UCITS be noticed.
37. On the topic of checking that the engagement in EPM does not result in a change of the declared Investment Objective and Policy of the UCITS (as required under the Guidelines), NCAs applied a number of supervisory practices. Data reporting that includes EPM [DE, IE, LU, UK] and portfolio analysis tools [EE] applied in some jurisdictions provide the NCAs with information on the activities of the UCITS to check the consistency of the investment objective of the UCITS with the assets held and techniques used by the UCITS.
38. In addition, regulatory practices of a number of NCAs [FR, IE, LU, UK] involve checks of compliance with the investment mandate of the UCITS, such as UCITS or umbrella fund deep dives, thematic reviews, or on-site visits covering these topics. By applying such practices, NCAs can analyse in depth the way the UCITS has actually been managed, including via its employment of EPM, compared what is permitted under its Investment Objective and Policy.

## **Analysis**

39. The AG found that the visited NCAs apply processes to assess the UCITS RMP at the authorisation stage of the ManCo, the UCITS or both. The majority of NCAs [DE, EE, IE, FR, LU] apply quite robust challenges to these processes to ensure that the UCITS and UCITS ManCos processes consider the UCITS EPM activities. One NCA [UK] places less emphasis

on the assessment of RPMs at this stage, however sample checks of RMP are performed on a case by case basis by the fund supervision team as part of other supervisory activities. Those ex post sample checks do, however, not necessarily involve an assessment of compliance with the Guidelines.

40. One NCA [LU] incorporated a strong interaction between the risk management and the UCITS and UCITS ManCo authorisation and supervision teams to ensure a consistent analysis of the RMP. This practice is supported by the requirement for ManCos to annually update RMP and by incorporating oversight of the RMP into the supervisory process. Authorisation and supervision teams of other NCAs [DE, EE, FR, IE] may on a case-by-case basis consult risk management experts or risk teams in the context of RMP reviews, particularly in more complex cases.
41. The process for assessing the RMP of UCITS of one NCA [IE] leaves a gap regarding UCITS specifically engaging in (Reverse) Repos and Securities Lending on an unleveraged basis, but do not engage in FDI. The internal risk management experts within the 'Derivatives Team' are only consulted in the case FDI are permissible assets for a UCITS. With this approach, the RMP of a good proportion of applications is assessed by a unit specialised in the assessment of the applied risk management processes, however other RMP are not assessed in the same level of detail. To ensure consistency of the UCITS authorisation approach, the AG considers that this NCA should request RMP and internal experts should be equally consulted when other techniques of EPM are within the investment focus of the UCITS.
42. One NCA's [FR] authorisation process for ManCos incorporates limiting the entity to activities that the applicant has specifically described in the application file. The applicant can only broaden its activity set at a later stage with a further update of its application, including an update to its RMP. No other assessed NCA had a similar practice of limiting the authorisation in the context of UCITS ManCos.
43. One NCA [UK] placed a lesser emphasis on the systematic assessment of RMP at the authorisation stage than other NCAs. While the authorisation unit assesses all documents received by the applicant, there is no strict requirement for case officers to ensure that the RMP is part of the application file. It lies in the discretion of the case officer to request RMP, if not initially sent by the applicant. It is therefore possible that authorisation is granted without the RMP being assessed at this stage, as policies and procedures of ManCos that are essential for the engagement of EPM (such as procedures of risk management, collateral management, or conflict of interest policies) are not systematically checked.
44. Regarding one NCA [EE], the portfolio analysis tool applied by this NCA picked up the use of FDI by one UCITS, however, no documented additional supervisory steps were taken. Thus, it was not proven whether a further supervisory review would have been required and what actions would have been taken.

45. Common challenges for NCAs centred more particularly on the use of FDI, be it for EPM or other purposes. The focus of challenges and allocation of resources is primarily towards FDI rather than other EPM techniques.
46. NCAs should consider where the communication links between their various authorisation, supervision and risk management teams can be strengthened to enhance their co-operation, co-ordination and assessment of UCITS and ManCos at their authorisation and on-going supervision life-cycles.

### 3.2.2.2 – Good Practices in the context of Internal Risk Management and Compliance with the Investment Mandate

47. Data analysis around general supervisory practices is becoming an increasingly important element in the supervisory process. A number of NCAs presented reporting tools that provided support and augmented their oversight of UCITS and their adherence to the Guidelines.
48. One NCA [LU] demonstrated a bespoke UCITS Risk Reporting tool that provides insight into UCITS' activities including data on EPM techniques such as (i) volumes per EPM type (minimum, maximum, average and semester-end values), (ii) overall net counterparty exposure arising from EPM techniques, (iii) collateral received in the context of EPM techniques, and (iv) leverage arising from the use of EPM techniques.
49. One NCA [DE] demonstrated reporting requirements pursuant to the “DerivateV” that provides for an overview of the use of EPM techniques by UCITS and related collateral management arrangements.
50. One NCA [UK] demonstrated a supervisory approach that is highly data-driven. One main source of data regarding the Guidelines is the annual Derivative Use Report that allows a thorough analysis of the UCITS market regarding derivatives and their risks.
51. One NCA [LU] outlined the interaction between the Risk Management Team and UCITS Authorisation and Supervision Teams that ensures a consistent analysis of the RMP for the UCITS and UCITS ManCos. This practice is supported by the requirement to annually update RMP to maintain an overview of changes to the RMP and to accurately calibrate the risks of UCITS and UCITS ManCos within the internal risk model. This information feeds back into the risk assessment for UCITS and UCITS ManCos and underpins engagement with the entities.
52. One NCA [UK] outlined the use of a Model Portfolio in the UCITS authorisation process, followed by a “Meeting Investors Expectations Review” post-authorisation review. The Model Portfolio provides a means for the Authorisation Team to assess the UCITS's investment strategy at the stage of authorisation against what is being described in the prospectus. The



“Meeting Investors Expectations Review” once the UCITS is established and operating for a reasonable time period allows the Supervision Team to assess whether the UCITS is operating as described on authorisation and as communicated to investors in the offering documents.

### 3.2.3 Operational Aspects

53. One of the fundamental Guideline expectations around operational aspects are that NCAs should check that all revenues arising from EPM, net of direct and indirect operational costs, should be returned to the UCITS. NCAs should also check whether these costs include hidden revenues. NCA’s should further consider whether instruments lent-out or instruments that form part of a repo / reverse repo arrangement are callable at any time, while relevant agreements can be terminated.
54. These requirements are connected to the requirements to disclose in the prospectus the relevant policies on operational costs and fees from EPM<sup>16</sup>. Under the Guidelines, it is essential that all revenues arising from EPM are returned to the UCITS, net of direct and indirect operational costs. Apart from these costs, no revenues should be transferred to other entities than the UCITS. These costs should not include hidden costs.
55. Regarding operational aspects, the Guidelines further clarify that EPM activities in the form of securities lending, Repo, or Reverse Repo should be terminable to the UCITS at any time and that securities lent out or subject to Repo agreements are callable at any time. Fixed-term Repos and Reverse Repos that do not exceed seven days should be considered callable at any time.

#### 3.2.3.1 – Revenues, Costs and Fees

##### Findings

56. The AG observed that NCAs apply different approaches regarding the Guidelines’ requirements relating to revenues, costs and fees, both regarding internal practices or external guidance. These differences relate to topics such as splits of revenues and defining permissible operational costs and fees. From the AG’s engagement with external stakeholders, the view was supported that the NCAs’ approach towards operational aspects of EPM activity is not homogenous.
57. From engagement with NCAs and external stakeholders, the AG observed divergent views of what constituted “revenue” and “revenue split” in relation to Guideline requirements. At one

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<sup>16</sup> Cf. Section 3.2.1.



end, revenue and revenue split was defined in reference to the gross amount of monies received based on the market-price of the operations. At the other end, revenue and revenue split was defined in reference to monies received (by a lending agent) net of fees / expenses incurred after undertaking the operations. Conflicting definitions of what constitutes revenue and the basis for revenue split complicates any comparison that NCAs and investors undertake to determine a relative value proposition.

58. In general, NCAs do not provide for any guidance in addition to the Guidelines on what cost and fee structures are in line with the requirements. With the exception of one NCA [FR], no NCA provided clear internal or external guidance on what constitutes permissible costs and fees to be deductible from the revenue from EPM.
59. Two NCAs [IE, UK] conducted a thorough market analysis via a thematic review on securities lending by UCITS as part of their EPM supervision. One NCA [IE] followed up on the findings of the market analysis at a later stage. These thematic reviews analysed how securities lending is organised by the market, what operational costs and fees exist and how revenues earned are split between the UCITS and other parties (as part of the operational costs). On basis of the market analysis, supervisory actions were taken in relation to outliers. However, neither NCA provided for additional guidance on the basis of the findings of the thematic reviews.
60. Two NCAs [DE, LU] stipulate in their regulatory framework relating to UCITS authorisations minimum percentages of revenues to be returned to the UCITS. However, the AG notes that in each case the NCAs do not provide any guidance on what constitutes permissible operational costs and fees.
61. One NCA [LU] applies a threshold of 51% to be returned to the UCITS on the basis of the gross revenue. This is an internal policy and the threshold serves as a backstop of minimal revenues to be returned to the UCITS. Regarding fees/costs and the requirement that there should be no 'hidden revenue', the NCA does not have a standardised practice of reviewing or challenging the operational set-up of UCITS on costs and fees for EPM. Case officers may interact with applicants in cases where the set-up is noticeably different from other UCITS. However, as there is no internal or external guidance, this lies in the sole discretion of the case officer. The AG concluded that the supervisory approach of LU does not ensure that all revenues, net of direct and indirect operational costs, are returned to the UCITS. The setting of a fixed threshold without providing any additional guidance on costs, fees and revenues and standardised reviews and checks of market participants on the fee structure cannot fully prevent the levy of hidden revenues to the detriment of the UCITS.
62. The other NCA [DE] provides two options in their external guidance to market participants ('Muster-Kostenklauseln') on how cost and fee policies should be established for UCITS in order to be permissible. While one option relates to a split of revenues on the basis of the gross revenues, the other option explicitly allows that at least 51% of the net revenue is to be returned to the UCITS, thus allowing a split of revenues after the direct and indirect operational

costs were deducted. No additional review or challenge of UCITS on the cost and fees relating to EPM is performed. The AG concluded that the practice of DE is in breach of the Guidelines' requirement to ensure that all revenues, net of direct and indirect operational costs, should be returned to the UCITS, as the threshold in force in DE relates to a proportion of the net revenue to be returned.

63. Regarding one NCA [EE], the portfolio analysis tool applied by this NCA picked up the use of FDI by one UCITS, however, no documented additional supervisory steps were taken. Thus, it was not proven whether a further supervisory review would have been required and what actions would have been taken.

## **Analysis**

64. The AG considers that only one NCA [FR] provided internal and external guidance that fully reflects the Guidelines. The applied rules of this NCA ensure that the revenues are expressed in gross values and are based on the gross revenue earned from the counterparty (such as the ultimate borrower of the security), best execution principles and conflicts of interest management. The disclosed revenues and costs/fees are expressed as a percentage or amount collected on a gross fee basis. This ensures that EPM engagement happens in the best interest of the investors, based on the price on the market. By requiring disclosure of the revenues on gross basis, investors benefit from clear and transparent information. This form of implementation helps delivering consistent and transparent information to both the NCA and investors of the UCITS, while operationally it allows for clear arrangements.
65. Regarding the thematic reviews of two NCAs [IE, UK], the AG observed that the information gathered allowed for valuable information regarding the market practice of UCITS engaging in EPM. However, the analysis of both NCAs did not result in a formalised follow-up that clarified the form of permissible cost and fee structures or relevant disclosure. Thus, there might remain certain regulatory ambiguity of how to approach EPM operationally and the market may apply different approaches so that comparability of market participants is hampered.
66. Regarding the two NCAs [DE, LU] providing for a minimum threshold of revenues to be returned to the UCITS, the AG considers that the approach of setting a minimum threshold on a gross basis [LU], i.e. before deduction of costs and fees, does not sufficiently reduce the risk of hidden revenues. Neither does the NCA have internal or external guidance on costs, fees and revenues nor does it apply a standardised regulatory practice to question or challenge UCITS ManCos on the set-up regarding fees, costs and revenues. Due to the lack of guidance, case officers can use their discretion and expertise to identify set-ups that are noticeably different from other UCITS and may interact with applicants in such cases. Thus, there remains the material risk that hidden revenues are included when setting the threshold of the minimum percentage of revenues to be returned to the UCITS.

67. Regarding the approach of setting the threshold on a net basis [DE], i.e. after deduction of costs and fees, the AG views it as not being in line with the requirements under the Guidelines. Setting a percentage of revenue to be returned to the UCITS after deducting costs and fees cannot effectively prevent hidden revenues to the detriment of investors of the UCITS. Under the rules in place in this jurisdiction, UCITS ManCos have the right to deduct up to 49% of the net revenues, without being required by the NCA to prove the provision of any service to merit such compensation. The AG considers that this should be remedied to ensure a common application of the Guidelines and compliance with same. Upon identification of this finding by the AG, one NCA [DE] confirmed that it has changed its external guidance to market participants ('Muster-Kostenklauseln') to ensure compliance with the Guidelines. As these changes took effect after the review period, the AG did not review or assess its implementation.
68. The AG considers that NCAs should develop clear internal and external guidance on the topic of fees, costs and revenues to ensure that the UCITS's policies regarding direct and indirect operational costs and fees are clearly disclosed in the prospectus and annual reports and that no hidden revenues are included in these positions.
69. For that, the disclosed revenues and costs/fees are to be expressed in gross values and are based on the gross revenue earned from the counterparty (such as the ultimate borrower of the security), best execution principles and conflicts of interest management. This allows regulators to question and challenge that the EPM operations are performed in the best interest of the UCITS and that costs, fees and revenues are clear and comparable.

### 3.2.3.2 – Other Operational Aspects, Termination of EPM activities and Recallability

#### **Findings**

70. Operational oversight by NCAs on the recallability of assets and termination of relevant agreements generally reflect each NCA's supervisory model. As a principle, NCAs set out the rules as described in the Guidelines and rely on the UCITS or UCITS ManCo itself, depositaries, service providers or auditors to ensure adherence to the Guideline requirements on these operational aspects.
71. External stakeholders noted their understanding of requirements around recallability, contract termination and liquidity management requirements for UCITS, while articulating that such requirements can limit the attractiveness of engagement with UCITS compared to other market participants. For example, the recallability requirements for UCITS may reduce both the opportunity to engage in and levels of amount of revenue generated by EPM. The requirements of the liquidity coverage ratio for credit institutions, for example, is not compatible with the requirement of the Guidelines regarding recallability for the UCITS, rendering securities lending and repo / reverse repo arrangements between these entities less attractive.

72. While some NCAs did not put in place any additional operational requirements for UCITS engaging in EPM going beyond the Guidelines, other NCAs [DE, FR, LU] require that certain conditions are met that are to some extent stricter or more detailed than the Guidelines, such as rules on eligible counterparties for EPM.
73. Regarding the requirement under para. 33 of the Guidelines, the AG noted that all NCAs followed the approach that fixed-term Repos and Reverse Repos that do not exceed seven days should be considered callable at any time. One NCA [DE] had a practice regarding fixed-term Repos and Reverse Repos exceeding seven days in the light of callability, allowing for transactions with maturity of up to 12 months, provided that a termination clause is in place. In contrast, the practices of another NCA [IE] forbid to exceed maturity of seven days for fixed-term Repos and Reverse Repos.

## Analysis

74. As described, NCAs supervise adherence with operational aspects regarding on the callability of assets and termination of relevant agreements in the course of the general supervision of UCITS, UCITS ManCos and relevant third parties.
75. In particular one NCA [FR] includes restrictions regarding the use of EPM that go beyond the requirements under the Guidelines; i.e. eligible counterparties must be regulated entities under prudential and market supervision with a minimum equity base of € 3.8 m; operations must be governed by a master agreement. For securities lending, where UCITS ManCos engage in such operations through a securities lending agent, this is considered as a delegation of financial management of the UCITS and must therefore comply with the obligations of this type of arrangement. In order not to be considered as a delegation, the lending agent must follow the precise instructions of the UCITS ManCo and the UCITS ManCo must put in place an appropriate system of risk management and have access to daily reports on the assigned activities.
76. On para. 33 of the Guidelines, the AG observed that with the exception of one NCA [DE], all assessed NCAs did not have a practice of specifically allowing fixed-term Repos and Reverse Repos exceeding seven days. One NCA even had a practice prohibiting such transactions. The Guidelines do not specify under which conditions such a longer maturity would be acceptable in the context of callability at any time, however, they do not per se exclude such a possibility. While all NCAs adhere therefore with the requirements under the Guidelines, the practices the AG found to be in place vary significantly regarding permissible fixed-term Repos and Reverse Repos.

### 3.2.3.3 – Good Practices in the light of Operational Aspects

77. For the identification of good practices surrounding the operational aspects of EPM engagement for UCITS, the AG points out the provision of additional guidance in applying these Guidelines, as evidenced by one NCA [FR]. Rules ensuring that the revenues are expressed in gross values and based on the market price of the operations, best execution principles and conflicts of interest management allow for a consistent and transparent comparison to determine a relative value proposition.

### 3.2.4 Collateral Management

78. Chapter XII of the Guidelines lays down requirements for the management of collateral for EPM received by UCITS. It is required that all assets received by the UCITS in the context of EPM are considered as collateral in accordance with the Guidelines and that all collateral used to reduce counterparty risk should comply at all times with (i) Liquidity, (ii) Valuation, (iii) Issuer Credit Quality, (iv) Correlation, (v) Diversification, (vi) Risk Management, (vii) Title Transfer, (viii) Enforceability, and (ix) Investment criteria.

79. The prospectus should also clearly inform investors of the collateral policy of the UCITS and the annual report should contain details around collateral received for OTC FDI and EPM operations.<sup>17</sup>

#### 3.2.4.1 – General Oversight of Collateral Management

##### Findings

80. Oversight of collateral management for EPM activity is generally checked to a great extent under the supervision of disclosures or checks of RMP. As previously outlined, the AG found that while all NCA's reviewed have internal procedures in place to check that relevant Guideline disclosures are included in the prospectus and annual report, not all go into the granularity required to detail all of the Guidelines' disclosure requirements or to assess and analyse UCITS' annual reports in the context of the Guidelines.

##### Analysis

81. Operational oversight by NCAs on collateral management, counterparties and general Guidelines requirements reflect each NCA's supervisory model. Generally, NCAs rely on the UCITS

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<sup>17</sup> See above under Section 3.2.1.

or UCITS ManCo itself, depositaries, service providers or auditors to ensure adherence to Guideline collateral managements requirements. Through breach/error reporting, on-site inspections, themed inspections, deep-dive reviews and cross divisional reviews, collateral management processes and procedures are examined by NCAs as part of the overall supervisory engagement. There is limited additional supervisory practice specifically in relation to collateral management not already mentioned under another section. The AG does not have any general observations in this regard.

#### 3.2.4.2 – Exemptions Related to Collateral Management Requirements

##### Findings

82. The AG identified an issue in the context of exemptions to the Guidelines related to collateral management requirements as set out in the Guidelines and the securities lending programmes of CSDs. While the Guidelines do not contain any provision that allows for a deviation of its requirements when securities lending activity is engaged in through a securities lending program of a CSD, the regulatory framework in two Member States [DE, UK] provide for exemptions to post collateral to a UCITS in accordance with the Guidelines.<sup>18</sup>
83. In one case [DE], UCITS using ‘organised securities lending systems’ are by law exempt from some of the collateral management requirements set out in the assessed Guidelines, provided that the ‘interests of investors are safeguarded’. The potential exemptions in particular relate to para. 43 d), e) and h) as well as para. 46 of the Guidelines. Such partial exemption has been granted to the securities lending program of Clearstream Banking.
84. In the other case [UK], the regulatory framework provides for an exemption to the requirement to post collateral where securities lending is undertaken through the securities lending programme of one specific CSD, this being Euroclear Bank SA/NV.<sup>19</sup> Thus, the UK framework fully exempts securities lending transactions carried out through Euroclear Bank SA/NV's Securities Lending and Borrowing Programme from the collateral management requirement set out in the Guidelines. Upon identification of this finding by the AG, the FCA confirmed that it will review this exemption.

##### Analysis

85. The Guidelines do not allow for any possibility to deviate from the requirements regarding collateral management. The AG found that both regulatory frameworks that provide for such

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<sup>18</sup> In the course of this peer review, the AG did not assess in what way either CSD makes use of the exemptions granted by the regulatory frameworks. The AG did not assess whether collateral (if any is posted) for securities lending activities through the individual securities lending programme of the CSDs is in line with the requirements under the Guidelines.

<sup>19</sup> See COLL 5.4.4.

exemptions, be they full exemptions [UK] or partial [DE], were in breach of the Guidelines' collateral management requirements. These exemptions from the Guidelines are not consistent with the objective of supervisory convergence in the Single Market for UCITS.

86. Regarding the other four assessed jurisdictions, the AG did not find similar exemptions to the Guidelines' requirements on collateral management.

87. One NCA [EE], due to highly limited use of EPM in the UCITS market of its jurisdiction has not developed internal or external guidance in this regard.

### 3.2.4.3 – Potential inconsistency between the Guidelines' Requirements with respect to “Title Transfer” and “Other Types of Collateral Arrangements”

#### Findings

88. The AG noted comments by NCAs around potential inconsistency between the Guidelines and the UCITS Directive with respect to ‘title transfer’ and “other types of collateral arrangement”<sup>20</sup>. In the context of collateral management as specified by para. 43(g) of the Guidelines, there might be an inconsistency between the aforementioned provision in the Guidelines and the UCITS Directive. While the Guidelines refer to ‘title transfer’ and ‘other types of collateral arrangement’ (such as pledging arrangements) to be permissible for collateral received by the UCITS for its EPM, Art. 22(7) (d) of the UCITS Directive stipulates that the assets held in custody by the depositary are allowed to be reused<sup>21</sup> only where the transaction is covered by high-quality and liquid collateral received by the UCITS under a title transfer arrangement.

89. One NCA [DE] confirmed that under its current legal framework as well as its internal and external guidance, other collateral arrangements than title transfer arrangements, such as pledging arrangements, are permissible. Other NCAs [EE, FR, IE, LU, UK] interpreted the Guidelines in such a way that since the application of UCITS V, the requirements under Guidelines are superseded and that therefore only title transfer arrangements are permissible.

#### Analysis

90. The AG points out that strictly on the compliance with the Guidelines, all NCAs seem to apply practices in line with the requirements. Regarding the potential inconsistency of the Guidelines with the legal requirements under the UCITS Directive, this report addresses policy recommendations under Section 4.2.

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<sup>20</sup> See as well below Section 4.2.

<sup>21</sup> ‘Reuse’ in the meaning of Art. 22(7) of the UCITS Directive comprises any transaction of assets held in custody including, but not limited to, transferring, pledging, selling and lending.

#### 3.2.4.4 – Good Practices in the light of Collateral Management

91. With reference to Section 3.2.2.2, the AG observed that the bespoke reporting tools of NCAs contain data on collateral and reuse. The inclusion of information around collateral, collateral management and counterparty exposures in the data reporting complements this more data-driven form of supervision and can contribute to their oversight of UCITS and their adherence to the Guidelines.



## 4 Policy Recommendations regarding the Guidelines

1. In the course of this peer review, the AG had the opportunity to discuss with experts from both NCAs and market participants the impact of the Guidelines from a regulatory compliance perspective. As was pointed out in the SMSG's advice to ESMA<sup>22</sup>, certain aspects of the Guidelines merit consideration surrounding the engagement in EPM. The SMSG's advice was considered at the stage of drafting the mandate in order to set the focus of this peer review accordingly.
2. While some parts of the Guidelines were assessed thoroughly regarding compliance of NCAs with the requirements (cf. Section 3 above), other parts of the Guidelines struck out as being in want of reconsideration from an ESMA policy perspective in the light of changes of the legal framework for UCITS (leading inter alia to potential inconsistencies of the requirements under the Guidelines with the UCITS Directive or SFTR) or general demand for more clarity on the substance of the Guidelines. This reconsideration could provide more robustness and clarity around the Guidelines for both NCAs and market participants<sup>23</sup>, and could improve regulatory standards for the benefit of (retail) investors.
3. In this section, the AG does not wish to recommend specific ways or approaches on how to best materially tackle some of the topics raised but rather summarises its findings on the areas that may merit subsequent policy work on the Guidelines. While the focus of the AG remained on the assessment of the NCAs' compliance with the Guidelines, some findings of the AG may be of interest when considering follow-up actions.

### 4.1 Definition of EPM

4. In accordance with Art. 11 of the Eligible Assets Directive, Art. 51 para. 2 of the UCITS Directive allows Member States to provide for the use techniques and instruments relating to transferable securities and money market instruments under the conditions and within the limits which they lay down provided that such techniques and instruments are used for the purpose of EPM. Such techniques and instruments need to be economically appropriate and are to be entered into in order to reduce the risk, or the cost, or to generate additional capital or income for the UCITS. When entering into EPM techniques, the risk management process of the UCITS has to capture their risks adequately.
5. Neither the Directives nor the Guidelines provide for an exhaustive list of techniques and instruments that are to be considered as EPM. Therefore, certain techniques and instruments may fall under the definition of EPM of some NCAs, while other NCAs would not consider the

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<sup>22</sup> Securities lending: SMSG advice to ESMA in anticipation of a peer-review of UCITS Guidelines compliance (ESMA2 2-106-265).

<sup>23</sup> In this context, the AG observed different interpretations by stakeholders and NCAs with regard to the oversight responsibilities of depositaries with respect to the Guidelines.

same as EPM. One set of activities, in particular securities lending activities and (reverse) repurchase agreements, seem to be generally considered to be falling under the definition of EPM. No NCA considered it possible to engage in these techniques outside the remit of the Guidelines. Concerning FDI, not all NCAs have the same stringent approach but rather apply a case-by-case analysis. Moreover, questions arose in some Member States as to the application of the Guidelines with regard to sell/buy backs and buy/sell backs. In this context, the legal framework of one Member State [DE] expressly excludes sell/buy backs and buy/sell backs from the scope of the Guidelines.

6. Most noticeable, UCITS are specifically permitted under the UCITS framework to invest via FDI. These investments can fall under the remit of the Guidelines, when complying with the requirements of Art. 11 of the Eligible Assets Directive, Art. 51 para. 2 of the UCITS Directive, yet are equally permissible outside EPM<sup>24</sup>. While EPM is generally seen as ancillary engagement to the investment strategy of a UCITS, UCITS can pursue their investment strategies mainly through investing in FDI.
7. Considering the requirements of UCITS to invest in FDI, dividing up FDI into EPM and other activities, i.e. FDI for investment purposes, does add to the complexity of the operations. At least one NCA [FR] does as a principle not consider FDI to fall under the definition of EPM. However, this NCA requires compliance with all relevant requirements set out in the Guidelines for investments in FDI.
8. The functioning of FDI require the safeguards as outlined in the Guidelines, but there are also additional legal requirements and safeguards set out in other pieces of regulation. Thus, ESMA could give consideration to whether the requirements of FDI should be considered separately from these Guidelines to avoid interpretational issues and reduce the overlap with other requirements.
9. With the entry into force and application of the SFTR the legal framework for UCITS engaging in EPM has changed, specifically considering disclosure requirements. The SFTR clearly refers to securities financing transactions and total return swaps used by UCITS<sup>25</sup>, provides definitions of such activities and specifies disclosures to end-investors and reporting obligations. These changes should be considered by policy follow-up work to avoid inconsistencies of the Guidelines with the SFTR. In this light, the AG considers that ESMA should ensure that the Guidelines are aligned with the regulatory framework, in particular the SFTR, to guarantee a homogenous approach regarding EPM.

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<sup>24</sup> For lack of better terminology, FDI for investment purpose.

<sup>25</sup> Cf. Recital 15 of the SFTR.

## 4.2 Requirements for collateral arrangements for EPM

10. In the context of collateral management as specified by para. 43(g) of the Guidelines, might be an inconsistency between this provision and the UCITS Directive. While the Guidelines refer to 'title transfer' and 'other types of collateral arrangement' (such as pledging arrangements) to be permissible for collateral received by the UCITS for its EPM, Art. 22(7) (d) of the UCITS Directive<sup>26</sup> stipulates that the assets held in custody by the depositary are allowed to be reused only where the transaction is covered by high-quality and liquid collateral received by the UCITS under a title transfer arrangement. 'Reuse' in the meaning of Art. 22(7) of the UCITS Directive comprises any transaction of assets held in custody including, but not limited to, transferring, pledging, selling and lending.
11. The Guidelines therefore seem to provide for other possible collateral arrangements for UCITS than the UCITS Directive.
12. On this point, it should be pointed out that Art. 22 (7) (d) of the UCITS Directive came into force after the Guidelines were already applicable. The Guidelines were not revised following the implementation of the relevant UCITS Directive.
13. At least in one assessed jurisdiction [DE], other collateral arrangements than title transfer arrangements, such as pledging arrangements, seem still to be permissible to UCITS engaging in EPM.
14. The AG recommends that any policy follow-up regarding the Guidelines should give consideration to addressing the potential inconsistency of para. 43(g) of the Guidelines with the Art. 22(7) (d) of the UCITS Directive regarding the aforementioned collateral arrangement requirements.

## 4.3 Costs, fees and revenues for EPM

15. As described under Section 3.2.4., the AG observed various approaches of NCAs to provide guidance on how UCITS should structure its EPM engagement from the point of view of costs, fees and revenues. The requirements under the Guidelines, most prominently para. 28 and 29, relate to rules on disclosure in the prospectus for the UCITS and to general operational aspects. In particular, the Guidelines specify that costs and fees should not include hidden revenues and that all revenues of EPM should be returned to the UCITS, net of direct and indirect operational costs.

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<sup>26</sup> This provision was introduced into the UCITS Directive with UCITS V (Directive 2014/91/EU of the European Parliament and of the Council of 23 July 2014 amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions, OJ L 257, 28.8.2014, p. 186.

16. When assessing compliance of NCAs with the Guidelines in this regard, the AG found that follow-up work should be envisaged in order to converge the different approaches of NCAs and thereby improve the disclosure to end-investors.
17. This relates inter alia to the fact that in relation to operational costs and fees, two NCAs [DE, LU] do not provide internal or external guidance on that topic but require a minimum percentage of the revenues to be returned to the UCITS, while taking different bases for this, i.e. gross revenues [LU] or net revenues [DE]. However, there remains the material risk that hidden revenues are included when setting such thresholds. Four NCAs [EE, FR, IE, UK] do not stipulate a minimum percentage to be returned to the UCITS.
18. Two of these NCAs [IE, UK] performed a thematic review on the issue of revenues for securities lending activities (cf. Section 3.2.3) to analyse the percentage of revenues that is returned to the UCITS on the market. However, these NCAs do not give external guidance to market members on what is considered a hidden revenue or a fair split of costs, vice versa.
19. One NCA [FR] requires that disclosures in the prospectus on the revenues passed on to the UCITS and direct and indirect operational costs/fees for EPM must be expressed as the percentage or the amount collected on the gross fee basis paid by the counterparty to the EPM activity.
20. From an operational point of view, this difference in application of the Guidelines by the NCAs may operationally lead to EPM engagement by an UCITS that is permissible under one understanding while being prohibited under another. Additionally, the diverging requirements regarding disclosure to end-investors create a situation that hampers comparability and full transparency of the UCITS' EPM activities for end-investors.
21. In relation to para. 28 and 29 of the Guidelines, the AG recommends that potential ESMA follow-up work should give consideration to further clarifying what basis must be taken to express the direct and indirect operational costs and fees to be deducted from the revenue to the UCITS. In the interest of transparency, the Guidelines should ensure that disclosures to end-investors are clear and provide sufficient information on the policies in place by the UCITS. Potential policy follow-up work could address as well how direct and indirect operational costs relate to services provided to the UCITS (be it for a securities lending agent or any other third party, or for the ManCo acting directly in relation to EPM). Additional work may also be considered to evaluate what constitutes a fair and appropriate split of gross revenues between the fund and other parties, including the lending agent and Manco. The AG found material differences on this point across NCAs, which could lead to divergence in outcomes for investors.

## 4.4 Recallability

22. Para. 33 of the Guidelines sets out that fixed-term repurchase and reverse repurchase agreements that do not exceed seven days should be considered as arrangements on terms that allow the assets to be recalled at any time by the UCITS.
23. In this regard, one NCA [DE] had a practice regarding fixed-term Repos and Reverse Repos exceeding seven days in the light of recallability, allowing for transactions with maturity of up to 12 months, provided that a termination clause is in place. In contrast, the practices of another NCA [IE] forbid exceeding maturity of seven days for fixed-term Repos and Reverse Repos.
24. Therefore, further clarifications concerning the interpretation of para. 33 of the Guidelines could help to improve supervisory convergence.



## 5 Annexes

### Annex 1 – The Mandate

#### **Mandate for a Peer Review on the Guidelines on ETFs and other UCITS issues (ESMA/2014/937)**

Updated on 29 November 2017

#### **Background**

1. ESMA published Guidelines on ETFs and other UCITS issues (ESMA/2012/832) on 18 December 2012 and an updated version on 1 August 2014 (ESMA/2014/937). These Guidelines give guidance on a number of issues, such as the treatment of UCITS established as ETFs, the use of financial indices for UCITS, and the use of techniques and instruments for the purpose of efficient portfolio management (EPM). Regarding EPM techniques, the Guidelines set out rules for market participants that engage in such techniques for UCITS, including on information to investors, return of revenues to the UCITS, requirements for the risk management and management of collateral. The Guidelines also apply to NCAs to ensure a common supervisory approach.<sup>27 28</sup>
2. Neither the Eligible Assets Directive<sup>29</sup> nor the UCITS Directive<sup>30</sup> give an exhaustive list of permissible techniques and instruments but rather lay down material requirements that must be met when conducting such activities. Thus, across jurisdictions variations of EPM techniques may be used by UCITS. Existing legislation allows for a broad range of activities to be classified as EPM, within the parameters of Art. 11 Eligible Assets Directive. As such, a broad range of activities can and are used as part of EPM, such as repurchase / reverse repurchase arrangements, securities lending, and may include the use of derivatives (all within the restrictions set out by Article 11). ESMA decided to address issues relating to these activities and their supervision by issuing the Guidelines. In the interest of promoting common supervisory approaches and practices in the application of the UCITS Directive

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<sup>27</sup> In accordance with Art. 11 of the Eligible Assets Directive, Art. 51 para. 2 of the UCITS Directive allows Member States to provide for the use techniques and instruments relating to transferable securities and money market instruments under the conditions and within the limits which they lay down provided that such techniques and instruments are used for the purpose of EPM. Such techniques and instruments need to be economically appropriate and are to be entered into in order to reduce the risk, or the cost, or to generate additional capital or income for the UCITS. When entering into EPM techniques, the risk management process of the UCITS has to capture their risks adequately.

<sup>28</sup> The published Guidelines compliance table (ESMA/2016/602) indicates that all NCAs have communicated that they comply or intend to comply with them. The Guidelines compliance table is annexed to this mandate (cf. Annex 1 bis).

<sup>29</sup> Directive 2007/16/EC implementing Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards the clarification of certain definitions.

<sup>30</sup> Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS).

and its implementing measures, ESMA also published Questions & Answers on the Application of the UCITS Directive (ESMA/2015/12 and in a consolidated version 2016/ESMA/181) that addresses topics covered by the Guidelines.

3. ESMA's Board of Supervisors agreed in the 2017 Supervisory Convergence Work Programme that a peer review on these Guidelines would be launched, with a possible focus on EPM techniques. This mandate aims at addressing exactly this topic, taking into consideration its importance from a retail investors' perspective. The use of EPM techniques may add to the complexity of UCITS funds and investors need to be informed accordingly in order to make an informed investment decision. The Guidelines set out specific provisions to address these concerns.
4. This peer review is a focused one. The reasons for this approach are mainly twofold. First, the Guidelines cover a great variety of topics relating to UCITS supervision. These topics are not necessarily interrelated. For efficiency's sake and taking into account the need to allocate scarce resources in the best possible way, restricting the peer review's scope to a particular subsection of the Guidelines seems appropriate and would allow a more informative and thorough review. Second, UCITS account for the vast majority of collective investments held by retail investors in the Union and EPM techniques may add to the complexity of these vehicles. This approach is consistent with the SMSG's advice to ESMA.
5. This peer review therefore aims at assessing the level of compliance and supervisory convergence between NCAs in the area of supervision of EPM techniques in order to ensure that the use of EPM techniques comply with the Guidelines, that robust risk management processes and collateral management processes are applied for UCITS in relation to EPM techniques, and that investors understand the strategy behind the use of the EPM techniques applied for the UCITS they invest in.
6. All NCAs will be asked to provide answers to two questions for background information on:
  - the permissibility of and legal constraints relating to EPM techniques for UCITS in their jurisdictions, and
  - the collection of EPM data (including – if such data is collected – the amount of EPM techniques for UCITS) by NCAs.
7. Only a small number of NCAs will be assessed in this peer review. These NCAs will be required to respond to a self-assessment questionnaire on supervisory practices and will be subject to on-site visits.



## Legal basis

8. This peer review will be conducted in accordance with Article 30 of Regulation (EU) No. 1095/2010 of the European Parliament and of the Council of 24 November 2010 (ESMA Regulation).
9. The peer review will be governed by the methodology of the former Review Panel (ESMA/2013/1709) (Peer Review Methodology), the guidance note in relation to on-site visits in peer reviews (ESMA/2015/RP/011) and the principles on stakeholder engagement in peer reviews (ESMA/2016/632).

## Scope

10. The objectives of this peer review will be guided by the Peer Review Methodology, in particular Section 3, para. 12. In the context of these Guidelines, the peer review will particularly assess how NCAs supervise the implementation of Chapter X, para. 25 - 35, and Chapter XII, para. 42 - 44 and 47 - 48 of the Guidelines, during both the authorisation process and the on-going supervision process. The other Chapters of the Guidelines, especially Chapters IV – IX, XI and XIII – XIV will not be within the scope of this peer review. The peer review will also assess the level of convergence in relation to supervisory practice and enforcement proceedings.
11. In relation to Chapter X, para. 25 - 35, the capacity of NCAs to supervise:
  - the use of EPM techniques for UCITS, especially in regards to the investment strategy and the risk management process of the UCITS;
  - the related disclosure to investors;
  - the recallability of lent out cash or securities;
  - the full return of revenues to the UCITS, net of direct and indirect operational costs.
12. In the context of rules on disclosure, it should be noted that the Securities Financing Transactions Regulation<sup>31</sup> provides – inter alia – for new requirements regarding disclosure of the use of EPM techniques for UCITS. These rules relate to disclosures in the prospectus referred to in Art. 69 of Directive 2009/65/EC<sup>32</sup> and the half-yearly and annual reports referred to in Art. 68 of Directive 2009/65/EC<sup>33</sup>. As these provisions of the SFTR compliment the provisions of the Guidelines, there is merit that the peer review assesses the provisions of the Guidelines relating to disclosure requirements.

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<sup>31</sup> Regulation (EU) 2015/2365 of the European Parliament and of the Council of 25 November 2015 on transparency of securities financing transactions and of reuse and amending Regulation (EU) No 648/2012.

<sup>32</sup> Art. 14 SFTR applies from 13 July 2017 in the case of UCITS constituted before 12 January 2016.

<sup>33</sup> Art. 13 SFTR applies from 13 January 2017.

13. In relation to Chapter XII, para. 42 - 44 and 47 - 48, the capacity of NCAs to supervise:
  - the management of collateral for EPM techniques;
  - the reinvestment of cash received as collateral when entering into EPM techniques;
  - the related disclosure to investors.
  
14. The review should be targeted and sequenced:
  - at a first stage, the Assessment Group will develop a self-assessment questionnaire. This self-assessment questionnaire is to be circulated to those NCAs to be assessed in this peer review. Simultaneously, all NCAs will be asked to provide background information on permissibility and legal constraints of EPM techniques for UCITS and on the collection of EPM data by NCAs (including – if such data is collected – the amount of EPM techniques for UCITS). This information will be added to the peer review report as background information.
  - at a second stage, after thorough analysis of the answers provided to the self-assessment questionnaire, the Assessment Group will carry out on-site visits of the NCAs to be assessed in this peer review. These visits will take place in order to complement the findings from the self-assessment questionnaire with the detailed information that will be needed to gain a thorough understanding of the supervision of UCITS engaging in EPM techniques, and for NCAs to show their compliance with the Guidelines. Information may be required from these NCAs in advance of the on-site-visit and meetings will be arranged between the Assessment Group members and the staff of the NCA such as the national experts in the field, including their management. Each on-site visit shall last for one to three days.
  - The Assessment Group may also gather other publicly available information.
  
15. The desk-based analysis during on-site visits shall consist of the review of a limited number of files related to the relevant Guidelines.
  
16. The NCAs in question will be requested to provide working documents, which the Assessment Group may request to be translated into English, clarifying any issue arising as part of the peer review process.
  
17. The peer review will only assess certain NCAs. The selection of the NCAs is based on the objective criteria as set out in the guidance note in relation to on-site visits in peer reviews (ESMA/2015/RP/011)

18. The selection of NCAs is therefore based on the following objective criteria :
- the relative significance of the UCITS market of the jurisdiction assessed through the market size;
  - the cross-border impact of the activity performed at national level, assessed inter alia in the course of the ESMA thematic study among National Competent Authorities on Notification frameworks and home-host responsibilities under UCITS and AIFMD (ESMA34-43-340);
  - the fact that a NCA was never visited on-site in the course of a peer review.
19. Regarding the market size, assessed by the total net assets of UCITS investment funds domiciled in a Member State, the top 5 jurisdictions are in descending order: LU, IE, UK, FR, DE. The same jurisdictions – however not necessarily in the same ranking – are among those with the highest number of UCITS with cross-border marketing activity. Taking into account these two criteria, the following NCAs were identified to be assessed by this peer review:
- Autorité des Marchés Financiers (FR)
- Bundesanstalt für Finanzdienstleistungsaufsicht (DE)
- Central Bank of Ireland (IE)
- Commission de Surveillance du Secteur Financier (LU)
- Financial Conduct Authority (UK)
20. Taking into account the third criterion, the following NCA was identified to be assessed by this peer review.
- Finantsinspeksioon (EE)

### **Seeking input from stakeholders**

21. As the Guidelines set out rules for market participants that engage in EPM techniques, the Assessment Group may seek input from stakeholders such as UCITS management companies and UCITS depositaries. This engagement allows for a better understanding of the supervisory practices in place, seen from the practical experience and complements the views provided by NCAs in the self-assessment process. Any such input will be governed by the principles adopted, i.e. Principles – Stakeholder Engagement in Peer Reviews (ESMA/2016/632). For clarity, as per paragraph 11 of ESMA/2016/632, engagement should not cover specific client files nor disputes/(pre) litigation between firms and NCAs, nor

files/data related to the NCAs' exercise of their supervisory tasks towards visited supervised stakeholders.

### **Review approach**

22. In accordance with the Peer Review Methodology, the peer review will be carried out by an Assessment Group. The Assessment Group will be composed of the following persons, with extensive knowledge and experience in the field of supervisory convergence, authorisation and supervision of UCITS as well as EPM techniques, as defined in the Guidelines.
23. The Assessment Group shall be co-ordinated by James Leen (CBoI, IE).
24. The Assessment Group will consist of:
  - Cristina Cabello Robles (CNMV, ES)
  - Olivier Ciron (CSSF, LU)
  - Riccardo Curcio (FCA, UK)
  - Wayne Smith (AMF, FR)
  - Matthias Wohlmann (BaFin, DE)
  - Kian Navid (ESMA)
  - Nick Lopez Green (ESMA)
25. Clemens Nimmerrichter, from ESMA's Legal, Convergence and Enforcement Department, will act as Rapporteur of the Assessment Group.
26. In line with the Methodology, the Assessment Group will report its findings to the Board of Supervisors, for its approval, after having consulted the Supervisory Convergence Standing Committee.

### **Review Period**

27. The period under review covers the application of the requirements in relation to EPM techniques under the Guidelines from 1 July 2015 to 30 June 2017.

### **Methodology**

28. As well as reviewing extant policies and procedures, such as procedures on supervising UCITS periodic disclosure and fund documentation, some of the tools that can be used for

this peer review include, but are not limited to, interviews with NCAs' staff, access to UCITS authorisation and supervision files and requests for explanations of the work carried out.

29. The obligations on professional secrecy as stipulated by Article 70 of the ESMA Regulation and subsequently by the ESMA Management Board Decision on Professional Secrecy and Confidentiality (ESMA/2011/MB/4) will apply to all members of the Assessment Group through their explicit consent to comply with those obligations.
30. As a matter of principle, all Assessment Group members should commit to actively participate in the review, including through the on-site visits. Furthermore, to perform this review within the deadline and deliver the outcome by May 2018, all NCAs must commit to cooperating with the Assessment Group and facilitating the work of the Assessment Group within the timelines set out.
31. The Coordinator, with the assistance of the Rapporteur, will work to prevent conflicts of interest arising in the Assessment Group. This will include the rule that no on-site team can include a representative of the NCA being visited, nor can an NCA representative work on the assessment of that NCA.
32. A confidentiality agreement containing also provisions on managing conflicts of interest will be signed by all members of the Assessment Group.

## **Evidence**

33. Competent Authorities will be asked to complement their replies to the questions with examples from their actions, practices and procedures, in the form of supervisory files, and samples, and their supervisory handbooks, instruction manuals and similar material. The evidence should demonstrate their supervisory actions in relation to the application of the Guidelines. The evidence will have to be provided in English, if available. When an English version of the evidence is not available, the answer has – to the extent practicable – to describe the relevant evidence in English.

## **Report and Publication**

34. The findings of the Assessment Group shall in any case be reported for the approval of the Board of Supervisors, after consultation of the Supervisory Convergence Standing Committee. As a matter of good practice, the findings should be presented to the Investment Management Standing Committee.
35. The report resulting from the work shall be made public, unless the Board of Supervisors decides otherwise at the time of approving the report.

## Time-line expected for the work

<b><i>Task/Event</i></b>	<b><i>Dates (tentative)</i></b>
<i>Approval of the mandate by the Board of Supervisors</i>	<i>September 2017 – October 2017</i>
<i>Drafting of questionnaire and background information questions by Assessment Group</i>	<i>October 2017</i>
<i>Launch of the background information questions to all NCAs and the self-assessment questionnaire to the assessed NCAs (to be completed within approximately 4 weeks)</i>	<i>November 2017</i>
<i>Analysis of replies, accuracy checks; begin drafting of report, and preparation of visits; organisation of on-site visits</i>	<i>December 2017 – Begin January 2018</i>
<i>On-site visits and analysis of files</i>	<i>End January 2018 - Mid March 2018</i>
<i>Accuracy checks with NCAs bilaterally</i>	<i>March-April 2018</i>
<i>Finalisation of report following consultation with the Supervisory Convergence Standing Committee</i>	<i>April 2018</i>
<i>Submission of Report to the Board of Supervisors</i>	<i>May 2018</i>

## Annex 1 bis – Guidelines compliance table

ESMA/2016/602

12 April 2016

### Guidelines on ETFs and other UCITS issues (ESMA/2014/937)

The following competent authorities\* comply or intend to comply with ESMA's Guidelines on ETFs and other UCITS issues (ESMA/2014/937):

		<b>Competent authority</b>	<b>Complies or intends to comply</b>	<b>Comments</b>
<b>Member States</b>				
LV	Latvia	Financial and Capital Market Commission	<b>Yes</b>	
LU	Luxembourg	Commission de Surveillance du Secteur Financier	<b>Yes</b>	
FR	France	Autorité des marchés financiers (AMF)	<b>Yes</b>	
ES	Spain	CNMV	<b>Yes</b>	
EL	Greece	Hellenic Capital Market Commission	<b>Yes</b>	
BE	Belgium	FSMA	<b>Yes</b>	
SK	Slovakia	National Bank of Slovakia	<b>Yes</b>	
CZ	Czech Republic	Czech National Bank	<b>Yes</b>	
DK	Denmark	Danish Financial Supervisory Authority	<b>Yes</b>	
LT	Lithuania	The Bank of Lithuania	<b>Yes</b>	

		<b>Competent authority</b>	<b>Complies or intends to comply</b>	<b>Comments</b>
UK	United Kingdom	Financial Conduct Authority	<b>Yes</b>	
NL	The Netherlands	Autoriteit Financiële Markten	<b>Yes</b>	
AT	Austria	FMA Austria	<b>Yes</b>	
PT	Portugal	CMVM, the Portuguese Securities Market Commission	<b>Yes</b>	
SE	Sweden	Finansinspektionen (FSA Sweden)	<b>Yes</b>	
HU	Hungary	Pénzügyi Szervezetek Állami Felügyelete – Hungarian Financial Supervisory Authority	<b>Yes</b>	
FI	Finland	Finanssivalvonta (FIN-FSA)	<b>Yes</b>	
RO	Romania	Romanian Financial Supervisory Authority	<b>Yes</b>	
CY	Cyprus	Cyprus Securities and Exchange Commission	<b>Yes</b>	
SI	Slovenia	Securities Market Agency	<b>Yes</b>	
DE	Germany	BaFin	<b>Yes</b>	
MT	Malta	Malta Financial Services Authority	<b>Yes</b>	



		<b>Competent authority</b>	<b>Complies or intends to comply</b>	<b>Comments</b>
PL	Poland	KNF – Polish Financial Supervision Authority	<b>Yes</b>	In the Polish legal system units of UCITS do not have a form of securities and hence cannot be traded on a secondary market. Therefore parts of the guidelines concerning UCITS ETFs will not apply to Polish UCITS.
IT	Italy	CONSOB	<b>Yes</b>	
IE	Ireland	Central Bank of Ireland	<b>Yes</b>	
EE	Estonia	Estonian Financial Supervision Authority	<b>Yes</b>	
BG	Bulgaria	Financial Supervision Commission	<b>Intends to comply</b>	The relevant ordinance is currently in the process of being amended and is expected to be finalised shortly.
HR	Croatia	HANFA	<b>Yes</b>	
<b>EEA EFTA States</b>				
NO	Norway	Finanstilsynet	<b>Yes</b>	
LI	Liechtenstein	Finanzmarktaufsicht (FMA)	<b>Yes</b>	
<b>European Territories under Article 355(3) TFEU</b>				
GI	Gibraltar	The Financial Services Commission	<b>Yes</b>	

\*The EEA States other than the Member States of the European Union are not currently required to notify their compliance with the ESMA Guidelines. This table is based on information provided from those EEA States on a voluntary basis.

\*\* Please note that, in the interest of transparency, if a competent authority continues to intend to comply after the application date, it will be considered “non-compliant” unless (A) the Guidelines relate to a type of institution or instruments which do not currently exist in the jurisdiction concerned; or (B) legislative or regulatory proceedings have been initiated to bring any national measures necessary to comply with the Guidelines in force in the jurisdiction concerned.



## Notes

Article 16(3) of Regulation (EU) No 1095/2010 (the ESMA Regulation) requires national competent authorities to inform us whether they comply or intend to comply with each Guideline or recommendation we issue. If a competent authority does not comply or does not intend to comply it must inform us of the reasons. We decide on a case by case basis whether to publish reasons.

ESMA endeavours to ensure the accuracy of this document, however, the information is provided by the competent authorities and, as such, ESMA cannot accept responsibility for its content or any reliance placed on it.

For further information on the current position of any competent authority, please contact that competent authority. Contact details can be obtained from our website ([www.esma.europa.eu](http://www.esma.europa.eu))

## Annex 2 – The Questionnaire

### QUESTIONNAIRE –

### PEER REVIEW ON THE GUIDELINES ON ETFs AND OTHER UCITS ISSUES

#### A. Introduction

1. The 2017 ESMA Supervisory Convergence Work Programme provided that a peer review on the Guidelines on ETFs and other UCITS issues will be launched in 2017.
2. This peer review will be conducted in accordance with Art. 30 Regulation (EU) No. 1095/2010 of the European Parliament and of the Council of 24 November 2010 (ESMA Regulation) and the revised [Review Panel] Methodology (ESMA/2013/1709) (Methodology). In line with the ESMA Regulation and the Methodology, the peer review must also include a review of the NCAs' capacity to achieve high quality supervisory outcomes, including the adequacy of resources and governance and the effective application of the Guidelines, the capacity of the NCA to respond to market developments, the degree of convergence in the application of law and supervisory practices, and the extent to which the practices achieve the objectives.
3. In accordance with the Methodology, the peer review will be carried out by an assessment group on the basis of the mandate approved by the Board of Supervisors on 27 September 2017 ("Mandate").
4. The Board of Supervisors put into scope Chapter X, para. 25-35, and Chapter XII, para. 42-44 and 47-48, of the Guidelines. Furthermore, the Board of Supervisors decided to focus the peer review on a number of NCAs to be assessed by this peer review. Thus, this questionnaire will be followed by an on-site visit to the NCAs participating.
5. Only those NCAs identified in the Mandate are required to complete the whole questionnaire. As established in the Mandate, all NCAs are, however, required to provide answers to Section C "Background Information" of this document. This section is to be answered via the electronic version.
6. In addition to the issue of incorporation of the Guidelines in the regulatory framework (Section C), the definition of EPM for UCITS (Section D), the setup of NCAs (Section F) and complaints handling & enforcement (Section L), the questionnaire structures the questions according to the topics covered by the assessed Guidelines, as defined in the Mandate. These sections cover rules on disclosure to end-investors of UCITS (Section G), internal risk management (Section H), operational aspects (Section I), compliance with the investment mandate (Section J), and collateral management (Section K).
7. In Sections G-K, the assessed NCAs will be asked to provide answers to the incorporation and application of the Guidelines in the regulatory framework (General Questions), the material content of the relevant section (Specific Questions), the supervisory approach and practices of the NCA towards the issue (Supervisory Tools), background information on topics relating to the parts of the Guidelines covered in the Section (Additional Questions), and be given the opportunity to provide any additional information of interest in this context (Any Other Information).
8. With the exception of the Specific Questions, NCAs can, if they so wish, refer to their answers given under another section.
9. The period under review spans from 1 July 2015 to 30 June 2017. All questions relate to that period and answers should cover that period. For questions asking for quantitative data (i.e. Q.F3, Q.F5, Q.F7), the date of reference for the provided answer should be 30 June 2017.

## B. Instructions to fill in the questionnaire

(These instructions refer to the questionnaire to be sent to the six NCAs that were identified in the mandate. For the questions under Section C., further instructions will be included in the electronic version to be sent to all NCAs.).

10. Where there is more than one body in a MS responsible for completing the questionnaire (whether as competent authority or as delegate, or as other), it is the responsibility of the ESMA member to ensure that all bodies answer to this questionnaire and represent the state of affairs in that MS (and not just in one body), and that the answers describe the aggregate of answers from all bodies and is provided in a timely manner.
11. Please provide the name and contact details of the person(s) who are responsible in each NCA for the completion of this questionnaire, and who can be contacted for clarifications, further information etc. by members of the AG.
12. If a clarification is required with regard to any particular question, please contact the Rapporteur, Clemens Nimmerrichter ([clemens.nimmerrichter@esma.europa.eu](mailto:clemens.nimmerrichter@esma.europa.eu)) at ESMA.

## C. Background Information

13. **This section is to be filled out by all NCAs.**

14. In order to provide background information on the use of EPM for UCITS within the EEA, clarity is sought from all NCAs on the formal legal framework regarding this topic. In addition, NCAs are requested to explain possible reporting obligations of UCITS Management Companies within the area under review.

Q.C1 Does your jurisdiction transpose Art. 11 of the Eligible Assets Directive and Art. 51 para. 2 of the UCITS Directive in such a way that allows UCITS to engage in EPM as stipulated in these provisions?

- 1) YES
- 2) NO

Q.C2 Is there any regulation or NCA guidance to market participants (such as UCITS Management Companies, Service Providers, Depositaries, etc.) in place that provide for legal constraints regarding the use of EPM for UCITS that exceeds the requirements of the UCITS Directive or the Guidelines (e.g. differences for investors type or, given certain circumstances, only certain types of EPM can be used, etc.)?

- 1) YES
  - a. Please explain and provide information on the form of legal constraints.
- 2) NO

Q.C3 Within your own understanding of EPM, are UCITS Management Companies in your jurisdiction subject to an obligation to report periodically to the NCA on the use of EPM for UCITS?

1) YES

- a. Please provide an overview of the reporting obligations in place.
- b. If available, please provide information regarding the data collected describing the aggregated volume of EPM for UCITS (in local currency of the NCA) and its calculation method, broken down by technique/instrument (and indicate the date the data refers to).

2) NO

## **D. Incorporation of the Guidelines**

15. With this section, the AG seeks to understand the way in which the Guidelines were incorporated by the jurisdictions or NCAs into the regulatory framework.

16. The approach chosen by the jurisdictions (or NCAs) should ensure a common understanding of the requirements by relevant parties, such as the NCAs internally and the financial market participants. Thus, the AG seeks verification of an effective incorporation in this section.

17. Please provide the following information:

Q.D1 How has your NCA incorporated the Guidelines in its regulatory framework?

- 1) Legal act or regulation
- 2) Formal, public guidance issued by NCA
- 3) Reference to Guidelines
- 4) Internal Guidance
- 5) Other

Q.D2 Per your response to Q.D1, please provide details.

Answer NCA:

Q.D3 Please elaborate on your approach towards the application of the requirements stipulated in the Guidelines by third parties (Service Providers, Depositaries, Auditors, etc.), in particular whether Depositaries and Auditors are required to control/audit the compliance of market participants with the assessed Guidelines.

Answer NCA:

Q.D4 For all Legal/Regulatory Act(s) and other relevant documents, such as supervisory handbooks, instruction manuals and similar material, evidencing the incorporation of the Guidelines, please provide copies in English (in case English versions are not available, summaries of these texts in English can be provided) as an attached PDF File to this questionnaire, showing:

- 1) The title page of the Legal/Regulatory Act(s) and other relevant documents that incorporate the Guidelines into the regulatory framework.
- 2) The relevant chapters, sections and articles of the Legal/Regulatory Act(s) and other relevant documents that reference the incorporation of the Guidelines.

## **E. Definition of EPM for UCITS**

18. Neither the UCITS Directive nor the Eligible Assets Directive nor the Guidelines provide for an exhaustive list of techniques and instruments that are to be considered as EPM. Thus, NCAs might have in detail different understandings of what techniques and instruments are to be considered EPM. This section aims at understanding how NCAs define EPM in their supervisory framework.

19. Please provide the following information:

Q.E1 Does your national regulation define EPM?

1) Yes

a. Please provide your national regulation's definition of EPM.

2) NO

Answer NCA:

Q.E2 How does your NCA satisfy itself that market participants (UCITS Management Companies, Service Providers, Depositaries, etc.) have the same understanding of what is considered EPM?

1) Definitions/guidance issued by your NCA (please explain)

2) Reference to definitions/guidance issued by another body (please explain)

3) Other (please explain)

4) No actions or initiatives in this area

Answer NCA:

Q.E3 Does your NCA consider securities lending to be EPM?

1) YES

a. Please explain whether all securities lending activities for UCITS are EPM.

2) NO

a. Please explain.

Answer NCA:

Q.E4 Does your NCA consider Repos/Reverse Repos to be EPM?

1) YES

a. Please explain whether all Repo/Reverse Repo activities for UCITS are EPM.

2) NO

a. Please explain.

Answer NCA:

Q.E5 Does your NCA consider sell/buy-backs and buy/sell-backs to be EPM?

1) YES

a. Please explain whether all sell/buy-backs and buy/sell-backs activities for UCITS are EPM.

2) NO

a. Please explain.

Answer NCA:

Q.E6 Are there other techniques/instruments (such as the use of derivatives) your NCA considers falling under EPM that are eligible for UCITS?

1) YES

a. Please explain.

2) NO

a. Please explain.

Answer NCA:

Q.E7 Does your NCA define techniques used for 'investment purposes'?

1) YES

a. Please explain, including the legal basis (guidance, other).

2) NO

a. Please explain.

Answer NCA:

Q.E8 How does your NCA satisfy itself that market participants (UCITS Management Companies, Service Providers, Depositories, etc.) domiciled in your jurisdiction have a common understanding what is allowable as EPM versus techniques for investment purposes?

1) Guidance issued by your NCA (please explain)

2) Reference to guidance issued by another body (please explain)

3) Other (please explain)

4) No actions or initiatives in this area

Answer NCA:



## F. Setup of the NCA regarding UCITS authorisation and supervision

20. In order to assess the compliance with the Guidelines, it is essential for the AG to understand the NCA's approach in relation to authorisation and supervision of UCITS so as to be able to constitute a view on the capacity of the NCA to achieve high quality supervisory outcomes and respond to market developments, in line with the Methodology. For that reason, this section is aiming at gathering information on the internal structure of NCAs and the processes in place regarding authorisation and supervision of UCITS.
21. The AG aims at assessing convergence in the outcome of the work of the NCAs in the scope of the authorisation, on-going supervision and enforcement roles of the NCAs. In order to assess the supervisory approaches, the setup of NCAs will be considered and weighed against the internal processes and actions taken.

### Identification of NCA(s)

Q.F1 Please identify the competent authority/ies involved in the authorisation, supervision and enforcement of the UCITS using EPM in your jurisdiction.

Answer NCA:

### Resources/Organisation/Governance

22. Within the review period, please provide the following information:

Q.F2 Please provide information on the organisational setup of your NCA regarding authorisation and supervision of UCITS and UCITS Management Companies, including

- 1) Please provide an organisational chart, highlighting departments/teams dealing with authorisation and supervision of UCITS and UCITS Management Companies.
- 2) Are one or more departments/teams of your NCA responsible for the authorisation and the on-going supervision of UCITS and UCITS Management Companies?
  - a. One department/team
  - b. more than one 
    - i. How do you ensure a common supervisory approach among these departments/teams?

Answer NCA:

Q.F3 The number of staff on FTE basis involved in the following processes:

- 1) the authorisation process for UCITS:

- 2) the on-going supervision and examination process (including thematic reviews and on-site inspections where relevant) for UCITS:
- 3) the authorisation process for UCITS Management Companies:
- 4) the on-going supervision and examination process (including thematic reviews and on-site inspections where relevant) for UCITS Management Companies:
- 5) the enforcement process (including on-site inspections where relevant):

Q.F4 As per Q. F3, please indicate if the same staff simultaneously performs other activities, (e.g. in relation to Alternative Investment Funds and Alternative Investment Funds Managers, Investment Firms, etc. for instance, authorisation and supervision is carried out by the same staff for UCITS/UCITS Management Companies and Alternative Investment Funds/Alternative Investment Funds Managers).

Answer NCA:

Q.F5 Please identify the number of subject matter experts / technical specialists in the field of EPM.

Answer NCA:

Q.F6 Please provide brief information/a summary on the supervisory approach followed by these departments/teams including criteria for the selection, content and frequency of thematic reviews and on-site visits.

Answer NCA:

Q.F7 Please provide the number of

- 1) UCITS (including sub-funds) under your supervision:
- 2) UCITS Management Companies under your supervision:
- 3) UCITS self-managed investment companies under your supervision:

Q.F8 In the UCITS authorisation process, do you require Management Companies to indicate whether EPM can be engaged in?

- 1) YES



a. Please explain.

2) NO

a. Please explain.

Answer NCA:

Q.F9 Can you readily identify the UCITS domiciled in your jurisdiction that have provided for the use of EPM in their constitutional documents?

1) YES

a. Please explain.

2) NO

a. Please explain.

Answer NCA:

Q.F10 Does the supervisory approach of your NCA differ where

1) the UCITS Management Company domiciled in your jurisdiction delegates collective portfolio management functions, as listed in Annex II of the UCITS Directive?

a. YES, please elaborate

b. NO

Answer NCA:

2) the UCITS Management Company domiciled in your jurisdiction manages or markets UCITS authorised in another MS (by establishing branches or under the freedom to provide services)?

a. YES, please elaborate

b. NO

Answer NCA:

3) the UCITS is domiciled in your jurisdiction and is managed by a UCITS Management Company domiciled in another MS (by establishing branches or under the freedom to provide services)?

a. YES, please elaborate

b. NO

Answer NCA:

- 4) the UCITS is domiciled in your jurisdiction and is marketed into other MS (by establishing branches or under the freedom to provide services)?
- a. YES, please elaborate
  - b. NO

Answer NCA:

Q.F11 Within the review period, did your NCA conduct thematic reviews relating to EPM for UCITS?

- 1) YES 
  - a. Please provide details.
- 2) NO

Answer NCA:

Q.F12 Within the review period, did your NCA conduct reviews or on-site visits at UCITS Management Companies that included assessment of the use of EPM for UCITS?

- 1) YES 
  - a. Please provide details.
- 2) NO

Answer NCA:

Q.F13 Within the review period, did your NCA conduct reviews or on-site visits at depositaries to UCITS that included assessment of the depositaries' oversight of the use of EPM by UCITS?

- 1) YES 
  - a. Please provide details.
- 2) NO

Answer NCA:

## **G. Rules on Disclosure to end-investors of the UCITS**

23. This section of the questionnaire covers the following sections of the Guidelines: Chapter X para. 25, 28, 35; Chapter XII 43(e) [partly], 47, 48.
24. Regarding disclosures, both at the authorisation and the supervision process, NCAs might apply different supervisory tools, allowing for sample checking, full document reviews and such. The AG seeks to understand NCAs' actions regarding disclosure requirements. The Guidelines set out details to be included in the documents disclosed to end-investors, primarily the prospectus and the annual reports of UCITS. The NCAs should have clear and effective processes to ensure compliance by the market participants which include both ex-ante and an ex-post examination of disclosure, as appropriate. NCAs should ensure that they appropriately follow-up on identified deficiencies of supervised entities.

### **General questions**

Q.G1 Does your NCA ensure that the specific requirements under Chapter X para. 25, 28, 35; Chapter XII 43(e) [partly], 47, 48 of the Guidelines are incorporated into your supervisory practices (as per para. 6 of the Guidelines)?

1) YES

a. Is the approach documented in the form of written policies and procedures?

i. How often are these written policies and procedures reviewed/updated?

2) NO

a. Please explain through which other means and how you ensure that these requirements are followed in your supervisory approach.

Answer NCA:

### **Specific questions**

Q.G2 Please provide information on how your NCA satisfies itself that UCITS comply with the investor disclosure obligations contained in the Guidelines regarding

1) the intention to use EPM, to be disclosed in the prospectus, and other disclosure requirements under para. 25?

Answer NCA:

2) the policy regarding direct and indirect operational costs/fees arising from EPM, to be disclosed in the prospectus and other disclosure requirements under para. 28?

Answer NCA:

3) the intention of the UCITS to be fully collateralised in different transferable securities issued or guaranteed by a MS, one or more of its local authorities or public international body to which one or more Member States belong, that can be accepted as collateral for an exposure to a

single issuer exceeding 20% of the UCITS' net asset value, to be disclosed in the prospectus under para. 43(e), and in the annual report under para. 48(b)?

Answer NCA:

- 4) the collateral policy of the UCITS, including the types of collateral, level of collateral required, haircut policy, and re-investment policy for cash collateral (including the risks arising from the re-investment policy), to be disclosed in the prospectus, as required under para. 47?

Answer NCA:

- 5) the details to be disclosed in the annual report under para. 35 and para. 48.

Answer NCA:

25. Where possible please provide examples to help illustrate your answers to these questions.

### **Supervisory tools**

Q.G3 Per your responses to the questions in this section, please outline whether any/all of the following supervisory tools are utilised and provide additional information and details regarding the purposes for which the different tools are used:

- 1) Sample checking
- 2) Full document review
- 3) Thematic review
- 4) Checklists
- 5) Periodic reporting by third parties, such as depositaries, auditors, etc.
- 6) Ad hoc reporting of exceptions or abnormalities by third parties, such as depositaries, auditors, etc.
- 7) Other

Answer NCA:

### Additional Questions

Q.G4 Does your NCA apply the same supervisory approach in regards to all forms of disclosure?

1) YES

2) NO

a. Please explain the main differences in the approach and its reasons.

Answer NCA:

Q.G5 Beyond the requirements of para. 35 of the Guidelines, does your NCA require the UCITS to further disclose to end-investors data on revenue generated from EPM and direct or indirect operational costs associated with such techniques/instruments?

1) YES

a. Please elaborate on the content, format and legal basis of such disclosure.

2) NO

Answer NCA:

### Any other additional information

26. Please provide any additional information you believe to be relevant to the NCA's supervision over the items in this section here.

Answer NCA:

## H. Internal Risk Management

27. This section of the questionnaire covers the following sections of the Guidelines: Chapter X para. 26, 34.

28. The risk management processes applied for the UCITS that engage in EPM need to be calibrated in a way that appropriately reflect the risk stemming from EPM. NCAs are requested to clarify their approach towards the supervision of firms' internal risk management. The AG seeks to understand how NCAs supervise this at the authorisation of UCITS Management Companies as well as in the on-going supervision of these entities. NCAs should ensure that they appropriately follow-up on identified deficiencies of supervised entities.

### General Questions

Q.H1 Does your NCA ensure that the specific requirements under Chapter X para. 26 and 34, of the Guidelines are incorporated into your supervisory practices (as per para. 6 of the Guidelines)?

1) YES

a. Is the approach documented in the form of written policies and procedures?

i. How often are these written policies and procedures reviewed/updated?

2) NO

a. Please explain through which other means and how you ensure that these requirements are followed in your supervisory approach.

Answer NCA:

### Specific Questions

Q.H2 Please specify which type of risks arising from the use of EPM are covered by your NCA's supervisory approach when assessing the risk management process of a UCITS. Please explain this approach.

Answer NCA:

Q.H3 How does your NCA satisfy itself that risks arising from the use of EPM are adequately captured by the risk management process of the UCITS? (As per to para. 26 of the Guidelines).

Answer NCA:

Q.H4 How does your NCA satisfy itself that the liquidity risk management process for UCITS using EPM is taking into account the use of these techniques in order to guarantee their redemption obligations? (As per to para. 34 of the Guidelines).

Answer NCA:

29. Where possible please provide examples to help illustrate your answers to these questions.



## Supervisory Tools

Q.H5 Per your responses to the questions in this section, please outline whether any/all of the following supervisory tools are utilised and provide additional information and details regarding the purposes for which the different tools are used:

- 1) Sample checking
- 2) Full document review
- 3) Thematic review
- 4) Checklists
- 5) Periodic reporting by third parties, such as depositaries, auditors, etc.
- 6) Ad hoc reporting of exceptions or abnormalities by third parties, such as depositaries, auditors, etc.
- 7) Other

Answer NCA:

### Any other additional information

30. Please provide any additional information you believe to be relevant to the NCA's supervision over the items in this section here.

Answer NCA:

## I. Operational Aspects

31. This section of the questionnaire covers the following sections of the Guidelines: Chapter X para. 29-33.
32. This section relates to the requirements regarding the operational set up for EPM. The Guidelines provide guidance in relation to operational issues of EPM such as the treatment of fees, hidden revenues or group entities or persons with "close links" acting as counterparty or performing other services relating to EPM. The AG seeks to understand how NCAs monitor and supervise financial market participants to ensure compliance with the Guidelines covered in this section, including mitigation of potential conflicts of interest of the parties involved. NCAs should ensure that they appropriately follow-up on identified deficiencies of supervised entities.

### General Questions

Q.11 Does your NCA ensure that the specific requirements under Chapter X para. 29-33 of the Guidelines are incorporated into your supervisory practices (as per para. 6 of the Guidelines)?

1) YES

a. Is the approach documented in the form of written policies and procedures?

i. How often are these written policies and procedures reviewed/updated?

2) NO

a. Please explain e.g. through which other means and how you ensure that these requirements are followed in your supervisory approach.

Answer NCA:

### Specific Questions

Q.12 Does your NCA have a definition of “revenues arising from efficient portfolio management techniques”, as set out in para. 29 of the Guidelines?

1) YES

a. Please provide the definition and explain, if necessary.

b. Please explain your NCA's approach, especially towards the hidden revenues and revenues stemming from the management of collateral.

2) NO

a. Please explain your NCA's approach towards the issue of revenues.

Answer NCA:

Q.13 Other than what is required under para. 35 f of the Guidelines, does your NCA receive any other scheduled reporting on revenue generated by UCITS engaged in EPM?

1) YES

a. What is the content, format and legal basis for this reporting?

b. For what supervisory purposes is such supplementary supervisory reporting utilised for?

2) NO

Answer NCA:

Q.14 Does your NCA have a definition of direct and/or indirect operational costs associated with EPM?

- 1) YES 
  - a. Please explain.
- 2) NO 
  - a. Please explain your NCA's approach in this regard.

Answer NCA:

Q.15 How does your NCA assess whether operational costs deducted from the revenue generated from EPM are fair and reasonable (and therefore do not constitute "hidden revenues" as set out in para. 28 of the Guidelines)?

- 1) Please elaborate on the criteria and approach for direct costs.

Answer NCA:

- 2) Please elaborate on the criteria and approach for indirect costs.

Answer NCA:

Q.16 Does your NCA prohibit UCITS Management Companies or any group entities or persons with "close links" (as defined in Article 2(1)(i) of the UCITS Directive) to the UCITS Management Company from acting as a counterparty to the UCITS, agent to the UCITS or providing third party services to the UCITS in relation to EPM?

- 1) YES 
  - a. Please elaborate, in particular on the legal basis and reasons for such prohibition.
- 2) NO 
  - a. Please elaborate on your NCA's approach with regard to management of conflicts of interests and supervisory means to ensure an effective conflict management of those market participants.
  - b. Please explain how your NCA satisfies itself that that UCITS Management Companies act in the best interest of the investors of the UCITS when group entities or persons with "close links" perform the services described above.



Answer NCA:

Q.17 For UCITS that engage in securities lending, how does your NCA satisfy itself that the UCITS is able at any time to

- 1) recall any securities that has been lent out? Please explain.

Answer NCA:

- 2) terminate any securities lending agreement into which it has entered? Please explain.

Answer NCA:

Q.18 Does your NCA have a set time limit during which the lent-out securities must be returned to the UCITS either upon recall or after termination of the securities lending agreement?

- 1) YES 
  - a. Please explain, including the legal basis (guidance, other).
- 2) NO

Answer NCA:

Q.19 Does your NCA have a requirement that the UCITS exclusively conducts its securities lending arrangements under a Global Master Securities Lending Agreement (GMSLA)?

- 1) YES 
  - a. Please elaborate, including on the legal basis (guidance, other).
- 2) NO 
  - a. Please elaborate.

Answer NCA:

Q.110 For UCITS that engage in Reverse Repos, how does your NCA satisfy itself that the UCITS is able at any time to

- 1) recall the full amount of cash subject to the Reverse Repo? Please explain.

Answer NCA:

2) terminate the Reverse Repo into which it has entered? Please explain.

Answer NCA:

Q.111 Where cash under a Reverse Repo is recallable by the UCITS at any time on a mark-to-market basis, does your NCA allow for a valuation methodology other than the use of the mark-to-market value of the Reverse Repo for the calculation of the net asset value of the UCITS?

1) YES

a. Please elaborate on the methodology.

2) NO

Answer NCA:

Q.112 For UCITS that enter into a Repo, how does your NCA satisfy itself that the UCITS is able at any time to

1) recall any securities subject to the Repo? Please explain.

Answer NCA:

2) terminate to terminate the Repo into which it has entered? Please explain.

Answer NCA:

Q.113 Does your NCA have a set time limit during which the securities subject to the Repo must be returned to the UCITS either upon recall or after termination of the Repo?

1) YES

a. Please explain.

2) NO

Answer NCA:

Q.I14 Are there any circumstances whereby your NCA considers that fixed-term Repos and Reverse Repos that exceed seven days may, based on the facts of the case, be classified as 'recallable at any time' by the UCITS?

- 1) YES 
  - a. Please explain.
- 2) NO 
  - a. Please explain.

Answer NCA:

Q.I15 Does your NCA have any statistics on the breakdown between fixed-term Repos and Reverse Repos that do not exceed seven days versus fixed-term Repos and Reverse Repos that are arranged for periods that exceed seven days?

- 1) YES 
  - a. Please provide relevant statistics and their source(s).
- 2) NO

Answer NCA:

33. Where possible please provide examples to help illustrate your answers to these questions.

### **Supervisory Tools**

Q.I16 Per your responses to the questions in this section, please outline whether any/all of the following supervisory tools are utilised and provide additional information and details regarding the purposes for which the different tools are used:

- 1) Sample checking
- 2) Full document review
- 3) Thematic review
- 4) Checklists
- 5) Periodic reporting by third parties, such as depositaries, auditors, etc.

- 6) Ad hoc reporting of exceptions or abnormalities by third parties, such as depositaries, auditors, etc.
- 7) Other

Answer NCA:

#### **Any other additional information**

34. Please provide any additional information you believe to be relevant to the NCA's supervision over the items in this section here.

Answer NCA:

## **J. Compliance with the Investment Mandate**

35. This section of the questionnaire covers the following sections of the Guidelines: Chapter X para. 27.
36. This section relates to the requirements regarding the compliance of UCITS Management Companies with the investment mandate of the UCITS. In order to be in the interest of the end-investors of the UCITS, use of EPM must be within the investment objective and policy, and risk profile of the UCITS. For this, UCITS Management Companies need to have effective oversight to ensure mandate compliance. The AG seeks to understand how NCAs supervise UCITS to ensure EPM is used in accordance with fund mandates. NCAs should ensure that they appropriately follow-up on identified deficiencies of supervised entities.

#### **General Questions**

Q.J1 Does your NCA ensure that the specific requirements under Chapter X para. 27 of the Guidelines are incorporated into your supervisory practices (as per para. 6 of the Guidelines)?

- 1) YES
- a. Is the approach documented in the form of written policies and procedures?
- i. How often are these written policies and procedures reviewed/updated?
- 2) NO
- a. Please explain through which other means and how you ensure that these requirements are followed in your supervisory approach.

Answer NCA:

### Specific Questions

Q.J2 How does your NCA define or quantify what “additional substantial supplementary risk” is in relation to guideline 27 (b) of these Guidelines?

Answer NCA:

Q.J3 How does your NCA satisfy itself that the use of EPM provided for in the UCITS constitutional documents do not result in a change of the declared investment objective of the UCITS?

- 1) Please explain the process at authorisation.

Answer NCA:

- 2) Please explain the process at an on-going basis.

Answer NCA:

Q.J4 How does your NCA satisfy itself that the use of EPM does not add substantial supplementary risks in comparison to the original risk policy as described in its sales documents and constitutional documents?

- 1) Please explain the process at authorisation.

Answer NCA:

- 2) Please explain the process at an on-going basis.

Answer NCA:

37. Where possible please provide examples to help illustrate your answers to these questions.

### Supervisory Tools

Q.J5 Per your responses to the questions in this section, please outline whether any/all of the following supervisory tools are utilised and provide additional information and details regarding the purposes for which the different tools are used:

- 1) Sample checking
- 2) Full document review
- 3) Thematic review



- 4) Checklists
- 5) Periodic reporting by third parties, such as depositaries, auditors, etc.
- 6) Ad hoc reporting of exceptions or abnormalities by third parties, such as depositaries, auditors, etc.
- 7) Other

Answer NCA:

#### **Any other additional information**

38. Please provide any additional information you believe to be relevant to the NCA's supervision over the items in this section here.

Answer NCA:

### **K. Collateral Management**

39. This section of the questionnaire covers the following sections of the Guidelines: Chapter XII para. 42-44.
40. For certain EPM, UCITS receive collateral to mitigate the risks associated with the transaction. The Guidelines set out criteria collateral must meet and specify the treatment of collateral received. The AG seeks to understand how NCAs ensure that these requirements are met and what actions NCAs take to supervise market participants in this regard. NCAs should ensure that they appropriately follow-up on identified deficiencies of supervised entities.

#### **General Questions**

Q.K1 Does your NCA ensure that the specific requirements under Chapter XII 42, 43 (a-j) and 44 of the Guidelines are incorporated into your supervisory practices (as per para. 6 of the Guidelines)?

1) YES

a. Is the approach documented in the form of written policies and procedures?

i. How often are these written policies and procedures reviewed/updated?

2) NO

a. Please explain through which other means and how you ensure that these requirements are followed in your supervisory approach.

Answer NCA:

### **Specific Questions**

Q.K2 Taking into account your NCA supervision process as described in Section F, how does your NCA satisfy itself that all assets received by UCITS in the context of EPM (including cash) are treated as collateral for the purpose of the Guidelines (as per para. 42)?

Answer NCA:

Q.K3 How does your NCA supervise that collateral received by UCITS using EPM complies at all times with criteria laid down in para. 43 (a-j) of the Guidelines? Please explain.

Answer NCA:

Q.K4 Has your NCA developed specific supervisory practices to all or some of the provisions laid down in para. 43 (a-j) of the Guidelines?

1) Yes

a. Please explain.

2) NO

Answer NCA:

Q.K5 With reference to para. 44, how does your NCA satisfy itself that re-invested cash collateral is diversified in accordance with the diversification requirements applicable to non-cash collateral?

Answer NCA:

41. Where possible please provide examples to help illustrate your answers to these questions.

### **Supervisory Tools**

Q.K6 Per your responses to the questions in this section, please outline whether any/all of the following supervisory tools are utilised and provide additional information and details regarding the purposes for which the different tools are used:

- 1) Sample checking
- 2) Full document review
- 3) Thematic review
- 4) Checklists
- 5) Periodic reporting by third parties, such as depositaries, auditors, etc.
- 6) Ad hoc reporting of exceptions or abnormalities by third parties, such as depositaries, auditors, etc.
- 7) Other

Answer NCA:

#### **Any other additional information**

42. Please provide any additional information you believe to be relevant to the NCA's supervision over the items in this section here.

Answer NCA:

### **L. Complaints handling & Enforcement**

Q.L1 Within the review period, has your NCA (or applicable body) received any complaints (by investors or other relevant parties) regarding matters covered by the in scope Guidelines?

- 1) YES 
  - a. Where available, please state the number of complaints and main areas they related to.
  - b. Please describe the number and general type of supervisory and/or enforcement actions taken by your NCA in response to those complaints.
- 2) NO

Answer NCA:

Q.L2 Within the review period, has your NCA received notification from auditors or depositaries or other third party involved in the UCITS governance structure regarding weaknesses or material breaches in relation to the in scope Guidelines?

1) YES

- a. Where available, please state the number and main areas covered by the findings reported to you by auditors, depositaries or other third parties.
- b. Please describe the number and general type of supervisory and/or enforcement actions taken by your NCA in response to those findings.

2) NO

Answer NCA:

Q.L3 Within the review period, has your NCA taken action where supervision teams recorded findings of non-compliance of market participants with the in scope Guidelines?

1) YES

- a. Where available, please state the number and main areas the supervisory findings.
- b. Please describe the number and general type of supervisory and/or enforcement actions taken by your NCA as a reaction to those findings.

2) NO

Answer NCA:

## Annex 3 – Questionnaire - Collection of Background Information

### A. Introduction

1. The 2017 ESMA Supervisory Convergence Work Programme provided that a peer review on the Guidelines on ETFs and other UCITS issues will be launched in 2017.
2. This peer review will be conducted in accordance with Art. 30 Regulation (EU) No. 1095/2010 of the European Parliament and of the Council of 24 November 2010 (ESMA Regulation) and the revised [Review Panel] Methodology (ESMA/2013/1709) (Methodology). In line with the ESMA Regulation and the Methodology, the peer review must also include a review of the NCAs' capacity to achieve high quality supervisory outcomes, including the adequacy of resources and governance and the effective application of the Guidelines, the capacity of the NCA to respond to market developments, the degree of convergence in the application of law and supervisory practices, and the extent to which the practices achieve the objectives.
3. In accordance with the Methodology, the peer review will be carried out by an assessment group on the basis of the mandate approved by the Board of Supervisors on 27 September 2017 ("Mandate").
4. The Board of Supervisors put into scope Chapter X, para. 25-35, and Chapter XII, para. 42-44 and 47-48, of the Guidelines. Furthermore, the Board of Supervisors decided to focus the peer review on a number of NCAs to be assessed by this peer review. Thus, this questionnaire will be followed by an on-site visit to the NCAs participating.
5. Only those NCAs identified in the Mandate are required to complete the whole questionnaire. As established in the Mandate, all NCAs are, however, required to provide answers to Section C "Background Information" of this document.
6. In addition to the issue of incorporation of the Guidelines in the regulatory framework (Section C), the definition of EPM for UCITS (Section D), the setup of NCAs (Section F) and complaints handling & enforcement (Section L), the questionnaire structures the questions according to the topics covered by the assessed Guidelines, as defined in the Mandate. These sections cover rules on disclosure to end-investors of UCITS (Section G), internal risk management (Section H), operational aspects (Section I), mandate compliance (Section J), and collateral management (Section K).
7. In Sections G-K, the assessed NCAs will be asked to provide answers to the incorporation and application of the Guidelines in the regulatory framework (General Questions), the material content of the relevant section (Specific Questions), the supervisory approach and practices of the NCA towards the issue (Supervisory Tools), background information on topics relating to the parts of the Guidelines covered in the Section (Additional Questions), and be given the opportunity to provide any additional information of interest in this context (Any Other Information).
8. With the exception of the Specific Questions, NCAs can, if they so wish, refer to their answers given under another section.
9. The period under review spans from 1 July 2015 to 30 June 2017. All questions relate to that period and answers should cover that period.

## B. Introduction

1. As established in the mandate, all NCAs are required to fill in Section C (Background Information) of the questionnaire.
2. Therefore, this document contains the questions of Section C.
3. In case your NCA was identified in the mandate to be assessed, a separate additional document will be sent, containing as well Sections D - L. Regardless, this document is to be completed.
4. Please provide the name and contact details of the person(s) who are responsible in your NCA for the completion of this questionnaire, and who can be contacted for clarifications, further information etc. by members of the AG.
5. If a clarification is required with regard to any particular question, please contact the Rapporteur, Clemens Nimmerrichter (nimmerrichter@esma.europa.eu) at ESMA.
6. Please submit the completed document via this tool by 8 December 2017, cob.

## C. Background Information

1. In order to provide background information on the use of EPM for UCITS within the EEA, clarity is sought from all NCAs on the formal legal framework regarding this topic. In addition, NCAs are requested to explain possible reporting obligations of UCITS Management Companies within the area under review.

Q.C1 Does your jurisdiction transpose Art. 11 of the Eligible Assets Directive and Art. 51 para. 2 of the UCITS Directive in such a way that allows UCITS to engage in EPM as stipulated in these provisions?

1) YES

2) NO

Q.C2 Is there any regulation or NCA guidance to market participants (such as UCITS Management Companies, Service Providers, Depositaries, etc.) in place that provide for legal constraints regarding the use of EPM for UCITS that exceeds the requirements of the UCITS Directive or the Guidelines (e.g. differences for investors type or, given certain circumstances, only certain types of EPM can be used, etc.)?

1) YES

a) Please explain and provide information on the form of legal constraints.

2) NO

Answer NCA:

Q.C3 Within your own understanding of EPM, are UCITS Management Companies in your jurisdiction subject to an obligation to report periodically to the NCA on the use of EPM for UCITS?

1) YES

a) Please provide an overview of the reporting obligations in place.

b) Please provide (if available) information regarding the data collected describing the aggregated volume of EPM for UCITS (in local currency of the NCA) and its calculation method, broken down by technique/instrument (and indicate the date the data refers to).

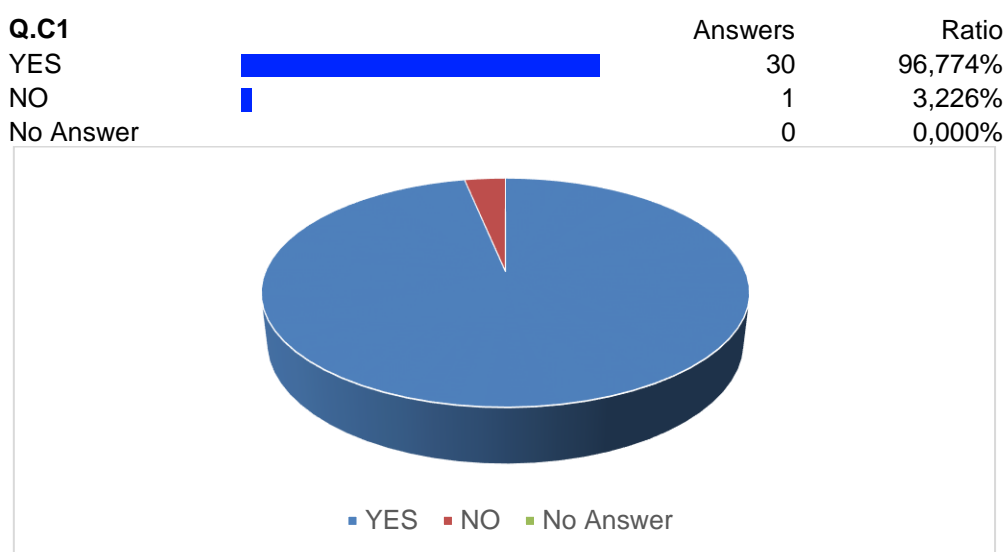
2) NO

Answer NCA:

## Annex 4 – Aggregated Answers - Collection of Background Information

**Q. C1 Does your jurisdiction transpose Art. 11 of the Eligible Assets Directive and Art. 51 para. 2 of the UCITS Directive in such a way that allows UCITS to engage in EPM as stipulated in these provisions?**

**Answers:**



- 30 NCAs replied to Q. C1 that their respective legal frameworks transposed Art. 11 of the Eligible Assets Directive and Art. 51 para. 2 of the UCITS Directive in such a way that allows UCITS to engage in EPM. One NCA (IS) replied that the Icelandic legal framework does not directly provide for such techniques, however, securities lending is permitted for UCITS if it is part of their risk management.
- Taking these replies, it seems as if UCITS are permitted to engage in EPM techniques of some sort across the whole EEA, regardless of their domicile.



**Q. C2 Is there any regulation or NCA guidance to market participants (such as UCITS Management Companies, Service Providers, Depositaries, etc.) in place that provide for legal constraints regarding the use of EPM for UCITS that exceeds the requirements of the UCITS Directive or the Guidelines (e.g. differences for investors type or, given certain circumstances, only certain types of EPM can be used, etc.)?**

**Answers:**



- In roughly two third of the EEA jurisdictions (64,52%) [AT, BG, DK, EE, ES, FI, HU, IE, IS, IT, LI, LV, LT, MT, NL, PL, RO, SE, SK, UK] no regulation or NCA guidance to market participants is set in place further legally restricting the use of EPM for UCITS. In roughly one third of the EEA jurisdictions (35,48%), specific legal constraints for UCITS engaging in EPM exist [BE, CY, CZ, DE, EL, FR, HR, LU, NO, SI, PT].
- The most prominent legal restriction relates to capping the maximum amount of EPM engagement for a UCITS, its individual amount or its exposure to a single counterparty, as indicated by 5 NCAs [DE, EL, HR, NO, SI]. In one jurisdiction [NO], a UCITS Management Company may not employ EPM for more than 50% of the UCITS AuM, one jurisdiction [SI] sets the threshold at 40% of the AuM. Similarly, thresholds exist for counterparty exposure, capping the value of lent securities to a single counterparty or to counterparties belonging to the same group with 10% of the UCITS assets [DE, SI]. In one jurisdiction [HR], repurchase agreements cannot amount to more than 20% of the UCITS AuM.
- Some jurisdictions [BE, FR, LU, PT, SI] require that counterparties to EPM are regulated financial institution(s).
- In two jurisdictions [FR, PT], it is a legal requirement to use standard agreements, such as the Global Master Securities Lending Agreement (GMSLA) for the EPM transactions for a UCITS.
- In one jurisdiction [CZ], only a limited type of EPM can be engaged in for a UCITS, i.e. repurchase agreements and financial derivatives.

8. In one jurisdiction [ES], only specific types of securities which are regulated and standardised in the Spanish stock markets can be lent. Bilateral or OTC securities lending is not allowed. Additionally, UCITS are not allowed to borrow securities.
9. In one jurisdiction [DE] the contract duration of (reverse) repurchase transactions cannot be longer than 12 months (while requiring that they are callable at any time).
10. In one jurisdiction [FR], only a mark-to-market methodology may be used. If mark-to market is unobservable, UCITS may use a mark to model based valuation.

**Q. C3 Within your own understanding of EPM, are UCITS Management Companies in your jurisdiction subject to an obligation to report periodically to the NCA on the use of EPM for UCITS?**

**Answers:**



11. UCITS are subject to additional reporting obligations relating to EPM engagement in roughly two third of the EEA jurisdictions (67,74%) [BE, BG, CZ, DE, EL, ES, HR, HU, IE, IT, LU, LV, MT, NL, NO, PL, PT, RO, SI, SK, UK]. In roughly one third of the EEA jurisdictions (32,26%), no additional national reporting obligations exist [AT, CY, DK, EE, FI, FR, IS, LI, LT, SE].

**Q. C3(a) If YES, please provide an overview of the reporting obligations in place.**

**Answers<sup>34</sup>:**

12. In BE, UCITS have to report quarterly to the FSMA the following information as part of a more extensive reporting obligation: (i) the value of the collateral received; (ii) the value of the financial instruments lent (shares, bonds, others); (iii) calculation of the global exposure including the global exposure from OTC derivatives.
13. In BG, the reporting obligations for Bulgarian management companies and collective investment schemes are set in the Collective Investment Schemes and Other Undertakings for Collective Investments Act (CISOUCIA) and Ordinance No.44 on the requirements to the activity of collective investment schemes, their management companies, national investment funds and managers of alternative investment funds (Ordinance 44).
14. In CZ, the UCITS' annual and semi-annual reports have to contain details of the following: (i) the exposure obtained through efficient portfolio management techniques; (ii) the identity of the counterparty(ies) to these efficient portfolio management techniques; (iii) the type and amount of collateral received by the UCITS to reduce counterparty exposure; and (iv) the revenues arising from efficient portfolio management techniques for the entire reporting period together with the direct and indirect operational costs and fees incurred.
15. In DE, the reporting obligations are laid out in the German Regulation on Derivatives ("DerivateV"). The frequency of reporting is on an annual basis. Some data refer to the 31st of December. These data are called the 'data for a given date'. Other data need to be reported as an average value capturing data from 1st of January to 31st of December of the reporting period. These data are called 'the period related data'. The reporting template is submitted to BaFin at the end of January of the following year at the latest (eg., reporting of 2017 data needs to be completed until the end of January 2018). Key elements of the 'data for a given date' reporting include the following information: (i) the management company states whether the used derivative is an equity derivative, currency derivative, interest rate derivative, commodity derivative, credit derivative, volatility/variance derivative, or other derivative. Furthermore, the capital management companies must state the type of the exposure by stating whether these are plain vanilla options, complex options, futures/forwards, plain vanilla swaps/swaptions, complex swaps/swaptions, or other type of derivative contract; (ii) the type of complex options and the type of complex swaps/swaptions, if used; (iii) the name of the top 4 counterparties as well as the exposure relative to the net asset value (in percentage); (iv) the name of the top 4 issuer and the exposure relative to the net asset value (in percentage); (v) the type of the structured products used and their market value; (vi) the exposure in securities lending and whether the securities lent out were government bonds, corporate bonds, stocks, or other instruments; (vii) the amount of collaterals received in a securities lending transaction as well as the types of the collaterals received during a securities lending transaction; (viii) the amount of the collaterals received during a securities lending transaction, which were re-used; (ix) the exposure arising from repurchase agreements; (x) the amount of the collaterals received from a repurchase agreement; (xi) the amount of the collateral during a repurchase agreement contract, which were re-used. The management company must also report some risk measures. If the management company uses the commitment approach for its investment fund, it reports the leverage measure

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<sup>34</sup> The descriptive part regarding the individual jurisdictions were taken directly from the answers provided by the NCA and were not materially challenged by the AG.

calculated according to the commitment method. If it uses the more advanced Value-at-Risk Approach, the VaR figure and the leverage calculated according to the gross method will be reported. In the excel template, which captures the period related data, the capital management companies must report to BaFin whether the derivative instruments were used for hedging purposes, investment purposes, hedging and investment purposes or other purposes (not specified). In this template, capital management companies must also state whether the investment fund was involved in a securities lending transaction during the reporting period. The capital management company must also state whether the investment fund re-used the collaterals received during a securities lending transaction in the reporting period. Both information are also provided for repurchase agreement contracts. The German Derivatives Regulation requires capital management companies, which use derivatives, securities lending transactions and/or repurchase agreements to disclose the following information in their annual reports: (i) the exposure, which was generated through the use of derivatives; (ii) the contract partners in a derivatives transaction (iii) the type and the amount of the collaterals received. For securities lending transactions and repurchase agreements, the capital management company must also disclose the revenues generated by securities lending and repurchase agreements during the whole reporting period. They also have to disclose direct and indirect ongoing costs and expenses (section 37 DerivateV). In addition to the reports pursuant to the DerivateV, BaFin also receives a statistical report from the Deutsche Bundesbank: Pursuant to section 13 para. 3 of the GCIC, the Deutsche Bundesbank shall make available to the BaFin the information it obtains from statistics collected in accordance with section 18 of the Bundesbank Act. These statistics collected by the Deutsche Bundesbank includes, inter alia, information on securities lending and repurchase transactions of German UCITS on an aggregated basis.

16. In EL, according to Article 25(2) of Decision 3/645/2013 of HCMC, ManCos are required to report on a quarterly basis the following: (i) description of repurchase & reverse repurchase agreements; (ii) detailed description of the collateral that have been received with reference to their valuation and haircut; (iii) detailed list with their positions in derivatives, showing the following: (i) the nominal value per derivative financial instrument and, in the case of OTC derivatives, their counterparty and the valuation process; (ii) the percentage of nominal value per derivative financial instrument on the net assets of the UCITS.
17. In ES, UCITS Management companies have a monthly reporting obligation of the whole portfolio (with a one month lapse in the data) including fields like description, amounts at the beginning and at the end of the month, prices, and counterparties.
18. In HR, management companies submit UCITS NAV report to the competent authority on a daily basis. Part of NAV report are information regarding the use of EPM. Currently, the only EPM that UCITS use are repos (repurchase and reverse repurchase agreements), and the NAV report contains the following information: (i) identification number of the agreement; (ii) identification of counterparty; (iii) date of entering into agreement and the date of termination; (iv) nominal and the fair value of the agreement; (v) asset used as collateral (ISIN of the securities) and; (vi) the fair value of collateral.
19. In HU, quarterly reporting is required on the type of the derivative instruments used, the related risks, quantitative limits, and the methodology used to estimate risks inherent to the derivative transactions (Paragraph (4) of Article 167 of Act XVI of 2014 on the collective investment schemes and their managers).
20. In IE, on an annual (Regulation 79(1) and Schedule 7 of the Central Bank UCITS Regulations) and semi-annual basis (Regulation 80(1) & Schedule 8 of the Central Bank UCITS Regulations), the responsible person shall submit the following information to the CBol: “In the case of a UCITS that engages in

efficient portfolio management techniques and instruments, information on: (i) the exposure obtained through efficient portfolio management techniques and instruments; (ii) the identity of the counterparty to the relevant efficient portfolio management techniques and instruments; (iii) the type and amount of collateral received by the UCITS to reduce counterparty exposure; and (iv) the revenues arising from efficient portfolio management techniques and instruments for the entire reporting period, together with the direct and indirect operational costs and fees incurred.” In addition, the Central Bank of Ireland receives a Money Market and Investment Funds Return (“MMIF”) which must be completed for all Irish authorized UCITS on a quarterly basis (monthly basis for money market funds). The MMIF return is intended to give a comprehensive overview of all transactions and positions of a Fund vis-à-vis residents and non-residents. Detailed profit and loss and balance sheet information are to be reported, including the following: Security-by-security information on equities, debt securities and derivatives. Information collected on securities lending/borrowing activities, loans and deposits and other assets/liabilities.

21. In IT, Art. 11 of the Eligible Assets Directive and Art. 51 para. 2 of the UCITS Directive have been implemented in the Bank of Italy Regulation on collective investment schemes. According to Bank of Italy’s Circular no. 189/1993 (as subsequently amended), management companies are subject to an obligation to report on a monthly basis to the Bank of Italy information on the portfolio composition of each fund they manage. The set of data to be transmitted includes, inter alia, information about securities lending, repos and reverse repos. The data to be reported refers to the situation in place at the end of the previous month. The information on collective asset management activities reported by asset management companies gets kept in a database called “PRISMA” which is maintained by the Bank of Italy and shared by the Bank of Italy with Consob according to a cooperation agreement between the two authorities.
22. In LU, starting from March 2016, the CSSF introduced the “UCITS risk reporting” in order to collect risk related information on Luxembourg based UCITS on a semi-annual basis, including amongst others the following information on (reverse) repos and securities lending/borrowing transactions used as EPM: (i) volumes per EPM type (minimum, maximum, average and semester-end values); (ii) overall net counterparty exposure arising from EPM techniques; (iii) collateral received in the context of EPM techniques; (iv) leverage arising from the use of EPM techniques. The data requested on EPM relates to the techniques and instruments specifically mentioned in the aforementioned CSSF circular 08/356, chapter X of the Guidelines and point 24 of the CESR’s guidelines concerning eligible assets for investment by UCITS. This is not to be considered as an exhaustive list of eligible EPM. In particular, Luxembourg based UCITS may also use financial derivative instruments in the context of EPM following from the provisions of the UCITS Directive, the Eligible Assets Directive and the aforesaid CESR’s guidelines. However, there are no specific requirements for the use of financial derivative instruments in that context other than the general provisions in European regulations concerning EPM (including provisions on the use of financial derivative instruments as EPM). On this basis, the CSSF decided to re-request data on financial derivative instruments in the UCITS Risk Reporting (e.g. data on global exposure, leverage and counterparty risk) without differentiating between EPM and other purposes. The UCITS risk reporting applies to all Luxembourg based (sub-)funds authorized by the CSSF as at semester-end. However, only UCITS with total net assets greater than EUR 500 million or an average realised leverage under the sum of notional method (for the derivatives used) during the semester greater than 250% are in the full reporting scope and have as a consequence to provide the aforementioned data on EPM (note: the second criterion on leverage only applies to UCITS under a VaR approach for global exposure calculation purposes). For the avoidance of doubt, please note that the UCITS risk reporting applies to all Luxembourg based UCITS whether the management company has its registered office in Luxembourg or in another Member State. As at 30 June 2017, about 75% (in terms of net assets) of the Luxembourg

based UCITS population is covered by the full reporting scope of the UCITS Risk Reporting and hence provided data on EPM. All the requirements are described in detail in the applicable guidelines which are available (together with all the other underlying documents such as in particular the reporting template) on the CSSF website under: <http://www.cssf.lu/en/supervision/ivm/ucits/legal-reporting/> (section "UCITS risk reporting").

23. In LV, UCITS Management Companies submit reports of UCITS portfolio to the NCA on a regular (quarterly) basis. Reports provide data on short term and long term liabilities arising from transactions of EPM.
24. In MT, in accordance with SLC 5.18 of Part BII of the Investment Services Rules for Retail Collective Investment Schemes, which transposes Article 11 of the Eligible Assets Directive, "The Scheme may employ techniques and instruments for the purpose of efficient portfolio management which include the use of Transferable Securities and Money Market Instruments. These operations may concern the use of Financial Derivative Instruments." SLC 12.8 of Part BII of the Investment Services Rules for Retail Collective Investment Schemes requires such Schemes to submit, together with the annual report, a report on their derivatives positions. The report is to include the following information - as at the year end of the Scheme - for every derivatives position of the Scheme: (i) details of the underlying risks; (ii) relevant quantitative limits and how these are monitored and enforced; and (iii) methods for estimating risks.
25. In NL, UCITS Management Companies are obliged to report about their derivative instruments in their portfolio, the quantitative limits and the methods that are used to estimate the risks attached to these instruments. But this reporting is not restricted to derivatives used for EPM, but for all purposes.
26. In NO, the UCITS management companies must submit quarterly reports to Finanstilsynet (NCA) on each UCITS they manage. Revealed breaches of investment limits established by the fund rules and relevant legislation are reported. The format of the report has just recently been updated, and reports will from January 2018 also include information on the use of EPM. The companies will give information on whether EPM are used or not within each UCITS. No additional information is required.
27. In PL, UCITS are obligated to send to the NCA quarterly reports, as well as half-yearly and yearly financial statements. These reports and financial statements are not dedicated exclusively to EPM techniques, but are designed to present in a comprehensive way the investment activity and financial situation of UCITS. Some parts of the reporting templates are connected with the EPM techniques. Namely, the reporting templates comprise a table dedicated to UCITS positions held in financial derivative instruments and also, as a balance sheet position, value of UCITS liabilities resulting from SBB / repurchase agreements and receivables resulting from BSB / reverse repo agreements. These values are reported with snapshot approach (at the reporting date).
28. In PT, in addition to the report foreseen in the Commission Delegated Regulation (EU) no. 231/2013 of 19 December 2012 Annex IV, the CMVM Instruction no. 6/2016 details and defines the contents, terms and establishes the way to deliver the required information for risk monitoring purposes and analysis of other matters.
29. In RO, There are no specific reports that UCITS employing EPM send to ASF at the moment. However, given the fact that the instruments used in the efficient management area are part of the UCITS portfolios under management, additional information on them is retrieved from the two types of reports that

UCITS Management Companies report weekly to ASF: (i) aggregated report which comprises, for every working day from the reference week, aggregated values for the UCITS assets and liabilities (split in generalised categories), as well as its number of investors, number of fund units and net asset unit value; (ii) detailed report which comprises, for the last working day of the reference week, a detailed situation on the UCITS assets under management. For every asset under management, UCITS report: (i) the name of the issuer; (ii) the number of units it owns; (iii) the date and nominal value/initial value/price paid on purchase; (iv) the due date; (v) accrued interest; (vi) market value; and (vii) the percentage it represents in the total assets managed by the respective UCITS.

30. In SI, management companies must report regular (monthly) report data on the UCITS portfolio. This data also includes: (i) information about securities which have been lent in securities lending agreements or repurchase agreements, (ii) information about amount of cash which has been lent or received in EPM; and (iii) data on investment in financial derivative instruments.
31. In SK, UCITS managements companies are subjects to obligation to report semi-annually on the use of EPM for UCITS to the National Bank of Slovakia.
32. In UK, COLL 6.12.3AR requires an authorised fund manager or a UK UCITS management company of an EEA UCITS scheme subject to COLL 6.12.3R(2) (Risk management Process) to submit an annual report to the FCA on their use of derivatives within the UCITS they manage using the form in COLL 6 Annex 2R. However, no specific regulatory reporting on other EPM techniques such as stocklending is required.



**Q. C3(b): If YES, please provide (if available) information regarding the data collected describing the aggregated volume of EPM for UCITS (in local currency of the NCA) and its calculation method, broken down by technique/instrument (and indicate the date the data refers to).**

**Answers:**

33. In DE, the data received for the reporting period 2016 gives the following figures: (i) equity derivatives: € 23.086.765.528; (ii) currency derivatives: € 32.139.045.920; (iii) interest derivatives € 16.499.711.975; (iv) commodity derivatives: € 1.648.456.528; (v) credit derivatives: € 6.296.398.161; (vi) volatility/variance derivatives: € 153.830.164; (vii) other derivatives: € 346.267.775;  $\Sigma$ : € 80.170.476.051
34. In EL, on 30 June 2017 the nominal value of repo, reverse repo and derivatives (mainly futures) used as EPM tools was approximately € 26m for the total market. On 30 June 2017, the AuM of all UCITS ManCos in Greece was € 6,7b.
35. ES reported the following:

Technique/Instrument	Number of CIS	Amount in € million	% of UCITS total NAV(**)
Collateral: received cash	126	379,71	0,13%
Collateral: received debt (*)	94	750,11	0,26%
Total collateral	215	1.129,82	0,40%
Repo operations >30 days	33	658,12	0,23%

(\*) Government Bonds given as collateral to CIS

(\*\*) UCITS Total NAV € 285.429,07 million

36. HR reported the following data of 30 November 2017, in Croatian Kuna (HRK):

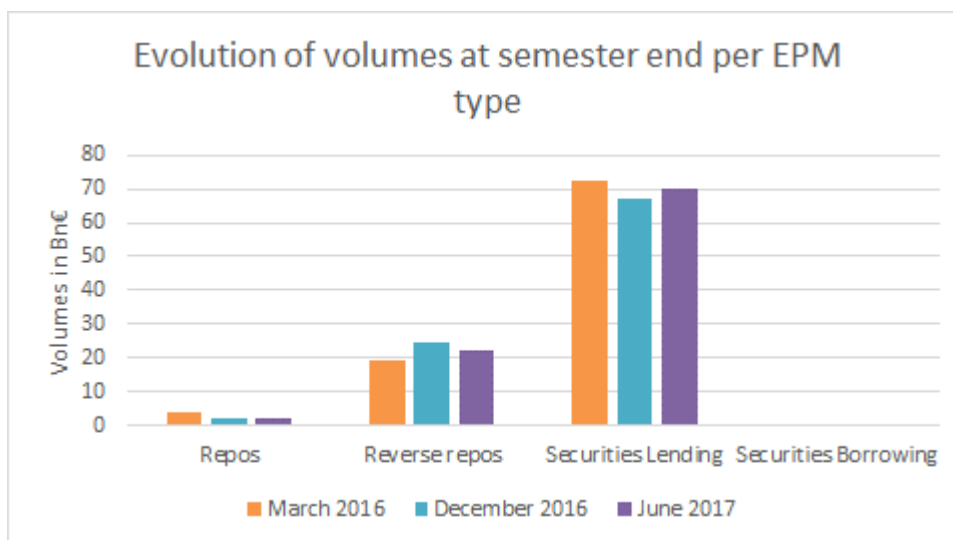
Technique/Instrument	Fair value of EPM	Fair value of collateral
Reverse repurchase agreements	59.390.771	63.488.873
Repurchase agreements	469.755.822	536.095.320
Overall repo agreements	529.146.593	599.584.192

37. IE reported that the MMIF Return allows the Central Bank of Ireland to identify Irish authorised investment funds engaged in EPM, specifically those funds that use techniques and instruments such as securities lending, securities borrowing, repurchase agreements and reverse repurchase agreements. The MMIF Return provides an indication of the quantum of the funds' activities in the above techniques and instruments.

38. IT reported the following data as of 30 June 2017, stating that additional information is available on: (i) collateral received and provided; (ii) type of counterparty; and (iii) type of underlying financial instrument:

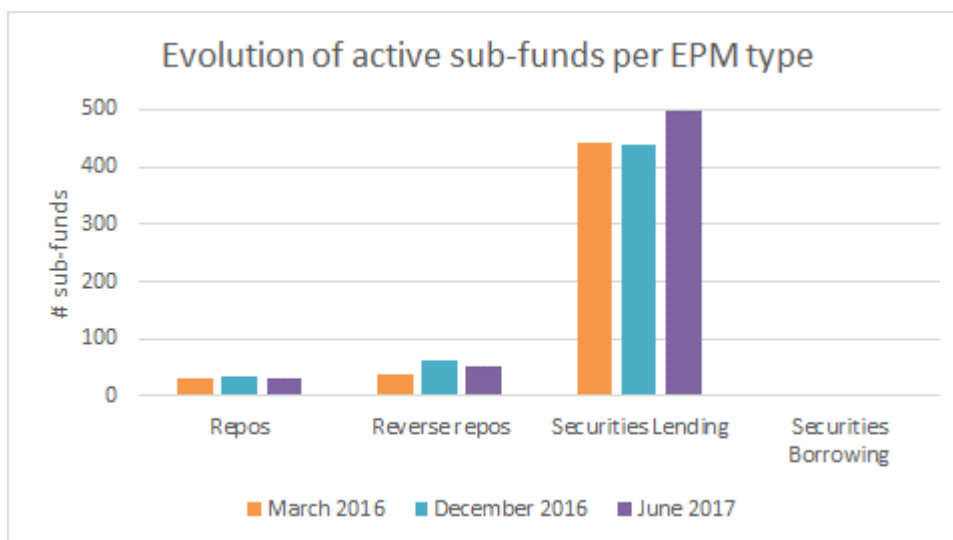
Technique/Instrument	Volume (in Euro)
Repurchase agreements	21,500,000
Reverse repurchase agreements	313,747,721
Securities on loan	1,404,399,157
Securities borrowed	56,045,622

39. LU reported the following data on the aggregated volume for EPM techniques following from the UCITS Risk Reporting (this data is available for a large part of Luxembourg based UCITS, representing about 75% of the net assets of the overall UCITS population in terms of net assets):



40. The volumes are based on the market value of the securities sold / lent / posted (respectively the cash paid / cash posted) to the counterparties of the transactions at the reporting date, without taking into account any netting effects and without considering the collateral received in order to mitigate the counterparty risk arising from these transactions. In total, the volumes of EPM amounted to 94.2 bn EUR as at 30 June 2017 (mainly securities lending), representing 3.8% of the total net assets of the UCITS in the full reporting scope of the UCITS Risk Reporting (securities lending: 2.8%).

41. The following graph shows the number of sub-funds that engaged in EPM transactions following from the data of the UCITS Risk Reporting:



42. In total, 537 sub-funds used EPM techniques as at 30 June 2017 (mainly securities lending), representing 31.5% of the number of UCITS sub-funds in the full reporting scope of the UCITS Risk Reporting (29% of the sub-funds in the full reporting scope made use of securities lending). The following table presents the relevant volumes and number of sub-funds in relation to EPM:

Technique/Instrument	30 June 2017		31 December 2016		31 March 2016	
	Volume in bn EUR	# sub-funds	Volume in bn EUR	# sub-funds	Volume in bn EUR	# sub-funds
Repo	2.2	31	2.1	33	4.0	30
Reverse Repo	22.1	52	24.8	64	19.1	38
Securities Lending	69.8	497	67.2	440	72.3	443
Securities Borrowing	0.1	1	0.2	1	-	-
<b>TOTAL</b>	<b>94.2</b>	<b>581</b>	<b>94.3</b>	<b>538</b>	<b>95.4</b>	<b>511</b>

43. Regarding the sub-fund that engaged in a securities borrowing transaction as at 30 June 2017 and 31 December 2016, the CSSF clarified that the transaction was cash driven (i.e. lending cash on a collateralised basis similarly to cash driven reverse repo transactions). In accordance with the relevant regulation, the concerned sub-fund did not engage in any short selling of the borrowed securities respectively non-cash collateral received.

44. In LV, the reporting showed no EPM transactions for UCITS at the end of October 2017.
45. PL reported that the reporting templates of the periodic reports sent by UCITS to the KNF, with regard to the utilization of financial derivatives instrument and SBB / repurchase agreements, comprise data at the reporting date. Data collected with regard to financial derivatives instruments comprise, for each UCITS derivative position, the name of instrument and underlying instrument, name of market, name and country of issuer, number of contracts, type of position (long/short) and book value of the derivative position at the reporting date. Data collected with regard to SBB / repurchase agreements comprise the value of liabilities resulting from SBB / repurchase agreements and receivables resulting from BSB / reverse repo agreements. Taking into account data reported by UCITS at the reporting date of 30 June 2017, the following aggregated description of the utilization of EPM techniques by UCITS may be presented: (i) out of about 290 UCITS reporting to KNF 74% of UCITS had outstanding positions in derivative contracts at the reporting date; (ii) the total number of outstanding positions in derivative contracts held by UCITS was about 1200, out of which 89% were OTC derivatives and 11% were exchange traded derivatives; (iii) the UCITS counterparties in OTC derivative contracts were mainly credit institutions (93% of all outstanding OTC derivatives positions); (iv) the majority of UCITS positions in derivatives contracts were held in currency derivatives (75% of all outstanding positions), which, in view of the specificity of the UCITS investment policy, were generally used for hedging purposes. 84% of currency derivatives were based on major currencies (EUR, USD, GBP, JPY). Other underlying instruments were: interest rates (10% of all positions), indexes (10%) and securities (5%); (v) the total value of unrealized gain on derivative transactions was about 98 million PLN (about 23 million EUR) and the total value of unrealized loss on derivatives transactions was about 118 million PLN (28 million EUR). These values were relatively small comparing to UCITS total assets value (less than 0.05%); (vi) out of about 290 UCITS reporting to KNF at the reporting date 30 June 2017, 16% of UCITS had outstanding positions in SBB / repurchase agreements and 12% had outstanding positions in BSB / reverse repo agreements; (vii) the total values of UCITS liabilities resulting from SBB / repurchase agreements was about 5.2 billion PLN (about 1.2 billion EUR) and the total values of UCITS liabilities resulting from BSB / reverse repo agreements was about 2.4 billion PLN (about 0.6 billion EUR). This value was relatively small comparing to the value of UCITS total assets at the level of about 97.7 billion PLN (about 23.2 billion EUR).
46. In PT, the reporting showed no EPM transactions for UCITS at the end of October 2017.
47. In RO, as of 29 September 2017, there are 19 UCITS Management Companies authorised on the Romanian market, which manage a total number of 74 UCITS. According to their emission prospectus, 63% of them are employing EPM and the instruments used with this purpose are money market instruments, like Repo and Reverse repo Contracts. At the reference date, the market value of Repo and Reverse Repo contracts represents 2% of the UCITS total asset value.
48. In SI, the reporting showed no EPM transactions for UCITS since 2014.

49. SK reported the following:

Technique/Instrument	30 June 2017	31 December 2016
Currency Futures		62 799 EUR
Currency Swaps		996 098 EUR
Futures	212 740 EUR	83 656 EUR
<b>Aggregated volume of EPM</b>	<b>212 740 EUR</b>	<b>1 142 553 EUR</b>

50. UK reported on the number of funds engaging in EPM, in total 868 UCITS regardless of their respective domicile. The aggregated AuM of these UCITS amasses to £ 511.6 bn. Of these 868, 779 UCITS were using the commitment method to calculate their global exposure, 59 the relative VaR, 30 the absolute VaR. The UK provided further in depth details on the kind of derivative used by UCITS and the number of funds using these instruments.

51. BE, BG, CZ, HU, MT, NL, NO were not able to provide aggregated data.

## Annex 5 – Statements from NCAs

1. NCAs may express their view on the outcome of the peer review report in a statement. The statement expresses the view of the NCA only and does not prejudice the follow-up by ESMA. Two NCAs [DE, UK] have issued a statement on the outcome of the peer review report.
2. BaFin has issued a statement which is reproduced below:

*'BaFin cordially disagrees with two findings and assessments made by the Peer Review Assessment Group. Unfortunately, the Peer Review Assessment Group did not pay sufficient consideration to significant facts showing Germany's compliance with the ESMA Guidelines or at least with the ESMA Guidelines' spirit and gist. These facts relate to Operational Aspects and the Collateral Management, both of which were marked "insufficiently compliant."*

### Operational Aspects

*The Peer Review Report states that BaFin's approach taken with respect to fees earned by the management company in the context of EPM Transactions was not in line with the ESMA Guidelines. The crucial point was that BaFin had allowed for a fee payable to the manager of up to 49% of the net revenues generated through EPM Transactions.*

*In light of nos. 28 and 29 of the ESMA Guidelines setting forth that all the revenues arising from EPM techniques, net of direct and indirect operational costs, should be returned to the fund, BaFin's practice was arguably too general to be entirely compliant with the ESMA Guidelines.*

*BaFin acknowledged this, immediately changed its practice and brought it in line with the ESMA Guidelines and other member states' practice.*

*BaFin also does not consider any potential deficiency of its previous practice material enough to result in the previous practice being labeled "insufficiently compliant."*

### Collateral Management

*As opposed to the ESMA Guidelines, the German investment code contains one exemption from certain collateral requirements in the context of EPM transactions. However, this exemption only relates to transactions cleared through approved institutions and is only available if investors' interests are safeguarded, including by way of collateral requirements similar to the ones set forth in the ESMA Guidelines. Furthermore, BaFin approval is required prior to any exemption being available. BaFin therefore considers the Peer Review Assessment Group's view that the German investment code is not compliant with the ESMA Guidelines too formal. The approval process and the equivalent protection of investors should have been attached more weight to. In any event, an "insufficiently compliant" seems disproportionate considering that there is hardly any substantive difference between BaFin's practice and the rules and mechanisms set forth in the ESMA Guidelines.'*

3. The FCA has issued a statement which is reproduced below:

*“We welcome the Report’s recognition of the FCA’s “sophisticated, risk-based and proportionate approach to supervision” and our overall satisfactory compliance with the Guidelines. However, a number of aspects of the report do not accurately represent the FCA’s supervisory approach. Our approach is explicitly focused on seeking to deliver certain key outcomes, rather than relying on checklists or rigid approaches that are not tailored to particular circumstances. We believe that our model is in line with ESMA’s expectations of a “formalised and systematic” approach to the supervision of the areas covered by the Guidelines.*

*Specifically, the following issues are inaccurate or incomplete representations of our approach:*

- In section 3.2.1.1, the report states that the FCA does not apply checklists or formalised internal procedures at the authorisation stage of a UCITS that cover the Guidelines. However, a documented FCA procedure exists for the authorisation of each type of firm, including firms holding the “Managing” function, whether an AIFM, UCITS ManCo or a Designated Investment Management Firm. No tailored authorisation form is available presently for UCITS ManCos owing to the very low number of applications. However separate guidance is produced for UCITS ManCos. All UCITS ManCo applications are treated as high priority and high risk within the organisation.*
- In section 3.2.1.2, the report states that the FCA does not have a methodical form of reviewing annual reports. However, the FCA would review UCITS annual reports on a targeted basis, and uses audit reports in its supervision as necessary, as risks are flagged.*
- The Report does not recognise throughout the role of FCA reporting tools as an effective element of our supervisory approach on issues covered by the Peer Review. The FCA’s use of the annual collection of data on the use of derivatives by UCITS, the use of model portfolios during the UCITS authorisation process, and the monthly Depositary Breach Reports submitted to the FCA, play important roles in addressing issues examined throughout the Review. ManCos are also required to report material breaches immediately, and depositaries are required to provide quarterly reports on their on-site visits to ManCos. The FCA utilises depositary oversight of collateral management processes as well as breach reports to reduce harm to consumers.*
- The Report specifically cites, in section 1, a lack of follow-up to a FCA 2015 review on fees and costs. However, fee split issues were addressed at the time and any subsequent breaches in requirements would be reported to the FCA and reviewed.*
- The Report states in section 3.2.3.1, that “in most jurisdictions, more detailed reviews [of annual reports of UCITS] are performed only in cases where statutory auditors report issues or breaches to the NCA in the annual report. A number of NCAs rely more on different sources of information in this regard, such as reports of ManCos or depositaries on EPM data or breach reports.” It is not clear why the FCA receives a lower level of compliance than others on this point for achieving the same outcome i.e. the review of annual reports following a breach.*

*The Report also implies an expectation that the only way to ensure full compliance with the operational aspects of the Guidelines (including on securities lending fees) is simply to issue guidance rather than demonstrate outcomes achieved.*



*In respect of the FCA's exemption from certain FCA collateral management rules for EPM transactions carried out through Euroclear Bank's Securities Lending and Borrowing Programme, the FCA will review the exemption and whether the justification for it remains, in terms of the Euroclear Bank Programme processes and risk management."*