APFI Response to ESMA

Dear ESMA,

Discussion Paper 'Share classes of UCITS'

The Association of Professional Fund Investors ('APFI') has gratefully responded to your invitation to provide comments. The APFI believes that fund investor bodies (such as the APFI) should also be properly involved in these discussions rather than ostensibly driven by trade bodies representing fund manufacturers. As an overriding backdrop the APFI seeks a fund share class regime that provides:

a) Fair transparent fees for all fund investors
b) Fair competition between large and smaller asset managers
c) Fairness to cross border fund investors and consistency with cross broader regulation (E.g. MIFID II, PRIIPs)
d) Performance comparisons are fair and representative

Response to Questions:

1. What are the drivers for creating different share classes?

A) The drivers should enable healthy competition between fund manufacturers, provide a range of different terms to suit different investment sums and investor types, segregation of different investor types where this is considered beneficial to those respective investor groups (E.g. retail versus institutional), currency options to hedge unnecessary currency risk arising between fund denomination and local denomination of the investor.

2. Why do certain UCITS decide to create share classes instead of setting up a new UCITS?

A) It is likely that asset firms seeks to minimise both regulatory and operational costs when setting up a new UCITS, including additional custodian charges, transfer agency, audit fees, box (cash) management, legal registration, individual prospectus requirements, listing fees, regulatory costs, board creation, incorporation and governance. Creation of distinct UCITS with similar sub-funds would confuse investors. Separate UCITS may generate unwanted performance comparisons. Share classes are often generated to provide a range of different terms (fees) and currency terms on the same strategy, which are easy to launch within one UCITS umbrella across a number of sub-funds simultaneously.

3. What are the costs of creating and operating a new share class compared to the cost of creating and operating a separate UCITS?

A) As per response to Question 2 there are a number of economies of scale allowable within a UCITS umbrella versus creating a separate legal entity.

4. What are the different types of share class that currently exist?

A) The number of different types existing in the cross-border fund market are near incalculable but broadly group into: Retail, platform, occupational, institutional, distributor and internal classes with multiple variations for income and growth classes, currency variations etc. Some share classes also have a Bid-Ask spread, whereas others are priced Mid-point. Some share classes (often Retail) also have contingent deferral charges, dilution levies, equilibrium charges, redemption and swing-pricing clauses.

5. How would you define a share class?

A) An investor-specific wrapper designed to segregate the pooled assets belonging to different investor types in an investment fund. This allows firms to segregate at point of sale and operationally post sale between seed investors, ongoing investors based on: investor type, size of investment, likely cash flow of investment pipeline, likely holding period and preferred currency. Share classes are often non-exchangeable and unredeemable with any party other than the issuing firm. Lastly a share class also serves as a mechanism whereby a firm can control the accessibility or pricing of a fund to one group of investor types without impacting investors in other share classes.

6. Do you agree that share classes of the same UCITS should all share the same investment strategy? If not, please justify your position.

A) In general this is the most transparent approach with 2 exceptions: share classes that hedge or are denominated in a different currency, may prudently take different country exposures to minimise the FX effect. Secondly some share classes may use duration or other hedging in order to suit specific investor needs. Wherever applied such variations should be clearly evident and explained.

7. Could you explain how the operational segregation between share classes works in practice?

A) The basic principles are common across all fund managers but in our experience the operation of box management and systems vary considerably from firm to firm. Such segregation should be in accordance with relevant client money and safe custody rules. Where possible fund managers should clearly state how segregation is applied and any differences in terms such as redemption clauses etc.

8. Do you agree that the types of share class set out in paragraph 8 are compatible with the principle of having the same investment strategy? In particular do you agree that currency hedging that is described in paragraph 8 complies with that principle? If not, please justify your position.

A) We believe currency hedging is a form of efficient portfolio management and complies with the spirit of the principle of 'having the same strategy'. Indeed we believe currency hedging is at times essential to minimise variances created by FX and costs arising are well managed.

9. Do you believe that other types of share class that comply with the principle of having the same investment strategy exist (or could exist) and should be allowed? If yes, please give examples.

A) Some share classes may use duration or other hedging in order to suit specific investor needs. We do not believe these fully meet the principle but recommend this would be an allowable investor for sophisticated and institutional investors.

10. Do you agree that the types of share class set out in paragraph 10 above do not comply with the principle of having the same investment strategy? If not, please justify your position.

A) We agree with the exception of currency and duration hedging where clearly states by the issuing firm.

11. Please provide information about which existing UCITS do not comply with the criteria laid down in paragraph 6 as well as an indication of the assets under management and the number of investors of these UCITS.

A) APFI currently does not have this data but encourages identification.

12. Do you see merit in ESMA clarifying how regulatory ratios such as the counterparty risk limit should be calculated (e.g. at the level of the UCITS or share classes)?

A) Yes.

13. Do potential and current investors get adequate information about the characteristics, risks and return of different classes in the same UCITS? If not, what else should be provided to them?

A) A 'ratio of share class variance' of the return and risk of the highest and lowest charging share class should be added to the Key Investor Information Document. This will help better understanding of risk outside of the Synthetic Risk Reward Indicator ('SRRI') which is often quoted only for the primary share class. An indication of total share classes per UCITS/sub-fund and number of share classes closed since fund launch would be useful additional information for the Supplementary Information Document or full prospectus.

14. Do you agree that ESMA should develop a common position on this issue? If not, please justify your position.

A) Yes we agree that ESMA should set a common set of transparent standards, which are fair to the broad universe of investors, including those outside of the EU and help promote competition but not disadvantaging boutique firms versus larger asset companies.

Notes to ESMA, about the APFI:

History

Founded in 2011, the Association of Professional Fund Investors was created by and for its membership. It enables professional fund investors to share ideas, ensure best practices and network with their peers.

Our Aim

APFI is dedicated to the advancement of the interests of professional fund investors and voicing the collective perspective of its members concerning key topics and trends within the global asset management industry.

Our Focus

At its core, APFI serves as a forum for its members to drive the development and the exchange of global best practices in the areas of research, analysis, due diligence and selection of asset management products. APFI seeks to build strong collegiate relationships among its members through a global networking framework. APFI advances the voice and perspective of the professional investor to industry dialogues on product development, regulatory and distribution topics concerning the global asset management industry. For more information go to: www.profundinvestors.com

For and on behalf of the APFI,

Jon 'JB' Beckett, Chartered MCSI

Association of Professional Fund Investors