UCITS ETF
a unique European format

UCITS ETF:

- A unique pan-European "UCITS ETF" label.
- European "Passport" with EU harmonized standards.
- Standardized disclosure documents.
- Strict custody segregation rules.
- Unified retail-oriented fund set of rules: eligible assets, diversification and concentration ratios, counterparty risk limits...
- Governance, risk and conflicts of interests' management to protect investors.

The vast majority of exchange-traded funds managed in the European Union are subject to the common European Community well-known protective Directive 2009/65/EC (UCITS Directive[1]) framework. The UCITS rules apply in the same pan-European harmonized manner to all UCITS ETFs indistinctively, from day one of operation and during their entire life.

A UCITS ETF can be clearly identified by European investors as it uses the identifier "UCITS ETF" as required by ESMA in all EU languages. This identifier is used in the fund's name, pre-contractual (key investor information) document ("KIID"), prospectus, marketing communications and rules of incorporation.

This unique identifier evidences three important features:

- **The vehicle is fundamentally an investment fund** (bearing all the protective features of a fund compared to another type of product such as a Note or a Certificate).
- **The fund is a UCITS** (bearing all the protective features of a common European retail proven framework).
- **The UCITS is in addition traded on exchange under an additional layer of European rules** (as required by ESMA, a UCITS which is not a UCITS ETF as defined in the ESMA's supplementary guidelines[2] is not allowed to use the 'UCITS ETF' identifier nor 'ETF' nor 'exchange-traded fund' terms).

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1) The European Directive 2009/65/EC known as "UCITS Directive" was successively amended, the latest amended Directive being known as of UCITS V Directive 2014/91/EU.

2) ESMAs' Guidelines on ETFs and other UCITS issues.

JUNE 2019

A UCITS ETF is a collective investment fund

A UCITS ETF abides by the common fund rules required by the European UCITS Directive and related texts.

The UCITS is managed by an asset management company that is authorised in its home Member State but following harmonized European rules.

Regarding the fund rules, with the retail investor's protection in mind, the UCITS framework, enriched and tightened throughout the time and since 1985, achieves a unified set of rules, such as, but not limited to:

- strict diversification and concentration limits of the fund's assets
- permitted list of eligible fund's assets with constraints
- limited temporary borrowing not for investment purposes (up to 10% of net assets) and capped global exposure through the use of derivatives (a UCITS global exposure relating to derivative instruments does not exceed the total net value of its portfolio)
- maximum counterparty risk limits
- mandatory segregation of assets held in ring fenced accounts at the fund's designated custodian
- defined asset valuation rules and liquid redemption policy (at least fortnightly)
- governance, risk and conflicts of interests management designed to protect investors
- appropriate and standardized disclosures (standardized documents such as pre-contractual document (KIID), prospectus and statutory documents, annual report…)
- european retail distribution "Passport" with EU harmonized standards and procedures

A UCITS framework consistent and harmonized throughout the EU

- It ensures a same level playing field for all ETF providers[3] (geographical & time consistency); same rules applicable to all at any time, at launch date and on a running basis.
- The "UCITS ETF" forms a well-recognized common European set of rules.
- It allows a clear distinction with other listed products (ETNs, ETCs, ETVs[4], etc.) that bear different risks.
- It has clear rules (eligible assets, diversification), risks control (e.g. counterparty risk), conflicts of interest management, due diligence process, etc.

3) "ETF provider" means the asset management company that is authorized to manage the fund.

4) ETNs - Exchange Traded Notes; ETCs - Exchange Traded Commodities; ETVs - Exchange Traded Vehicles.

- It offers a strong investor's protection: appropriate and standardized level of disclosures, and the possibility for ETF end-investors to exit the fund in case of secondary market disruption (the fund's nature allows for secondary market investors to redeem directly from the ETF in case of secondary market disruption; investors always have the possibility to redeem on the primary market).

- A same regulation applies on both direct and indirect[5] replication ETFs: the efficient portfolio management's use, whether under the form of securities lending activities or a total return swap, is defined by a harmonized set of rules in the ESMAs' Guidelines on ETFs and other UCITS issues.

- ETFs benefit from the UCITS passport, allowing distribution in Europe and listing of a same and single product over multiple market places.

A UCITS ETF is further regulated by the European regulations

- The European regulatory environment encompasses other protective regulatory pieces that apply to UCITS ETFs such as EMIR, SFTR, BMR, MiFID 2[6], etc.

- Under MiFID 2, all ETFs are simple products, no matter the replication method used.

- Index definition: in the European Union, indices used by ETFs are increasingly regulated (by the ESMAs' Guidelines on ETFs and other UCITS issues – the section on financial indices and by the European Benchmarks Regulation 2016/1011 "BMR") guaranteeing essential features like being systematic and rules based with no room for conflict of interests.

A UCITS ETF also benefits from strong listing requirements

- Market makers obligations: strict rules applying (see Euronext regulated market rules for example): they are required to provide a minimum listing time during the trading session, an offer for a minimum size on both buying and selling sides and a maximum bid-offer spread.

- Circuit breakers & corridor around a reference and indicative value (on Euronext regulated market for example the iNAV ensures a maximum level of protection in terms of limited deviation of price from the UCITS's indicative NAV):
    - Indeed, on Euronext regulated market for example, investors benefit from the calculation of an Indicative Net Asset Value (iNAV) based on the underlying index intraday level; the iNAV is calculated and published every 15 seconds. The iNAV

5) Also known as physical and synthetic replications.

6) EMIR - European Market Infrastructure Regulation 648/2012, SFTR - Securities Financing Transactions Regulation 2015/2365, BMR - European Benchmarks Regulation 2016/1011, MiFID 2 - Markets in Financial Instruments Directive 2014/65/EU.

is an important indicator for investors to supervise the evolution of the ETF price on an intraday basis. The iNAV is calculated by an independent provider from the ETF manager.

- Euronext has set maximum ranges around this iNAV and rules for suspension of quotations ('circuit breakers') in case there is a decorrelation between the ETF execution price on the exchange and the iNAV. For example, on Euronext there is a maximum price corridor where the ETF can be traded, otherwise its trading is suspended for investor protection. The boundaries are set to +/- 1.5% for European stocks, +/- 3% for others.

European UCITS ETF retail investors benefit from additional safeguards in case of liquidity issues

- All European ETF providers generally (and whenever the market structure allows it) work with a large and diversified number of APs or other market makers/brokers to avoid dependency to one market maker.

- In addition, under certain exceptional markets conditions and liquidity provisions retail investors may be allowed to redeem their ETF units directly on the primary market with the ETF (see the ESMAs' Guidelines on ETFs and other UCITS issues).

- ETF provider's continuity plan: in the event of a significant reduction in the liquidity of the underlying assets of an index tracked by an ETF, or significant valuation problems linked to lack of liquidity, the ETF has the possibility, justified by the best interest of investors, to be suspended on the primary market. In addition, BMR requires a back-up plan in case there is an issue with the index.

- In France, there is a requirement from the regulator for the ETF providers to prepare an action plan in case there is a default of a counterparty, be it the securities lending counterparty or the swap counterparty.

The Association Française de la Gestion Financière – AFG (French Asset Management Association) represents and promotes the interests of third-party portfolio management professionals. It brings together all asset management players from the discretionary and collective portfolio management segments. These companies manage nearly €4,000 billion in assets and represent one quarter of the asset management market in Continental Europe.

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