UCITS ETF
a unique European format

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UCITS ETF – Key points

- 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

1 - Defining a UCITS ETF

The vast majority of exchange-traded funds managed in the European Union are subject to the common European Union (EU) 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 Information Document – 'KID')[2], prospectus, marketing communications and rules of incorporation.

This unique identifier evidences 3 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 ETF 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[3] is not allowed to use the 'UCITS ETF' identifier nor 'ETF' nor 'exchange-traded fund' terms).

[1] *The European Directive 2009/65/EC known as the 'UCITS Directive'*
[2] *The PRIIPs KID (Key Information Document) replaced the UCITS KIID (Key Investor Information Document) since the January 2023. PRIIPs means 'Packaged Retail Investment and Insurance-based Products' regulation (EU) No 1286/2014*
[3] *'ESMAs' Guidelines on ETFs and other UCITS issues': ESMA/2012/832 dated Dec.17, 2012, and updated in 2014 - ESMA/2014/937*

2 - 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 (KID), prospectus and statutory documents, annual report…),
- European retail distribution 'Passport' with EU harmonized standards and procedures.

3 - UCITS ETFs can be both passively or actively-managed

UCITS ETF is a listed wrapper for UCITS, whether they are index-tracking or actively-managed type of funds.

In addition, the French regulatory framework provides with:

- harmonized listing rules for funds with the other EU markets. The circuit breakers for French regulated markets and MTFs (Multilateral trading Facilities) refer to the rules prevailing on the regulated market[4]
- expanded listing of funds to actively-managed funds[5]
- specific transparency rules attached to active ETFs[6]

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[4] *Decree No. 2023-344 of May 5, 2023, relating to the operating modalities of circuit breaker mechanisms applicable to UCITS and AIF https://www.legifrance.gouv.fr/jorf/id/JORFTEXT000047523918*
[5] *ETF are no longer limited to index-tracking funds (Decree of March 27, 2024), approving modifications to the general regulations (RG) of the Financial Markets Authority (AMF)*
[6] *AMF Recommendation Doc 2024-04 of June 5, 2024*

4 - A UCITS framework consistent and harmonized throughout the EU

The UCITS framework ensures a same level playing field for all ETF providers[7] (geographical and 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[8], etc.) that bear different risks.
- It has clear rules (eligible assets, diversification), risk control (e.g. counterparty risk), conflicts of interest management, due diligence process, etc.
- 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)
- A same regulation applies to both direct and indirect[9] 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.

5 - 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 instruments, markets, distribution and sustainable finance regulations. [10] etc.

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

UCITS ETFs benefit from a common index definition. Indeed, in the European Union, indices used by ETFs are regulated by the ESMAs' 'Guidelines on ETFs and other UCITS issues' (the section on financial indices) guaranteeing essential features like market representativity, rule-based construction, conflict of interests management. The largest indices are also covered by the European Benchmark Regulation 2016/1011 ('BMR').

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[7] *'ETF provider' means the asset management company that is authorized to manage the fund*
[8] *ETNs - Exchange Traded Notes; ETCs - Exchange Traded Commodities; ETVs - Exchange Traded Vehicles*
[9] *Also known as physical (direct) and synthetic (indirect) replications*
[10] *Examples are: 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, SFDR – Sustainable Finance Disclosures Regulation 2019/2088*

6 - 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 for listed funds rely on a general principle of price control based on the general regulated market rules under which the ETF is listed. They protect investors from misprices in volatile markets.
- Circuit breakers and collars around a reference value are designed to ensure the same level of protection as for the underlying assets. If ETF prices deviate from pre-defined thresholds, trading in the ETF is temporarily halted, in order to prevent investors from trading at prices that would misrepresent its fair market value.

Indeed, on Euronext regulated market for example, investors benefit from two layers of safeguards thanks to dynamic and static collars. The dynamic reference price changes throughout the trading day after each trade, with the last traded price becoming the new reference. The static reference price remains the same during all trading session unless it is manually changed by Euronext's Market Operations team. The maximum boundaries are +/-5% for dynamic collars and +/10% for static collars[11].

Thus, ETF's listed price volatility will be limited by these mechanisms around the ETF's reference value. The reference value is determined under the regulated market listing rules. These mechanisms proved their efficiency during recent episodes of extreme market volatility.[12]

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[11] *Euronext Trading Safeguards: https://www.euronext.com/en/for-investors/market-quality/trading-safeguards*
[12] *BIS Bulletin N. 6, 'The recent distress in corporate bond markets: cues from ETFs', Sirio Aramonte and Fernando Avalos, 14 April 2020 - IOSCO report on ETFs 'Findings and observations during Covid-19 induced market stresses, 12 August 2021 - The Federal Reserve of New York, 'The Federal Reserve's Corporate Credit Facilities: Why, How and For Whom', 20 October 2020 - Bank of England 'Interim Financial Stability Report', May 2020 - AMF Statement in the Focus on ETFs of the World Federation of Exchanges, June 2021*