



# UCITS III and Exchange-Traded Funds

**Chances are you've heard of the term "UCITS" or "UCITS III." But what does it really mean, and how does it apply to exchange-traded funds (ETFs)?**

## **What is UCITS III?**

UCITS stands for Undertakings for Collective Investment in Transferable Securities.

UCITS III is the latest version of European Union (EU) regulations governing the creation and distribution of pooled investment funds, including mutual funds and ETFs.

## **Why is UCITS III important?**

UCITS III is a stamp of EU-wide regulatory approval. A UCITS fund listed on one European exchange may be "passport" to and distributed in all other member states. Almost all European ETFs are now structured to comply with UCITS III.

## **Why do ETF providers cross-list funds on different exchanges?**

ETFs are cross-listed on different European exchanges to attract retail flows from within the respective markets—a recognition that cross-border marketability is not as easy as it seems. In addition, some EU member states have imposed additional regulatory requirements on top of the UCITS directive.

## **How is UCITS III different from earlier UCITS requirements?**

UCITS III allows investment in a much wider range of underlying asset classes.

## **What about underlying investments in derivatives?**

These are permissible, up to 100% of net asset value. So swap-based ETFs can be UCITS-compliant.

## **Are ETCs UCITS?**

No. Exchange-traded commodities (ETCs) cannot be UCITS, as they are not funds. In addition, ETCs often represent exposure to a single commodity or commodity group, and so would not comply with the diversification rules.

## **Diversification rules?**

Yes. To be UCITS-compliant, a fund must be suitably diversified. No individual constituent should represent more than 20% of a fund's net asset value, a figure that can be relaxed at the regulator's discretion to 35%. These diversification limits are more stringent than for U.S. ETFs.

## **Should U.S. ETF providers consider applying UCITS guidelines to their own funds?**

That depends on the provider's goals. A fund company looking to cross-list ETFs or establish a presence in Europe may want to build their ETF families around the UCITS guidelines from the start.

## **Is the UCITS stamp relevant in other parts of the world?**

Yes, it is increasingly being recognized worldwide as the mark of a stable, well-regulated investment product. Over 40% of net new UCITS sales are outside the EU, notably in Switzerland, South America and Asia. In Hong Kong, Singapore and Taiwan, for example, more than 70% of authorized investment funds are now UCITS-compliant.