INVERCO REPLY TO ESMA DISCUSSION PAPER ON UCITS EXCHANGE-TRADED FUNDS AND STRUCTURED UCITS

1.- GENERAL COMMENTS

Besides the answers to the individual questions in Section II, certain general comments are included below.

The essence of the collective investment schemes relies on the fact that individual investors trust their savings to a management company, with appropriate knowledge and experience to manage them on a professional basis, that assumes a fiduciary duty to act in the best interest of investors. Therefore, the final investor must understand the features, risks and returns of the product –and the regulatory efforts should be focused on this goal-, but it is not reasonable nor feasible that he/she understands every detail of the management techniques employed by the management company.

According to this premise, the answers to the questionnaire are inspired in the four following remarks:

1. The relevant input to assess the complexity of an instrument should be the complexity for the investor to understand the features, risks and returns of the instrument, rather than the complexity of the portfolio management techniques employed by the manager.
2. All UCITS should remain being considered as non complex. A different issue is that specific features of certain UCITS could recommend to adapt the information to investors, although in any case this approach should be tackled on a case-by case basis, and not by categories such as ETF or structured, because these broad categories put together UCITS with a very different degree of sophistication.
3. Rules in order to ensure more transparency to investors —by means of strengthening and/or clarifying all the information that retail investors must receive— are always welcome. Notwithstanding, provision of information to investors should be limited to relevant, concrete and easy-to-understand issues, avoiding those technical or complex aspects that should not be understood by the average investor.
4. Provision of investment services over UCITS is under MiFID provisions, so it is not appropriate the establishment of distribution measures targeted exclusively to UCITS. The new guidelines should be aimed at reinforce disclosure and best practices and, if distribution and/or warnings are to be set out, their scope should be all products under MiFID framework, not only UCITS. Even more, it should be taken into account that nowadays retail investors are in general better protected from a disclosure and transparency point of view under UCITS, as these products are more regulated than other wrappers.

2.- ANSWERS TO THE QUESTIONNAIRE

<u>**Retailisation of complex products**</u>

1. Do you agree that ESMA should explore possible common approaches to the issue of marketing of synthetic ETFs and structured UCITS to retail investors, including potential limitations on the distribution of certain complex products to retail investors? If not, please give reasons.

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We disagree with the proposal of implementing distribution measures targeted exclusively to UCITS. The new guidelines should be aimed at reinforce disclosure and best practices and, if distribution and/or warnings are to be set out, their scope should be all products under MiFID framework, not only UCITS. Even more, it should be taken into account that nowadays retail investors are in general better protected from a disclosure and transparency point of view under UCITS, as these products are more regulated than other wrappers.

2. Do you think that structured UCITS and other UCITS which employ complex portfolio management techniques should be considered as 'complex'?

The implementation of MiFID implied a classification of financial instruments into two groups, complex and non complex, depending on certain criteria set out in article 19.6 and article 38 of Directive 2006/73 (Level II). The adscription of an instrument to one or both categories determines a different obligations for the entities providing investment services on this instrument, which are stronger in the case of complex instruments.

UCITS have been automatically included in the non complex category under MiFID, because they fulfill all requirements envisaged in art. 38 of the Level 2 MiFID Directive: they are very strictly regulated and very liquid products at prices that are publicly available to market participants and that are either market prices or prices made available, or validated, by valuation systems independent of the issuer, do not involve any liability exceeding the acquisition cost and provide a high degree of investor protection, since UCITS are already subject to a high level of disclosure and to stringent risk management rules. It is worth noting that Key Investor Information Document has turned into the information benchmark by the European Commission in the regulation of other financial instrument targeted to retail investors.

For these reasons, all UCITS should remain being considered as non complex. A different issue is that specific features of certain UCITS could recommend to adapt the information to investors, although in any case this approach should be tackled on a case-by case basis, and not by categories such as ETF or structured, because these broad categories put together UCITS with a very different degree of sophistication.

Which criteria could be used to determine which UCITS should be considered as 'complex'?

Criteria to distinguish complex and non complex instruments are already established in article 38 of Directive 2006/73 and are, in our opinion, appropriate. In case they were amended, the relevant input to assess the complexity of an instrument should be the complexity for the investor to understand the features, risks and returns of the instrument, rather than the complexity of the portfolio management techniques employed by the manager.

3. Do you have any specific suggestions on the measures that should be introduced to avoid inappropriate UCITS being bought by retail investors, such as potential limitations on distribution or issuing of warnings?

See answer to question 1.

4. Do you consider that some of the characteristics of the funds discussed in this paper render them unsuitable for the UCITS label?

No.

5. Are there any issues in terms of systemic risk not yet identified by other international bodies that ESMA should address?

No.

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6. Do you agree that ESMA should give further consideration to the extent to which any of the guidelines agreed for UCITS could be applied to regulated non-UCITS funds established or sold within the European Union? If not, please give reasons.

Regulated non-UCITS funds established or sold within the European Union should be subject to the AIFMD provisions or, in case them fall outside its scope, to their domestic regulations. In addition, in case these funds are marketed to retail investors, MiFID provisions should be applicable.

7. Do you agree that ESMA should also discuss the above mentioned issues with a view of avoiding regulatory gaps that could harm European investors and markets? If not, please give reasons.

Yes.

ETF

8. Do you agree with the proposed approach for UCITS ETFs to use an identifier in their names, fund rules, prospectus and marketing material? If not, please give reasons.

Yes.

9. Do you think that the identifier should further distinguish between synthetic and physical ETFs and actively-managed ETFs?

In the implementation of such proposals, it should be taken into account the principles which inspired the replacement of simplified prospectus by the Key Investor Information Document. Therefore, we consider that inclusion of certain references to concepts like synthetic, physical or actively-managed, amongst others, should be avoided because they are difficult to understand by the average investor.

10. Do you think that the identifier should also be used in the Key Investor Information Document of UCITS ETFs?

Yes.

11. Do you agree with ESMA's analysis of index-tracking issues? If not, please explain your view.

Yes.

12. Do you agree with the policy orientations identified by ESMA for index-tracking issues? If not, please give reasons.

Yes, provided the extra information supplied to the investors leads to a better understanding of the product and excludes excessively technical concepts. Otherwise, investors would be unable to understand the information and the result would be a massive paper-chase of limited value to investors and a considerable overhead for the fund industry. It must be highlighted that this situation was mentioned in the White book as the main reason to replace the simplified prospectus by the Key Investor Information Document.

13. Do you think that the information to be disclosed in the prospectus in relation to index-tracking issues should also be in the Key Investor Information Document of UCITS ETFs?

Yes, in the terms mentioned in answer to question 12.

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14. Are there any other index tracking issues that ESMA should consider?

No.

15. If yes, can you suggest possible actions or safeguards ESMA should adopt?

N/A

16. Do you support the disclosure proposals in relation to underlying exposure, counterparty(ies) and collateral? If not, please give reasons.

Yes. In broad terms, we agree with ESMA proposals regarding clarification and harmonization of the requirements that ETF should comply with regarding underlying exposure, counterparties and collateral, as far as these proposals will improve the level playing field of all ETF under the scope of UCITS Directive, irrespective of their home Member state. Notwithstanding, the implementation of these proposals should not rest flexibility to the normal operating of these vehicles.

17. For synthetic index-tracking UCITS ETFs, do you agree that provisions on the quality and the type of assets constituting the collateral should be further developed? In particular, should there be a requirement for the quality and type of assets constituting the collateral to match more closely the relevant index? Please provide reasons for your view.

We consider that additional guidelines should be issued regarding the type of assets eligible as collateral and their quality, but these guidelines should be aimed to harmonize the level playing field across Europe, rather than to set stringent and demanding requirements which could rest flexibility to their normal operating. In this sense, we consider that it is not necessary a closer match between the quality and type of assets constituting the collateral and the relevant index, as these assets are not investments, but just collaterals.

18. In particular, do you think that the collateral received by synthetic ETFs should comply with UCITS diversification rules? Please give reasons for your view.

No, collateral received by synthetic ETF should be diversified to a certain extent, in order to avoid unduly concentration in case they should be executed, but these limits should not be so stringent and demanding as those UCITS portfolios have to comply with, because such assets are not investments, but just collaterals

<u>Securities lending activities</u>

19. Do you agree with ESMA's analysis of the issues raised by securities lending activities? If not, please give reasons.

Yes.

20. Do you support the policy orientations identified by ESMA? If not, please give reasons.

Yes, although provision of information to investors should be limited to relevant, concrete and easy-to-understand issues, avoiding those technical or complex aspects that should not be understood by the average investor.

21.Concerning collateral received in the context of securities lending activities, do you think that further safeguards than the set of principles described above should be introduced? If yes, please specify.

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No.

22. Do you support the proposal to apply the collateral criteria for OTC derivatives set out in CESR's Guidelines on Risk Measurement to securities lending collateral? If not, please give reasons.

Yes.

23. Do you consider that ESMA should set a limit on the amount of a UCITS portfolio which can be lent as part of securities lending transactions?

Although it does not seem necessary to set a limit, in case of being established it should be high enough, for example, 75% of the UCITS portfolio.

24.Are there any other issues in relation of securities lending activities that ESMA should consider?

No.

25. If yes, can you suggest possible actions or safeguards ESMA should adopt?

N/A.

<u>**Actively managed UCITS ETFs**</u>

26. Do you agree with ESMA proposed policy orientations for actively managed UCITS ETFs? If not, please give reasons.

See answer to question 20.

27. Are there any other issues in relation to actively managed UCITS ETFs that ESMA should consider?

No.

28. If yes, can you suggest possible actions or safeguards ESMA should adopt?

No.

<u>**Leveraged UCITS ETFs**</u>

29.Do you agree with ESMA analysis of the issues raised by leveraged UCITS ETFs? If not, please give reasons.

Yes.

30.Do you support the policy orientations identified by ESMA? If not, please give reasons.

See answer to question 20.

31.Are there any other issues in relation leveraged UCITS ETFs that ESMA should consider?

No.

32. If yes, can you suggest possible actions or safeguards ESMA should adopt?

N/A

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Secondary market investors

33. Do you support the policy orientations identified by ESMA? If not, please give reasons.

Yes, except for the comments on answer 36.

34.Are there any other issues in relation to secondary market investors that ESMA should consider?

No.

35. If yes, can you suggest possible actions or safeguards ESMA should adopt?

N/A

36. In particular, do you think that secondary market investors should have a right to request direct redemption of their units from the UCITS ETF?

No. As the main advantage of an ETF compared to a traditional index Fund is the possibility of buying and selling their units through a secondary market, we consider that direct redemption of their units from the UCITS ETF should not be a right of investors, and, at the most, it should be confined to those situations whereby market makers could not provide liquidity what, at least in the Spanish regulations, are exceptional, because market makers assume stringent and demanding requirements that can only be exonerated with the prior authorization of CNMV.

37. If yes, should this right be limited to circumstances where market makers are no longer providing liquidity in the units of the ETF?

See answer to question 36.

38. How can ETFs which are UCITS ensure that the stock exchange value of their units do not differ significantly from the net asset value per share?

Spanish regulation envisages the existence of entities which assume the commitment to offer bid and offer prices, within a maximum price range, with the goal to align the stock exchange value with the net asset value per unit.

Structured UCITS- Total Return Swaps

39.Do you agree with ESMA analysis of the issues raised by the use of total return swaps by UCITS? If not, please give reasons.

Yes.

40. Do you support the policy orientations identified by ESMA? If not, please give reasons.

As previously mentioned, we support the ESMA's initiative to set new guidelines in order to establish a policy of full disclosure in relation to the investments of Structured UCITS, since it will be beneficial for both investors and the asset management industry in general (these measures strengthen the role of asset managers and their fiduciary duties by preventing its transfer to the derivative counterparties without adequate controls, procedures and disclosure).

On other hand, though we agree that Structured UCITS must comply with the diversification requirements of the UCITS Directive in relation to their investment portfolio in general, we consider that UCITS should not be required to comply with these rules in relation to the exposure to the underlying assets because:

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- Taking into account that these UCITS are structured to achieve at maturity a pre-defined pay-off, investors should be already duly protected by means of a full disclosure of the investment strategy and pay-off objective.
- Most attractive structures linked to baskets are structured including very few components (otherwise, the structures are not economically feasible), so if this proposal is eventually adopted asset managers shall not be able to launch Structured UCITS whose pre-defined pay-off is linked to a basket of shares, for example (which means a great portion of our structured funds).
- Since there are no restrictions to launch these structured products under other wrappers (such as notes or deposits), this would be prejudicial not only to the asset management industry (from the point of view of competition with other sectors of the financial industry), but also —and logically— to investors, as they would have only access to these structures through wrappers not as regulated as the UCITS are.

41.Are there any other issues in relation to the use of total return swaps by UCITS that ESMA should consider?

No.

42. If yes, can you suggest possible actions or safeguards ESMA should adopt?

N/A

<u>Structured UCITS- Strategy indices</u>

43. Do you agree with ESMA's policy orientations on strategy indices? If not, please give reasons.

Any initiative in order to strengthen and clarify the rules to be met by an index in order to be defined as a financial index, as well as to ensure compliance with them is welcome, especially taking into account the proliferation of strategy indices. We consider the proposed policy orientations are in the right direction.

44. How can an index of interest rates or FX rates comply with the diversification requirements?

In our opinion, it is not possible an index of interest rates or FX rates complies with the diversification requirements defined in the Directive, as such requirements are referred to individual issuers and index of interest rates or FX rates are not referred to any particular issuer.

45.Are there any other issues in relation to the use of total return swaps by UCITS that ESMA should consider?

No.

46. If yes, can you suggest possible actions or safeguards ESMA should adopt?

N/A.

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