

AMUNDI reply to ESMA Discussion Paper

“ESMA’S policy orientations on guidelines for UCITS Exchange-Traded Funds and Structured UCITS”

Amundi is grateful for the opportunity to comment ESMA’s consultation on ETF and Structured UCITS.

Before giving a reply to each of the questions of the consultation, we would like to stress on three major points:

1. With regard to **complexity of products**, we believe it very important to make a clear distinction between the elaboration of a structured product, which may be quite complex, and what the investor needs to understand in order to get a good appreciation of the risks of the product and of the perspective of pay off. The understanding of how the product has been elaborated and the internal risk of such an elaboration could be a matter the regulator has to cope with when the visa is granted for the product. It cannot be a concern for the investor. This point is of main importance because many structured funds are less risky than other classical funds and do not present any difficulty of understanding in term of final pay off. In this respect, the AMF Position (dated 15th October 2010) was very clear.
2. **ETF** : a comprehensive and accurate analysis of the mechanism of synthetic replication achieved by our Risk Management teams, and the discussion we have conduct with AMF on this topic has confirmed our conviction that no systemic risk would result from the development of synthetic replication and that counterparty risks are not greater with synthetic ETF than with physical ETF. For the same reason explained above, it would be very detrimental for synthetic ETF to be marketed as “synthetic” if we take into account the negative impact such an adjective may have on investors.
3. **The level playing field** with other structured products which are not in the UCITS or AIFM directive fields is another major issue that we want to point out. We hope that the PRIPS directive will be rapidly enforced in order to restore a fair competition between financial actors.

II - General policy discussion (retailisation of complex products & financial stability and systemic risk)

Q1. 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.

Synthetic ETFs and structured UCITS are regulated under **UCITS rules**, which provide a strong European regulatory framework. As such, they are subject to the same requirements and constraints as other UCITS. Consequently, there should be no limitation on the distribution of synthetic ETFs and structured UCITS to retail investors.

Unlike other UCITS funds, synthetic ETFs must also comply with a second set of rules (the **'listing rules'**), including the obligation to calculate and publish an indicative NAV, spread limits and minimal bid/ask spreads, and the need to have several market makers. The two sets of rules ('regulatory' and 'listing') impose very detailed requirements on the investment product itself and provide a high level of investor protection.

We think that before considering limitations on the distribution of certain UCITS, **regulators should first regulate other less regulated products like ETN and structured notes. A regulatory level playing field (as defined in the PRIIPs initiative) should be pursued to prevent less regulated products from replacing more regulated ones in distribution channels, which is already the trend in the market.**

Q2. Do you think that structured UCITS and other UCITS which employ complex portfolio management techniques should be considered as 'complex'? Which criteria could be used to determine which UCITS should be considered as 'complex'?

1. **No.** If we were to apply such reasoning to the motor industry, should we conclude that a car with a complex engine is not safe for drivers?
2. From a general point of view, we do believe that a distinction has to be made between the financial product structure (i.e. portfolio management technique) and its payoff. From a retail point of view, complexity is linked to the risks borne by investors and the degree of protection offered. Therefore it is much more closely linked to the fund's payoff than to its financial structure, especially as the fund's structure is well regulated under UCITS rules.

Put another way, investors have to understand both the UCITS' return objectives and risks factors, but they do not need to understand the techniques employed. It is the investment manager's duty to select appropriate techniques to achieve the risk-return objectives of the UCITS.

3. Given this prerequisite there are two possibilities: a) either the MiFID framework is not reviewed and kept as it is today, b) or it is changed to make a distinction between 'complex' and 'non complex' UCITS. In both cases the answer to the Q2 section is clearly 'No' but some clarifications must be made:

- a. No review of current MiFID rules: if some of the UCITS were categorised as 'complex' under MiFID requirements in the current MiFID framework, they would belong to the same category as other financial products such as ETVs (Exchange Traded Vehicles), ETCs (Exchange Traded Commodities) and ETNs (Exchange Traded Notes), which are already 'complex' products under MiFID. In terms of distribution, they would be viewed from the same perspective with the same set of distribution constraints.

Although they look similar to UCITS from a financial point of view, their legal form is completely different. It appears that these financial instruments – such as Notes or Certificates – are far less regulated than UCITS (no diversification rules, issuer risk, no counterparty risk limit, lack of independent valuation, lack of best execution requirements, no auditor nor custodian).

Having 'complex' UCITS in this context would remove visibility from a retail point of view. Also, having Notes, Certificates and UCITS in the same category would be very harmful for investors since it would encourage financial agents and markets to create and develop those less-regulated financial products. **This encourages a strict distinction among PRIPs, i.e. between UCITS (which are already very well regulated) and other listed products (such as the other ETPs) that are not UCITS.**

- b. MiFID rules are reviewed and some UCITS may be 'complex': then **'complex' UCITS must be the more sophisticated UCITS products. As we said above, products' 'complexity' should not be linked to the portfolio management technique (nor the financial instruments used in the portfolio) but to the products' payoff itself** (for example, hedge fund UCITS or leveraged/short UCITS could be 'complex' while other UCITS tracking 'vanilla' market indices would not) and to the level and transparency of risk.

In those cases **the 'complex' definition should apply not to a broad category of UCITS products as a whole**, but on a case by case basis, i.e. to specific funds as AMF suggested in its "Position" on complex products of the 15th of October. **The fact that an ETF is listed on an exchange should not be a determining factor in whether it is deemed 'complex'.** We may have 'simple' ETFs (such as ETFs based on well known indices) and 'complex' ETFs (such as ETFs based on hedge fund indices).

4. In all cases it is important to underline that:
 - a. **ESMA should provide strict definitions and guidelines on which UCITS would be classified as ‘complex’**
 - b. **any limitation on retail distribution should strictly apply through MiFID rules, i.e. using the four criteria established by MiFID, and more specifically through suitability and appropriateness tests.**

Q3. 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?

We believe that UCITS are suitable for retail investors.

Nevertheless, should a new category of ‘complex’ UCITS be created, **we would clearly favour a system of warnings and disclosures (related to the fund’s portfolio technique, strategies and risks) over strict limitations on distribution.**

To restrict the marketing of those ‘complex’ products, a threshold (minimum amount in euro for subscriptions) could be put in place. Having a ‘complex’ category would allow wealthy investors to invest in those products while preventing mass retail distribution (i.e. with distribution limitations). The key element to distinguish between the two categories would be the assumed investor’s ability to understand the product and its risk/return profile. **In terms of distribution limitations, ESMA should clearly establish the different categories of investors and issue guidelines.**

Q4. Do you consider that some of the characteristics of the funds discussed in this paper render them unsuitable for the UCITS label?

No, we do not consider that some of the characteristics of the funds discussed in this paper render them unsuitable for the UCITS label. Like all other UCITS, structured UCITS are subject to a strong regulatory framework: the same European standards apply (same set of requirements, constraints and disclosure rules) and are at the heart of strong retail investor protection.

ETFs provide valuable features for retail investors because they are simple (index tracking and passive), transparent (index tracking and real time pricing), liquid (intra-day liquidity and several market makers) and low cost products whether based on physical or synthetic replication. Today, ETFs are probably among the most transparent products in the savings industry in terms of the disclosure of funds assets.

It is important to emphasize that restricting the UCITS framework would be very harmful for investors and would encourage financial agents and markets to favour less-regulated financial products.

Q5. Are there any issues in terms of systemic risk not yet identified by other international bodies that ESMA should address?

From our point of view there are no additional issues in terms of systemic risk that ESMA should address.

Q6. 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.

Any distribution rules should apply under the MiFID framework. In this context, it is extremely important that ESMA should emphasize the following:

- making appropriate distinction between European ETFs that are UCITS and those that are not subject to such detailed regulation
- making appropriate distinction between UCITS ETFs and other similar non-funds products such as exchange traded products which provide much less investor protection and transparency
- improving the understanding of these distinctions among investors and the public

Special attention should be given to US-based ETFs that are marketed and distributed in Europe through private placement, for example, or to retail clients via a listing on Euronext Amsterdam. These funds are not regulated like UCITS (being more risky with active management, higher leverage etc.) and are much less protective than other European UCITS ETFs.

The UCITS guidelines and label should therefore be preserved. **We encourage ESMA to keep the 'ETF' name for European UCITS ETFs only.** This would allow for a clear distinction between European ETFs and other regulated non-UCITS ETFs.

Q7. Do you agree that ESMA should also discuss the above-mentioned issues with a view to avoiding regulatory gaps that could harm European investors and markets? If not, please give reasons.

Yes. Regulatory gaps harm European investors and markets. Those gaps are increasing over time and **it appears that UCITS (which are already very well regulated) are getting more and more regulated while other financial products (such as notes) are not. This contradicts the PRIIPs initiative.**

ETFs are often confused with other ETPs (such as ETNs, ETCs and ETVs) yet the features of these products and the underlying risks for investors are different. We strongly encourage ESMA to clarify the situation and make appropriate and clear distinctions between these products, in terms of both regulatory frameworks and distribution among retail investors. Investors should naturally understand that the highest level of protection is achieved with UCITS rather than with other financial products.

As stated above, ESMA should also target non-European funds that are already widely sold in Europe through private placement or listings and will soon fall within the scope of the AIFM Directive.

III – Exchange Traded Funds

III.1 Title

Q8. 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.

We fully agree with the proposal to use an identifier such as 'ETF' in the UCITS ETF name. The identifier 'Exchange-Traded Fund' would certainly be too long and would make ETF providers remove other very important ETF characteristics from the fund's name, having a detrimental effect on investor information.

This 'ETF label' has to be well defined and protected. It should be used exclusively for index-tracking, listed and actively traded UCITS funds. Such a rule would be equivalent to the one currently applied to 'Money Market Funds'.

To carry the 'ETF' name a fund would need to comply with strict rules, such as:

- **being a UCITS fund**
- **being a passive listed product, with a transparent index and systematic, non discretionary management rules**
- **being 'actively traded' on a regulated European exchange;** this would require having at least one market maker acting on this regulated market / exchange, and complying with the three obligations of a market maker: offering a minimum size on the ETF trading, with maximum spreads and during a minimum of time presence
- **for non-UCITS ETFs marketed in Europe, only funds that are equivalent to European UCITS ETFs (similar regulatory rules and actively traded on at least one regulated securities market) could use the 'ETF' label;** US-based ETFs or specific Swiss commodities ETFs could not be sold in Europe using the 'ETF' acronym. Going forward, MiFID rules and disclosures in terms of distribution should be reviewed to enable better regulation
- **having regulators' authorization to use the 'ETF' acronym.**

It is also extremely important to distinguish between ETFs and other ETPs (Exchanged Traded Products that are not funds) as the risk of confusion between each category is currently very high. Although they appear similar from a financial point of view (all are listed on an exchange), they are

different in terms of legal structure (UCITS funds versus investment banks' Notes or Certificates) and underlying risks. These Notes and Certificates are far more risky than UCITS ETFs: issuer risk, lack of independent valuation, no diversification requirements nor counterparty risk limit, no depositary nor auditor.

Lastly, companies and other entities could not use the 'ETF' label in their name (ETFS) or in any other financial product (like Exchanged Traded Futures, which are another class of non regulated ETPs) that do not comply with the requirements listed above.

Q9. Do you think that the identifier should further distinguish between synthetic and physical ETFs and actively-managed ETFs?

We do not agree with the proposed approach to use an identifier in the UCITS ETFs name that would distinguish between synthetic and physical ETFs for the following reasons:

- **Physical and synthetic ETFs are now UCITS funds** and as such must comply with the same regulatory constraints. Adding an identifier would be a very discriminating measure, bringing perceptions into clients' investment policies
- **An identifier in the ETF name would not add any relevant information in terms of exposure, performance, tracking error or risks** compared with the information stated in the fund's KIID and prospectus. Investors may have different constraints or expectations and should therefore be able to make their own investment analysis and choose ETFs with full knowledge of the performance and underlying risks
- **An identifier would widen the ETF name**; the main objective of the ETF name is to quickly identify the index tracked rather than the ETF replication method. Given that ETF names are already quite long enough, one can imagine that in order to comply with fund database constraints, ETFs providers would have to remove some current relevant information from the name to keep it within an acceptable length. Adding the identifier would be at the expense of overall product clarity
- **It is harmful for the investor to require a fixed identifier on one type of replication.** If market conditions so require, then in the best interests of funds' unitholders we should allow UCITS ETFs:
 1. to switch from one replication technique (i.e. portfolio management) to the other,
 2. to use both replication techniques at the same time (i.e. 90% of the underlying Index owned by the fund through physical replication or unfunded swap structure and the remaining 10% of the index gained through a funded swap structure)

What rules, portfolio management techniques and thresholds (% of the underlying index owned by the funds) would determine into which of the two categories ETFs are placed? This

may be a hard task. Let us give the following examples: a 'physical' ETF that uses sampling replication and owns 'only' 70% of the index; a 'swap-based ETF' that owns more than 90% of the index through an unfunded swap

- If an identifier is required for synthetic ETFs, a similar identifier should also be required for physical ETFs that carry risks: counterparty risk through securities lending and tracking error risk through sampling replication, for example. We could therefore submit the following **identifiers: 'swap-based ETF' (for synthetic ETF) and 'full -or sampling- replication with share lending ETF'**.
- Requiring an identifier only for synthetic ETFs would be unfair and totally misleading in terms of risks communicated to investors

There should be an identifier to distinguish between tracker ETFs and 'actively-managed ETFs'.

Although actively-managed ETFs are traded on an exchange, the listing should not allow them to use the 'ETF label': they have a different payoff profile from other listed ETFs, they are not index trackers (c.f. section Q38) and from an investor perspective they introduce complexity and increase the likelihood of misunderstanding products.

Let us give two examples of the issues arising from an actively-managed ETF:

- Issues regarding the underlying index itself (if this is defined according to an active strategy): when an underlying benchmark is disclosed, some of the main features of a UCITS index may be not respected in an actively-managed ETF, for example the underlying index may not be representative of its market or a non-systematic methodology may be used.
- Issues regarding the performance of the ETF: the payoff of an actively-managed ETF can differ significantly from the defined underlying benchmark (with possible high tracking error).

We recommend using an identifier for an actively-managed ETF to make a clear distinction from tracker ETFs. This identifier could, for example, be 'AMT' ('Actively-Managed Traded' product).

Lastly, other UCITS that use derivatives and securities lending techniques would not have these labelling constraints, meaning these new requirements would lead to discrepancies in funds naming policies and to a key selling issue for ETFs (competitive disadvantage).

Q10. Do you think that the identifier should also be used in the Key Investor Information Document of UCITS ETFs?

We think it would be appropriate to include the main characteristics of the ETFs prominently in the KIID:

1. First, the description of the index being tracked. This is obviously the most important matter for the investor.

2. Then, the information concerning the replication method (synthetic – unfunded or funded, physical – full or sampling) and a full description of the counterparty risks.
3. The expected tracking error.
4. The securities lending policy (for all UCITS).

III.II Index Tracking Issues

Q11. Do you agree with ESMA's analysis of index-tracking issues? If not, please explain your view.

We agree with ESMA's analysis of index-tracking issues except on item #23 as the issue raised is not specific to synthetic replication.

Dividend re-investment and dividend tax issues apply to both synthetic and physical ETFs, and may lead to tracking error.

In French ETF prospectuses, the maximum limit on tracking error allowed under European regulations has to be disclosed. In addition to this maximum limit we could also disclose a 'tracking error objective': this would allow UCITS ETFs to give more accurate tracking error data to investors as the expected tracking error figures for these funds are generally below the current limit disclosed in fund prospectuses.

Incidentally, please note that the first sentence of #21 contains an error: **the tracking error is the standard deviation of the distance, not the distance itself**. It is particularly important to stress this as the concepts are very often confused in marketing documents, reports and other communications to clients. ESMA should restrict the use the term "tracking error". Indeed, performance differences and tracking error data are both important for clients. They do not refer to the same thing but are complementary; they help investors in comparing indexed funds with their benchmarks. Both are key factors in ETFs quality appraisal.

More generally, **we encourage ESMA to establish and publish a clear tracking error formula** (i.e. the mathematical formula) **applicable to all indexed funds** so as to:

- avoid any confusion between the performance gap (which is a 'distance' between the index and the ETF) and the tracking error (which is the standard deviation of the distance)
- harmonize tracking error calculations across Europe (some asset managers calculate the tracking error using the data on one specific weekday while other use a weekly average)
- allow for a comparison of tracking error between European index tracking funds

Index-tracking issues are not specific to ETFs but to all indexed UCITS such as actively-managed and non-indexed funds.

Q12. Do you agree with the policy orientations identified by ESMA for index-tracking issues? If not, please give reasons.

We agree with the policy orientations identified by ESMA for index-tracking issues and the information to be produced in the UCITS ETF legal documentation.

French UCITS funds already comply with the stated requirements.

Q13. 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?

We 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.

The Key Investor Information Documents of UCITS ETFs currently give a clear and concise description of the index.

As already mentioned above in section Q10, it is important that additional information should respect the intrinsic purposes of the KIID, giving short and intelligible information to retail investors.

Q14. Are there any other index tracking issues that ESMA should consider?

Regarding tracking issues we could suggest the following points for all UCITS ETFs:

- **Establish a tracking error formula and require this same formula to be used for all funds so that comparisons can be made between ETFs**
- Create an obligation to disclose ex-post tracking error data (e.g. the tracking error over the past three years) in annual reports so that comparisons can be made between European jurisdictions
- **Define ‘indexed fund’: within a tracking error limitation range a fund would be an ‘indexed fund’ while above the limit it would become an ‘actively-managed fund’ (a limit of 1% or 2% could be reasonable)**
- Create an obligation to disclose the expected tracking error in the KIID.

Q15. If yes, can you suggest possible actions or safeguards ESMA should adopt?

See above

III. III Synthetic ETFs – Counterparty risk

Q16. Do you support the disclosure proposals in relation to underlying exposure, counterparty(ies) and collateral? If not, please give reasons.

Regarding the legal documentation of the fund, we agree with the disclosure proposal relating to underlying exposure, counterparties and collateral. ETF investors should obviously be informed about the replication method (physical – sampling or full, versus synthetic – funded or unfunded), the securities lending policy and the use of collateral.

Provided that the disclosure requirements would be the same for all UCITS using derivatives or lending securities, we fully agree with this proposal.

Q17. For synthetic index-tracking 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 closely the relevant index? Please provide reasons for your view.

We think that **as long as fund assets comply with liquidity, valuation, issuer credit quality and diversification constraints, it is not necessary to have a special requirement for the quality and type of assets constituting the collateral to match closely the relevant index.**

However, if further developments were to be required for synthetic ETFs we could impose the following portfolio management rules on the type of assets: equities for equity ETFs; bonds and other money market instruments for fixed income, commodities and money market ETFs. This would place the ETF in the same asset category as the index's underlying.

Collateral definitions and constraints are already very clear in Box 26 of CESR' Guidelines on Risk Measurement (this provides guidelines in terms of qualitative requirements such as liquidity, valuation and issuer quality). There is no need to refine these constraints or perfectly adequate guidelines any further.

Q18. 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 should not be subject to UCITS diversification rules. Diversification requirements within synthetic ETFs would bring additional and inappropriate costs compared to physical replication: synthetic ETFs would incur the costs of the swap-counterparty guarantee *and* diversification rules while physical ETFs would incur only those costs resulting from diversification rules.

As explained above, Box 26 of CESR' Guidelines on Risk Measurement already introduce qualitative requirements on collateral diversification.

Moreover, collateral diversification rules and UCITS fund assets diversification rules pursue two distinct objectives: the primary aim of the former is to reduce counterparty risks while the purpose of the latter is to diversify the exposures in the fund's assets (minimum number of securities preventing 'concentration' of the investment). In this respect, collateral quality is more important than diversification.

As stated above, any proposal regarding collateral and counterparty risk should apply to all UCITS and not specifically to swap-based ETFs).

III. IV Securities lending activities

Q19. Do you agree with ESMA's analysis of the issues raised by securities lending activities? If not, please give reasons.

We agree with ESMA's analysis of the issues raised by securities lending activities.

Q20. Do you support the policy orientations identified by ESMA? If not, please give reasons.

As mentioned above, provided the disclosure requirements are the same for all UCITS ETFs using derivatives or lending securities, we fully agree with this proposal.

We strongly encourage ESMA to require the same level of disclosures for all over-the-counter transactions (including both derivatives and securities lending). This would bring transparency to the funds' cost structure.

In French prospectuses, there is already a requirement to mention the fee sharing arrangements on securities lending.

Above all, it would make sense for any collateral disclosure requirement on securities lending to be the same as that on Synthetic ETFs.

Q21. 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.

We do not see any need for the introduction of safeguards beyond those listed by ESMA.

Q22. Do you support the proposed 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.

We agree with the proposal.

Q23. 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?

We consider that **at this stage there is no need to limit the amount of a UCITS portfolio which can be lent as part of securities lending transactions.** This is neither necessary nor appropriate. Moreover, it would be detrimental to investors as it could reduce the fund's performance.

Q24. Are there any other issues in relation of securities lending activities that ESMA should consider?

From our point of view, **it is important to include a requirement that the fund's prospectus should mention the fee sharing arrangements in relation to securities lending.**

Q25. If yes, can you suggest possible actions or safeguards ESMA should adopt?

NA

III. V Actively-managed UCITS ETFs

Q26. Do you agree with ESMA's proposed policy orientations for actively managed UCITS ETFs? If not, please give reasons.

We agree with ESMA's proposed policy orientations for actively managed UCITS ETFs.

Q27. Are there any other issues in relation to actively managed UCITS ETFs that ESMA should consider?

Actively managed ETFs are justifiable provided that they are 'real' ETFs as we defined above, i.e. they are 'actively traded' on one regulated European market.

Today, however, **European ETFs are mostly passive products that comply with UCITS rules.**

In other jurisdictions such as the United States, 'active ETFs' are allowed; the 'ETF' wrapper complies with US tax requirements rather than regulatory guidelines. Therefore it is extremely important for ESMA to:

- make sure that these 'active ETFs' comply with the ETF label requirements and can therefore keep their terminology when marketed and distributed in Europe
- keep and level regulatory and distribution playing field between European UCITS ETFs and other ETFs.

Q28. If yes, can you suggest possible actions or safeguards ESMA should adopt?

The 'active managing' strategy has to be specified. From our point of view it should be possible to have listed 'active ETFs' as long as investors can easily identify these products; **they must use terminology different from that of other UCITS ETFs** (as explained above, using an identifier such as

‘AMT’) and publish both underlying risks and fund rules in a clear way so as to avoid any confusion with other UCITS ETFs. Moreover, **they should be listed on a different stock exchange segment to other ‘passive index-tracking’ UCITS ETFs.**

UCITS ETFs using the ETF ‘label’ must remain passive listed products, with a transparent index that follows systematic and non discretionary managing rules.

As explained above, the ‘ETF label’ has to be protected. It should be used exclusively for index-tracking, listed and actively traded UCITS funds. To carry the ‘ETF’ name a fund would need to have at least one market maker acting on a regulated market / exchange, and complying with the three obligations of a market maker: offering a minimum size on the ETF trading, with maximum spreads and during a minimum of time presence. This would allow the fund to have real liquidity on the exchange.

For those listed funds that do not comply with the three market making obligations, use of the ‘ETF’ label should not be possible.

III. VI Leveraged UCITS ETFs

Q29. Do you agree with ESMA’s analysis of the issues raised by leveraged UCITS ETFs? If not, please give reasons.

We agree with ESMA’s analysis of the issues raised by leveraged UCITS ETFs.

As a reminder, under UCITS regulations only a leverage of 2 is allowed.

Q30. Do you support the policy orientations identified by ESMA? If not, please give reasons.

We fully support the policy orientations identified by ESMA.

Q31. Are there any other issues in relation to leveraged UCITS ETFs that ESMA should consider?

We do not see any other issue in relation to leveraged UCITS ETFs that ESMA should consider.

Q32. If yes, can you suggest possible actions or safeguards ESMA should adopt?

NA

III. VII Secondary market investors

Q33. Do you support the policy orientations identified by ESMA? If not, please give reasons.

We agree with the policy orientations identified by ESMA.

Q34. Are there any other issues in relation to secondary market investors that ESMA should consider?

We do not see any further issue raised in relation to secondary market investors.

Q35. If yes, can you suggest possible actions or safeguards ESMA should adopt?

NA

Q36. In particular, do you think that secondary market investors should have a right to request direct redemption of their units from the UCITS ETFs?

Firstly, it must be remembered that primary access to the primary market is a UCITS requirement. The terms on which subscription/redemption orders are placed directly with the fund are subject to the laws of the fund's home country, and to the rules in the fund's prospectus. In particular, France currently allows direct orders from non market makers. As stated in the prospectus, entry/exit fees (expressed in EUR or as a percentage of the amount traded) can be charged by the management company to the investor. The level of fees applied is at the discretion of the management company.

So in theory all investors are allowed to place subscription/redemption orders for a French UCITS ETF. In practice, only Authorized Participants (i.e. market makers) do not incur entry/exit fees. **The aim of this is to direct orders to the secondary market in order to increase ETF liquidity, reduce the number of primary market trades on the fund** (trades that would generate transaction and hedging operational costs for the fund) **and protect ETF performance.**

Furthermore, the European clearing system is not suited to retail. From an operational point of view it is important to draw a parallel between UCITS ETFs and other UCITS in terms of retail distribution. The roles of market maker (for UCITS ETFs) and distributor (for other UCITS) are similar in the sense that both act as 'trades centralizing agents'. For UCITS ETFs, retail investors do not have direct access to custodians' accounts, while Paying Agents and Transfer Agents have no involvement in the ETF distribution process overseas (orders are placed directly through the exchange and do not go through these 'trades centralizing agents'). Given these constraints, **it seems complicated and time-consuming from an operational point of view to allow direct orders from retail investors.**

Nevertheless, under exceptional circumstances both retail and institutional investors should be able to place their trades on the primary market provided that they pay subscription/redemption fees. These will cover the operational costs of the fund's hedging (like any other non ETF UCITS fund). The subscription/redemption order would be executed at NAV.

Q37. If yes, should this right be limited to circumstances where market makers are no longer providing liquidity in the units of the UCITS ETF?

Exceptional circumstances should include those cases where the secondary market would not function properly but there would be no dysfunction on other markets (i.e. primary and underlying

index markets). In order to accept direct redemptions from investors, the UCITS ETF must be able to trade the underlying hedging on the index's dedicated markets. If the fund is unable to hedge its position (by adjusting the OTC derivatives, substitute basket or collateral assets), then no direct orders could be allowed.

Events affecting the secondary market could, for example, include the absence of any market maker for a specific ETF.

Q38. How can ETFs which are UCITS ensure that the secondary market value of their units does not differ significantly from the net asset value per unit?

On item #47 it must be noted that the ETF's official NAV differs from the real-time price of the listed product: ETF prices are determined by all market makers on the secondary market and follow changes in the underlying market; the official NAV is the ETF price at a very specific moment during the day when the NAV is calculated (close or fixing etc.). Therefore ETFs cannot 'ensure' that the secondary market value of their units does not differ significantly from the NAV.

Investors can ensure that the secondary market value of a UCITS ETF does not differ significantly from its net asset value per unit by using the Indicative Net Asset Value (iNAV).

The iNAV is the fund's real-time theoretical market value at a given moment, used as a reference price by market makers and day traders. The iNAV is published by the stock exchange operator throughout trading hours on every day on which the fund's NAV can be calculated and published.

The price of a unit traded in the secondary market depends on supply and demand and roughly matches the indicative NAV.

The secondary market is provided by "market makers" acting as market counterparties. They contract with concerned market companies so as to maintain the difference between the highest bid and lowest offer prices within a set range. Their activities ensure that trading in fund units remains liquid. They also ensure, through arbitrage between the primary and secondary markets, that the fund's listed market price does not diverge significantly from its iNAV.

On Euronext, for example, the iNAV is published every 15 seconds throughout the Paris trading session (09:05 – 17:40). For indices covering European underlying, reservation thresholds are set to give a range of 1.5% either side of the fund units' iNAV as published by Euronext Paris SA (3.0% for all other geographical zones).

The iNAV data and thresholds described above are good indicators and safeguards. However, some European stock exchanges (such as the London Stock Exchange) do not publish iNAV since it is not one of their listing rules.

In this respect, harmonisation of stock exchange listing rules would be beneficial and would improve investor information and protection.

Proposals to improve UCITS ETFs legal documentation

Broadly speaking, it is important to distinguish between synthetic, physical and actively managed products in the fund's legal documentation (prospectus) and marketing material. The description of the fund's investment policy and rules, assets used, tracking error, underlying risks and any other information relevant to the ETF structure should provide investors with the necessary information.

A clear description of product features in the legal documentation will be of greater benefit to investors than an abstract wording. Both the KIID and the prospectus should contain this information. The KIID should, for example, include:

- The replication method: full replication (full or sampling) / swap-based (funded or unfunded)
- Whether a strategy is used: leverage/short/other and if 'other' then details of the underlying strategy
- The Reuters and Bloomberg codes of the underlying index
- Information about disclosure of the fund's assets (website address to find the details)
- The securities lending policy
- The tracking error limit or objective (in %) using the same tracking error formula established by ESMA

Asset managers could disclose other 'dynamic' information in the fund's marketing material. This would include:

- The securities lending / derivative counterparties' names
- The list of countries where the ETF is registered and listed
- The names of market makers (or authorized participants)
- The tax status (for countries such as Germany, Austria, the UK)

IV Structured UCITS

IV.1 Total Return Swaps

Q39. Do you agree with ESMA's analysis of the issues raised by the use of the total return swaps by UCITS? If not, please give reasons.

Yes we agree, except on the following sentence in point 56: "While it may be considered that the composition of the physical assets held by a UCITS is not relevant to the asset diversification test, by virtue of the diversification provided through the swap, it is not clear that Article 52 of the Directive would allow for this interpretation."

1. We believe that a consistent interpretation by most regulators, all over Europe, has been that diversification has to be implemented after derivatives, and only after derivatives.
2. We believe that this is reinforced by a simple economic analysis: the purpose of diversification is to diversify the exposure of investors. Exposure is real only after derivatives.
3. The physical assets held by UCITS are in fact economically equivalent to collateral and there is no quantitative diversification requirement as regards collateral, but only a qualitative one.

Q40. Do you support the policy orientations identified by ESMA? If not, please give reasons.

We strongly believe that UCITS investment portfolio that is swapped should not be subject to the diversification rules applicable to standard investments. Instead, it should comply with Box 26 of CESR's Guidelines on Risk Measurement.

Justification: The UCITS Directive sets diversification rules in order to prevent any exposure to a given issuer from having too much of an impact on the UCITS' performance/NAV. The investment portfolio swapped in a TRS has no impact on the UCITS' performance/NAV, since it is swapped. Rather, the UCITS incurs a counterparty risk on the counterparty of the TRS, and this risk is subject to the 10% limit. As indicated in paragraph 26 of the Discussion Paper, in such a structure the investment portfolio plays exactly the same economic role as collateral. It should therefore be subject to the same kind of rules as Box 26 of CESR's Guidelines on Risk Measurement.

About the question on whether to treat a counterparty as an investment manager:

We agree if the counterparty has discretion and flexibility over investments that have an impact on the performance/NAV of the UCITS. But if the counterparty has discretion only over the collateral of the TRS (i.e. the investment portfolio that is swapped), it would be illogical to treat it as an investment manager. As for any swap, the investment manager of the UCITS sets guidelines for acceptable collateral and the counterparty has discretion within these guidelines to choose the securities it gives as collateral.

Regarding the **investment management delegation agreement**, we should consider two cases:

1. The assets exchanged through the swap have no impact on the fund's performance and risk profile (common to almost all European synthetic UCITS ETFs): the asset manager enters into an agreement with the swap counterparty by establishing and agreeing detailed and well defined asset eligibility rules. In this case the swap counterparty does not act as a 'fund manager' (although it manages the index hedge) and therefore, from our point of view, it should not be obliged to enter into any investment management delegation agreement.
2. The assets exchanged through the swap affect the fund's performance and risk profile (common to actively-managed UCITS ETFs): the swap-counterparty management decisions affect the performance of the fund and the management policy is similar to that of a normal fund's asset manager; in this case the swap-counterparty should enter into an advisory agreement with the asset manager.

With regard to point 2, some European jurisdictions (like France) do not allow a bank to become an asset manager. This would make the ESMA proposal non-applicable or if passed the regulation should be harmonized across Europe.

To this end, the guidelines should be applicable to all UCITS that use derivatives and not only to 'Structured UCITS'.

Q41. Are there any other issues in relation to the use of the total return swaps by UCITS that ESMA should consider?

From our point of view, there are no other issues in relation to the use of the total return swaps by UCITS that ESMA should consider.

Derivatives are already strongly regulated in Europe through the CSR Guidelines on Risk Measurement.

Q42. If yes, can you suggest possible actions or safeguards ESMA should adopt?

NA

IV. II Strategy indices

Q43. Do you agree with ESMA's orientations on strategy indices? If not, please give reasons.

We agree with the proposal but we would like to emphasize the following points:

- Diversification: we do not understand the 'impact' concept; the definition (quantitative or qualitative) would need to be clarified

- Rebalancing: the rebalancing frequency (which has to be disclosed in the prospectus) is not a guarantee of transparency and nor is it linked to the cost issue; intra-day or daily rebalancing could therefore be acceptable
- Cost and index rebalancing are not issues as long as they are clearly defined and disclosed
- Strategy index methodologies must be based on a model; therefore they must be systematic and non discretionary
- The indices' valuation must be independent

Q44. How can an index of interest rates or FX rates comply with the diversification requirements?

Provided that most interest rate or FX rate indices are achieved through bonds portfolios, it should be possible to comply with the diversification requirements mentioned.

Special care must be paid to ETF regulatory and marketing documentation since investment management techniques and associated risks have to be disclosed in an appropriate manner.

Q45. Are there any other issues in relation to the use of total return swaps by UCITS that ESMA should consider?

A more detailed definition of "indices of indices" is needed.

From our understanding, the UCITS Directive and ESMA guidelines should be applied here, i.e. diversification rules should be required. An index that includes some sub-indices in its assets should not take into account the sub-indices for the sake of diversification, insofar as that the sub-indices are themselves indices.

From our point of view, there are no other issues in relation to the use of total return swaps by UCITS that ESMA should consider.

Q46. If yes, can you suggest possible actions or safeguards ESMA should adopt?

NA