

**RESPONSE BY AXA INVESTMENT MANAGERS
(EU Transparency Register number 75149096203-49)**

to

ESMA DISCUSSION PAPER ON UCITS ETFs AND STRUCTURED UCITS

AXA Investment Managers

AXA Investment Managers is a multi-expert asset management company backed by the AXA Group, a world leader in financial protection. It manages €516 billion across its specialty brands, which include fixed income, equities, funds of hedge funds, private equity, real estate and structured finance. It operates globally in 23 countries, including 17 centres in Europe.

We set out below our responses to the specific questions raised in ESMA's discussion paper. In particular we consider that:

- (a) UCITS should, so far as possible, be kept both pure and simple, and introducing complexity by establishing different classes with different rules could introduce complexity which may undermine confidence in the global UCITS brand and damage its competitiveness particularly outside the EU;
- (b) There should be a level playing field between UCITS and substitute non-UCITS retail products in terms of disclosure and marketing rules, as envisaged by PRIIPs, but where there are specific risk (such as embedded counterparty risks in ETFs and structured UCITS) this should be made absolutely transparent to investors.

Retailisation of complex products / Financial stability and systemic risk

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.

We start from two principles as noted above and consider that synthetic ETFs and structured UCITS should either fall within the general rules for UCITS, or should be subject to regulation as a separate category of funds which are not UCITS and are clearly not seen as such.

Investment products are subject to multiple risks (e.g. suitability risk, market risk, liquidity risk, counterparty risk etc). These risks should be disclosed to investors, and managers should have controls to manage these risks. But it does not follow that all products which use "complex" portfolio management techniques are inherently riskier than those that do

not. For example, a geographical or sectoral traditional equity fund may be significantly riskier than a synthetic index tracking ETF.

2. 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'?

Products which are inherently more complex and risky should be subject to specific distribution regimes, which highlight the risk characteristics of such funds.

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?

Investment strategy and risks should be disclosed to investors, together where appropriate with a statement describing for whom it may and may not be suitable.

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

Possibly: see our comments on 1 and 2 above. However, the key issue is clear disclosure to investors of the risk characteristics of such funds.

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

We are not aware of any.

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.

UCITS is the regulatory standard for EU regulated retail funds. Non-UCITS funds should generally be unregulated or subject only to domestic regulation by Member States, except in so far as necessary for financial stability and systemic risk. The creation of a plethora of different types of European regulated retail funds will lead to confusion, problems and disputes over classification, and may not cater for currently unforeseen new product types.

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.

We support the extension of disclosure and selling practices regulations to all substitute retail products under the PRIIPs regime, but do not

advocate seeking to regulate the manufacturing aspects of such products. Investors should, however, be made aware that, unlike UCITS, these are not subject to product regulation and approval.

Exchange Traded Funds

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 we agree with this proposal, but should also be made clear that the fund is a UCITS ETF. The same principle should also be applied to ETFs that are not UCITS, and to non-fund substitute products such as ETNs and SPVs.

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

This should be made clear in the fund documentation (including KIID), but it should not be part of the identifier as this would lead to confusion due to too many possible combinations (3 investment strategies x 4 product types = 12 possibilities).

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

Yes.

Index tracking issues

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.

Tracking errors should be expressed as a target range, rather than a maximum which implies a guarantee of performance within that limit. Managers should be required to give information in the annual report on whether actual tracking errors have remained within that range, and to provide explanations where this is not the case.

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?

We agree subject to the point below.

Factors affecting the ability of full or sampling replication to track an index apply to all trackers using replication, regardless of whether or not the fund is an ETF or a UCITS. The KIID should make only general reference to this issue, with fuller details being confined to the prospectus.

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

See our response to 12 above.

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

No comment.

Synthetic ETFs – counterparty risk

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

Yes.

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.

The quality and type of assets held as collateral should be subject to regulation to reduce the risk of loss in the event of default, and this should include diversification. It should not have to match the relevant index in any way as its purpose is to provide security of capital in the event of default of the counterparty, not to achieve the investment objectives of the fund. The rules should not prevent quasi-matching collateral, but should not require it.

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.

Yes. In the event of counterparty default the ETF will be left holding a pool of collateral assets which it will then seek to realise, and it should not be exposed to concentration risks that would not otherwise be permitted in a UCITS.

Securities lending activities

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

Yes, subject to the points below.

It would be consistent to apply collateral rules for OTC derivatives transactions also to securities lending.

UCITS rules relating to securities lending should apply to all UCITS, not merely to UCITS ETFs.

The risks relating to market squeezes where securities lending is prevalent are not confined to ETFs, or even to UCITS or to funds generally, but apply also to all investment portfolios including managed mandates and self managed portfolios. This should be governed by general regulations relating to short selling and market abuse, and not through specific regulation of ETFs and UCITS.

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

Yes.

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.

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?

No. The only restriction should be on the proportion lent to a particular borrower counterparty

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

We are not aware of any.

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

Not applicable.

Actively managed UCITS ETFs

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

Yes.

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

We are not aware of any.

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

Not applicable.

Leveraged UCITS ETFs

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.

Yes.

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

We are not aware of any.

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

Not applicable.

Secondary market investors

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

The warning should be reworded as follows:

*'ETF units are not usually redeemable from the fund other than by authorised participants of creation units. Investors who acquire units on the secondary market must buy and sell shares with the assistance of a stock broker and investors may incur brokerage fees and **may** pay more than the current net asset value when buying units and **may** receive less than the net asset value when selling units.'*

There may be specialist ETF managers who are not geared to processing large numbers of small retail transactions.

If retail investors are to have the right to redeem units directly from the UCITS, there is also an argument that they should also be able to acquire units directly from the UCITS. This would fundamentally change the current ETF business model and create additional arbitrage opportunities, meaning that NAV premiums and discounts would be less likely to arise. We make this point without expressing a view on whether or not it is desirable.

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

See above.

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

See above.

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.

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

There is an obligation on market makers to provide liquidity.

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?

If there are at least two market makers, market forces should intervene to arbitrage if prices vary significantly from NAV.

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.

Yes.

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

We are not aware of any.

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

Not applicable.

Strategy indices

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

Whilst we agree with ESMA on intraday rebalancing, we believe that daily rebalancing should be acceptable.

We also suggest that there should be an onus on managers, when launching new funds, to demonstrate to competent authorities that there is a need or demand from investors for the product in the form of a UCITS.

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

We suggest that existing diversification rules based upon concentrations of market and counterparty risk are not readily transferable to interest and FX rate indices, and that, rather than seeking to do so, separate specific rules or guidance should be developed.

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

We are not aware of any.

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

Not applicable.

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15 September 2011