

European Securities and Markets Authority
103 rue de Grenelle
75007 Paris
France
www.esma.europa.eu

Chris Barnard
Germany

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**- Your Ref: Comment letter on ESMA's policy orientations
on guidelines for UCITS Exchange-Traded Funds and
Structured UCITS**

Dear Sir,

Thank you for giving us the opportunity to comment on your discussion paper on ESMA's policy orientations on guidelines for UCITS Exchange-Traded Funds and Structured UCITS. In general I agree with the issues that you have raised here and the policy orientations that you have identified. I would like to comment in particular on the retailisation of complex products and rider activities.

Retailisation of complex products

Market and financial product developments have brought more complex products within the reach of retail investors. Regardless of whether this is or is not appropriate, it is critical that such investors are clearly informed of the risks inherent in more complex products, and that they fully appreciate their risk. Structure and form should not be used as a means of circumventing the intent of securities' and markets' rules and regulations. Therefore it is important that regulators consider substance over form. In this case, we can take a "look through" principle to more complex products.

For example, the definition of complex product should consider two features: a latent feature test would determine whether the product exposes the investor to any new risk factor compared with investing in the basic underlying instruments; and a quantitative test would determine whether the product arbitrarily or artificially increases the exposure to the existing

risk factors of the basic underlying instruments. This consideration of “new risk” and “increased risk” is a good starting point for defining complex products, and such a principles-based approach is generally superior to (by definition non-exhaustively) listing the various complex or non-complex instruments or products. Under this suggested approach, almost any non-linearity in payouts would be considered complex, which is reasonable and appropriate in the context of retail investment.

Rider activities

The additional risks from rider activities, such as securities lending, repo and collateral management should be disclosed and of course measured, monitored and controlled. The prospectus should include a detailed description of such activities, which should be sufficient and complete so that investors would be able to understand the risks involved in these rider activities.

Answers to specific questions raised by ESMA

I generally agree with your analysis of issues and policy orientations.¹

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’?

Please refer to my comments above for criteria which could be used to determine which UCITS should be considered as complex.

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?

For completeness and consistency, I would agree with this to the extent that it would address legitimate retail investor protection issues.

Q18: In particular, do you think that the collateral received by synthetic ETFs should comply with UCITS diversification rules?

I agree that the collateral received by synthetic ETFs should comply with UCITS diversification rules. This is basic risk management.

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?

I do not think that further safeguards should be introduced, as the set of principles described in the paper should be sufficient.

¹ E.g. answer yes to questions 1, 7-13, 16, 19, 20, 22, 26, 29, 30, 33, 34, 39, 40 and 43.

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?

I would not support a limit on the amount of a UCITS portfolio which could be lent as part of securities lending transactions. Such a limit would be arbitrary and should not be necessary in the context of the principles described in the paper.

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

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?

Investors should have a right to request direct redemption of their units from the UCITS ETF, but only when market makers are no longer providing liquidity in its units.

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?

I do not think that this is a problem. Investors already accept the premise that secondary market values may differ from the net asset value per unit. In fact this is one of the key features of such investment vehicles. In any event, significant deviations should be auto-arbitraged away in short time.

Yours faithfully

C.R.B.

Chris Barnard