



ESMA's policy orientations on guidelines for UCITS Exchange-Traded Funds and Structured UCITS

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NAFOP (The National Association of Fee Only Planners) is intended to protect the interests of professionals who provide advice on estate and personal financial planning without having any conflict of interests with their clients (fee only). It is within these business activities that they provide the service of investment advice as defined by MiFID.

Actually, there are no official statistics about the real presence of financial advisors in Italy. In 2002 the European Commission Romano Prodi was Head of Commettee; he was regarding law proposal on Directive about investment services: he stated that Italian advisors was about 7.000. Our association, the more representative in Italy, has realized since 2005 an important role of interlocutor of legislator and authority for regulation of investment advisory.

The distinctive characteristic of NAFOP's partners is their formal commitment to be remunerated only by their customers; moreover they don't receive any fee or commission from subjects that sell financial products. In addition, we save interests of freelance in financial advisory.

Under CE 39/2004 and CE 73/2006 Directive and with refer to article 3 of CE 39/2004, a role was specifically recognized by the Italian legislator: this figure is authorized to provide investment advisory and not to intermediate money of the clients. For this reason, the Ministry of Finance and Economy has stated that the principal requirements of this advisory figure was that the only remuneration can be given it's the one paid by the customer. In that way, a new and original profession was recognized in financial advisory.

NAFOP has a very clear idea about this issue.

Fee only financial planners associated with NAFOP have a specific experience on what investors understand and on what the word "risk" mean. In fact, this experience has been accrued during a real advisory experience: structuring investment portfolios and control the risks involved have always been our primary goals. The investor requires support to our consultants to understand all the characteristics of the new deals and the risks of new and realized investments. This experience is more significant as it was accrued in connections where advisors operate in absolute independence from banks, insurance firm and other companies that pay royalties for their budget. So, our advisory is oriented for its nature to advice against investment products which are difficult and more risky. For principle, Nafop thinks that it is harmful to limit the distribution of financial products:

- It restricts further alternatives of investors and limits competition; this imply indirectly an increase of implicit costs of financial products;
- It doesn't necessary prevent diffusion of really dangerous products for money savers.

Experience shows that any formal definition of complexity or risk is becoming obsolete in a world where high volatility on financial markets, uncertainty about the creditworthiness of the operators and continuous product innovation are the main characteristics. Distinction between complex and not – complex products is meaningless to protect the money saver. First of all, the complexity of structuring a product does not necessarily mean greater risk. In second place, information asymmetries on regulations allow the distribution of complex structures within bank and insurance boundaries.

From the other hand we think regulations on transparency of financial products are strategic to save investors. They should regard three key elements for public opinion: pay-off structure, counterparty risk, investment liquidity.

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These information should be provided in two distinct level:

1. The first should match the actual KIID, easily accessible to retail investors for both methods of publicity and clarity of exposure. In our opinion, this would lead to an improvement in the quality of information;
2. The second should provide further clarity on information, in advantage of more prepared investors and for investors who perform advisory activity. We retain that advisory quality – and in particular the presence on market of fee only financial advisor (without conflict of interest) – can be an essential element for saving investor's interests.

It's necessary to reach an uniform regulation on transparency on financial products which have all potentially a function of financial investment; this regardless of belonging to the formal category of stocks, bond, OICVN, certificate, ETP in general or insurance products.

Moreover we think that all transparency issues concern more UCITS structure instead of ETFs; in fact ETFs use a more predictable management approach. Structured UCITS, on the other hand, have an higher margin of discretion, product a poor disclosure about their management approach and don't participate to the voluntary transparency process recently performed by ETFs's issuer.

Finally, regarding stability risk of markets created by massive use of derivatives form UCITS, NAFOP believes that a regulation of activities which can create systemic risk is necessary. However, these activities aren't related exclusively to UCITS. They can be used with the aim to reduce, and not to increase, system risk. NAFOP believes that this regulation must be performed during the structuring phase of investment products. This regulation can be implemented putting limits on creation or release of derivative contracts. We feel that this issue of "atypical products" must be regulated on the basis of their quantity and related on patrimonial size of issuer. Under this conditions, it could be useful to limit derivative contracts used by UCITS at those contracts issued by issuer who accept this regulation.

Made these premises, we reply at specific questions that we feel we can give real contribution.

II. General policy discussion

Retailisation of complex products

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.

NAFOP doesn't believe convenient to set distribution limits to synthetic and structured ETF. These limits could create damages to investors, retail in particular; they could also prevent an efficient access to more transparent and efficient financial tools. Regarding investor's interests, solution has to be found on transparency duty and on the role of financial advisory. To limit the distribution of UCITS would deprive investors of financial tool potentially useful and not necessarily riskier than others, pushing the same investors to other products with more implicit fee and less regulated.

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'?

We don't think that consider complex the structured ETFs could be useful. As stated before, we think that it could be inappropriate to classify them as complex. Complexity that can damage investors is not function of the product's structure but it follows the difficulties to perceive how this structure can react to market volatility and, in second place, to identify counterparty risk. It is possible that a safer product stems from a complex structure, and at the same time a simpler product results riskier.

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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.

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.

In general, ETFs disclosure looks better than the one performed by active mutual funds (or Sicav), especially in the one about derivatives and counterparty risk. Averagely ETFS disclosure is better respect to index linked, structured bonds and other banking products. We believe that the possibilities to create investment products for retail in a different way from UCITS must remain free. Investors' interest must be pursued making uniform transparency and informations. At this point, we think that Key Investor Information Document's information level is actually poor.

III. Exchange Traded Funds

III.I. 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.

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

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

Nafop believes that these labels are appropriate.

III.II. Index tracking issues

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

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

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?

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

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

High level of tracking error represent a factor of low quality of product but doesn't necessarily mean higher risk for investors. ETFs issuer should provide more information about the index tracked and on tracking methodologies.

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.

NAFOP believes disclosure regards counterparty risk is really important. It should regard total risk amount, number and quality of counterpart, quality and diversification of collateral.

Q17: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.

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.



NAFOP thinks it's necessary to dedicate a focus on transparency of collateral with the index, but without no duty of alignment. Freedom of issuer about more transparency can increase competition between them; this in behalf of investors.

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 believe that a full disclosure of security lending activities, weight on total size of fund, collateral accepted and use of proceeds are necessary.

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

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.

Q22: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.

NAFOP joins ESMA directives about these points.

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?

NAFOP believes preferable that issuers have full freedom on this topic, with the aim to establish a better regime of competition; this cannot change to the obligations of quality of the collateral and the obligations of transparency.

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.

NAFOP joins ESMA directives about these points.

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.

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

NAFOP joins and shares ESMA analysis about these points.

III.VII. Secondary market investors

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

NAFOP joins and shares ESMA analysis about this point.

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?

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NAFOP believes that investor, on secondary market, must be provided of the right of redemption in cases where the liquidity is less than its domestic secondary market.

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?

NAFOP believes that for all ETF and ETP a more transparency and more obligations on market makers have to be made. We think that it could be a good idea to set condition the pricing of all ETP to the presence of a plurality of market makers.

IV. Structured UCITS

IV.I. Total Return Swaps

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

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

IV.II. Strategy indices

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

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

Q45:Are there any 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?

NAFOP joins and shares fully analysis of ESMA regarding these two points.

NAFOP believes necessary that UCITS have precise obligations of disclosure of the pay-off investment mechanism and of counterparty risk that investor takes. These factors result more difficult to understand for the retail investor with respect to investment strategy and risk of ETF and ETP in general.

Moreover, we believe that reporting obligations for this kind of products should have a major frequency than annual; at least quarterly.

Thank you for your attention

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