

**ICGN**

International Corporate Governance Network

Via web submission
<http://www.esma.europa.eu>

21 September 2011

Dear Sirs,

**RE: Discussion paper on ESMA's policy orientations on guidelines for UCITS
Exchange-Traded Funds and Structured UCITS.**

We are writing on behalf of the International Corporate Governance Network (ICGN). The ICGN is a global membership organisation of institutional and private investors, corporations and advisors from 50 countries. Our investor members are responsible for global assets of U.S. \$18 trillion.

The ICGN's mission is to raise standards of corporate governance worldwide. In doing so, the ICGN encourages cross-border dialogue at conferences and influences corporate governance public policy through ICGN Committees. We promote best practice guidance, encourage leadership development and keep our members informed on emerging issues in corporate governance through publications and the ICGN website. Information about the ICGN, its members, and its activities is available on our website: www.icgn.org.

We welcome this timely discussion of issues related to UCITS and ETFs, investment vehicles which are rapidly growing in significance. We believe that given this growth a reconsideration of the rules for such funds is appropriate and necessary.

We are supportive of much of the thinking embedded in the consultation, and believe that there are a number of issues which need to be considered in such fund vehicles to ensure that they operate properly in the interests of their investors and do not harm the sound functioning of the financial markets. However, we believe that there is one area which is not considered in the consultation but if it were addressed effectively might avoid the need for many of the details of the rules which are contemplated. This is the issue of the governance structures of the funds. We at the ICGN are increasingly considering the governance standards of investment vehicles - much attention has been paid to the governance of public corporations in order to make them accountable to their owners, the shareholders, but many investment vehicles have markedly weaker governance structures even though many of these also aggregate the savings of large numbers of consumers who deserve protection. We believe that establishing independent governance standards for UCITS and ETFs might obviate the need for many of the detailed standards considered in the consultation.

There are several areas which the Commission raises in this consultation, such as collateral, stock lending, leverage, counterparty risks and conflicts of interest, where the clear policy concern is that the funds may not be acting fully in the interests of their investors and customers. We believe that a governance structure overseeing such funds and providing independent oversight such that actions have to be wholly and fully in the interests of the fund investors would add real value and enable markedly less rigid regulatory structures.

We believe that the basic standards of governance that would be required are simple and relatively clear: a board of directors who are free of conflicts of interest and otherwise genuinely independent of the fund manager, elected regularly by investors, which is empowered to take key decisions regarding the fund which might otherwise give rise to related party transactions or other circumstances where the interests of the fund manager and of the investors may diverge. The ICGN's Global Corporate Governance Principles (attached to this response) provide an overview of investors' basic expectations of public company boards; these concepts may be applied by analogy within fund boards. We believe that it may be too complex and administratively inappropriate to put such boards in place for each individual fund but believe that they should be established at some appropriate umbrella level to oversee a number of individual funds.

Beyond these general comments we make some brief responses to the specific issues raised in the consultation:

Financial stability and Systemic Risk – questions 1-7

We agree that it is appropriate to consider establishing limitations on the distribution of certain complex products to retail investors. The level of structuring and complexity of some funds is such that they will be extremely hard for retail investors to understand and the risks of mis-selling and of systemic impacts mean that restricting their sale seems appropriate. We believe that these same concerns need to apply to UCITs and to other funds.

Exchange traded funds – questions 8-10

We agree that ETFs need to be clearly labeled as such and that synthetic and physical ETFs and actively managed and passively managed ETFs need to be transparently labeled as such. To do otherwise risks misleading and confusing investors.

Index-tracking issues – questions 11-15

In the same way, we agree that there needs to be transparency around the issues raised with regard to index-tracking.

Synthetic ETFs and counterparty risks – questions 16-18

We agree that it is absolutely fundamental to the proper functioning of the markets that there be disclosure and transparency about the issues of counterparty risks and collateral. We also agree that the appropriate UCITs requirements need to apply to collateral just as they would to any other asset. We would hope that our proposal above, regarding the governance of these funds, will help protect the interests of investors in regards to these risks.

We would note that one further aspect of synthetic ETFs should be noted publicly: that as they are not the direct owners of the underlying assets whose performance the ETF intends to match, they are unable to carry out stewardship on those assets – ie they are unable to vote actively on any relevant resolutions and otherwise act as an involved owner.

Securities lending – questions 19-25

We agree with the analysis regarding securities lending and draw to ESMA's attention the ICGN's own guidance on how the risks regarding stocklending can best be managed on behalf of long-term owners – our Securities Lending Code of Best Practice is attached to this letter. We would suggest that this is an area where rather than establishing hard rules across the whole UCITs sector an independent governance structure could appropriately oversee lending such that the interests of investors are effectively protected.

Actively managed UCITs ETFs – questions 26-28

We agree that the proposed transparency is necessary so as to ensure that investors are not misled as to the nature of their investment.

Leveraged UCITs ETFs – questions 29-32

We agree that the proposed transparency is necessary so as to ensure that investors are not misled as to the nature of their investment. We would hope that our proposal above, regarding the governance of these funds, will help protect the interests of investors in regards to these risks.

Secondary market investors – questions 33-38

We agree that the position of secondary market investors needs to be protected and we believe that the ESMA proposals are appropriate and proportionate.

If you would like to discuss any of these points, please do not hesitate to contact Carl Rosén, our Executive Director, at +44 (0) 207 612 7098 or carl.rosen@icgn.org. Thank you for your attention and we look forward to your response on the points above.

Yours sincerely,



Paul Lee
Chair, ICGN Shareholder Responsibilities Committee