

THEAM RESPONSE TO ESMA'S DISCUSSION PAPER

22 SEPTEMBER 2011

THEAM welcomes the possibility to reply to ESMA's Discussion Paper and would like to insist on the fact that:

- a) ETF are UCITS, nothing less nothing more, except that they are listed on a European stock exchange. UCITS should be treated the same, whether they are listed or not; and
- b) therefore appropriate definitions and categories should be used for this consultation. Some guidelines should apply to all UCITS (like those concerning derivatives or share lending), some guidelines, like those concerning tracking error, should apply to some UCITS categories, like indexed UCITS

Retailisation of complex products

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.

Under the UCITS Directive (Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities) , UCITS are permitted to use derivatives for the purpose of efficient portfolio management. The use of OTC derivatives follows strict rules that were established to mitigate risks (100% maximum global exposure, 10% max counterparty risk, special risk management reporting, reliable and verifiable valuation on a daily basis, taking into account of the underlying etc).

Structured UCITS and synthetic ETFs respect these regulatory requirements, and therefore do not create higher risk than other UCITS . Furthermore, the derivatives instruments used in respect of synthetic ETFs or structured UCITS can be very different; for example, in the case of synthetic ETFs, derivatives are used to replicate an index with a

simple pay-off and in the case of structured UCITS, the pay-off of the derivatives may include more complex components.

As a consequence, we do not consider it necessary to introduce additional constraints in respect of the distribution of synthetic ETFs and structured UCITS. In addition, in many jurisdictions, specific regulatory frameworks already exist in respect of structured UCITS (for example, in France with the AMF Position No 2010-05 - 15 October 2010 relating to the Marketing of complex financial instruments).

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'?

We believe that it could make sense to distinguish between simple UCITS and complex UCITS. European regulators, in any case, have already decided that some UCITS should not be marketed to mass retail.

However, such policy may be difficult to implement as "complex" and "non-complex" qualifications should not apply to broad categories, but to specific funds. There are complex Structured UCITS, but there are also simple Structured UCITS. The same applies for ETFs : on the one hand, there are some simple ETFs, for example those that are purely referenced on simple indices, but on the other hand, there are also complex ETFs, for example, those that are referenced on Hedge Fund indices. There are also other UCITS that are complex and that are neither ETFs nor Structured Funds.

There cannot be a unique and simple set of criteria to define what is complex and what is not. In our opinion, the driver is the capacity of investors to understand the product payoff, and risks involved.

The management technique utilised by the fund should not of itself be considered as a criteria in determining complexity.

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?

We believe that ESMA should provide specific guidelines setting out clearly which categories of funds it considers to be complex. As a corollary, funds that would not fall within the scope of such guidelines would be considered automatically as non-complex. For example, with regards to Structured UCITS, ESMA could be inspired by the AMF position (AMF Position No 2010-05 - 15 October 2010 Marketing of complex financial instruments) available at: http://www.amf-france.org/documents/general/9662_1.pdf. Furthermore, we would suggest that ESMA could provide specific guidelines for so-called "Newcits", based on the complexity of the strategy and the difficulty for investors understanding the strategy employed.

We firmly believe that ETFs should be treated for regulatory purposes simply as UCITS that are listed on a stock exchange. Their complex or non-complex categorisation should result from their UCITS nature and not derive purely from the fact that they are listed; listing does not add any complexity to their structure nor to the strategy. It follows that ETFs that are solely referenced on market indices should, of course, be considered as non-complex UCITS.

For UCITS identified as “complex” warnings could be used in the fund prospectus and/or marketing documents.

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

The funds discussed in this paper strictly respect the UCITS rules and risk constraints, and are therefore fully eligible for the UCITS label.

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

Yes. International bodies (such as the FSB) have failed to mention one potential source of risk concerning ETFs: sampling replication.

Sampling replication creates a risk for investors that a UCITS, which is supposed to be indexed, is in fact only benchmarked to the index. Unlike for purely replicated physical funds as well as swap based funds, the quality of tracking is directly dependant on the fund manager’s proprietary model, and therefore incurs model risk. In times of market stress, such replication techniques could fail to work, resulting in significant tracking error and performance lags. At minimum, in our view, investors should be warned clearly and comprehensively about the potential risks generated by sampling replication.

We also believe that there should be some minimum tracking error requirements for a UCITS to be qualified as an index fund. ETFs that use sampling replication should be qualified as “actively managed ETFs”.

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.

We believe that any distribution guidelines should apply to all financial products under MiFID, particularly if ESMA believes that there are systemic risk issues. The issues analyzed in the Discussion Paper are not peculiar to UCITS ETFs or UCITS funds.

Non-EU ETFs listed on European Regulated Markets should also be covered by the rules, as they are heavily marketed to European institutional investors, and are available to retail investors in the Netherlands (and elsewhere through their listing On Euronext Amsterdam).

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.

Yes. Indeed, we would argue that the main areas of complexity and opacity relate to instruments often confused with ETFs (ETNs, ETC and ETVs – these are mentioned on page 3 of the Financial Stability Board note on ETF dated April 2011). A template KIID encompassing ETF, ETN, ETC and ETV could be considered within the proposed European regulation on packaged retail investment products aka PRIIPS. Regulation should take into account also the specificity of the various products (ETN, ETC or ETF) , ETN have, similar to synthetic ETF, a better ability to deliver performance in line with the index than other ETF (especially sampling ETF). Therefore, we would argue that regulation or guidelines reflect these differences and characteristics. ,

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, the ETF “brand” should be protected and reserved to UCITS that are actively traded on at least one European regulated market in Europe.

By “actively” traded we mean that the funds have at least one official market maker who has signed a contract with a stock exchange.

ESMA might consider a harmonization of stock exchange market making requirements (in terms of time presence, maximum bid offer spread and minimum size) across European exchanges.

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

Although the replication methodology should always be highlighted in all marketing documents (factsheets, presentations, data providers description page, website, etc.) we believe it is dangerous to set out the methodology in the prospectus.

Indeed, we should not forget that the objective of the fund manager is to track the benchmark index, and that he/she must make every effort within the regulatory framework to achieve this objective. For example, if the fund is managed in pure replication, and the composition of the index changes in such a way that the fund manager may no longer track the benchmark properly, or if the underlying market becomes no longer accessible to the manager, than the manager should resort to synthetic replication in order to ensure the performance continuity. Similarly, if the fund is managed synthetically, and it happens that the fund manager finds no counterparty willing to swap the performance of the underlying index at a reasonable price, than the fund manager should be able to implement its management expertise to track the index directly.

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

It seems to us appropriate to insert prominently in the KIID the main characteristics of the ETFs:

- a) the description of the index that is tracked. This is obviously the most important topic for the investor;
- b) whether there is full replication of sampling replication, the expected annual performance lag vs the index and the expected tracking error;
- c) information concerning the replication method (synthetic, physical, funded, unfunded etc) and a full description of the counterparty risks involved (including the type of collateral received).

Index Tracking Issues

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

No. Tracking Error is not the ex-post distance between the return of the ETF's portfolio and the return of its tracking index. Tracking error refers to the daily volatility of this difference. There is much confusion on the meaning of this term, and it would be useful if ESMA could provide a coherent and precise definition.

With synthetic ETFs, the tracking error does not depend on the swap counterparty quality of management. The payoff of the swap is contractual, and the Tracking Error risk is entirely transferred to the counterparty. This strategy does introduce counterparty risk, yet this risk is monitored according to UCITS regulation (e.g. through collateral agreements). We should remember that physical ETFs may also give rise to counterparty risk when they engage in securities lending activities.

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

We agree that the policy of index-tracking UCITS should be disclosed, including its maximum level.

As stated in question 9, we believe that fixing the fund replication methodology (physical or synthetic) in the prospectus would not be to the advantage of the investors, as it will limit the fund manager in its capacity to achieve its objective – that is, to track properly the benchmark index. Moreover, as mentioned in question 11, whether the fund is swap based or physical will not portend the TE level of the fund. For transparency reasons, we nevertheless agree that this information should be disclosed in the KIID.

We believe that disclosing whether the fund manager is allowed to use a sampling policy is key, as it implies a model-based proprietary investment strategy, the quality of which can significantly impact the tracking error of the ETF.

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?

Yes we agree: these are key elements that should be included, in a simplified form, in the KIID.

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

We would like to draw ESMA's attention to the tracking error risks associated with physically replicated funds using a sampling methodology. In contrast to purely replicated physical funds as well as swap based funds, the quality of tracking is directly dependant on the fund manager's proprietary model, and as such may be assimilated to actively managed or quantitative funds.

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

We believe that the prospectus should disclose whether or not the fund manager is allowed to use a sampling methodology.

Synthetic ETFs – counterparty risks

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

We see no justification for any further disclosures than those already applied to UCITS under existing European legislation. The prospectus should set the guidelines of the fund, but cannot contain dynamic information, such as portfolio compositions, collateral compositions, or counterparty names.

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.

UCITS regulation requires strict collateral rules and in our view there has been no argument to explain why these guidelines are not sufficient or inadequate.

We should not confuse the second order risk arising from a lack of diversification of a collateral with the real credit risk. A weakly diversified collateralised obligation is still much better than the diversified portfolio of credit risk authorised in UCITS.

The main risk for the investor, in our opinion, is the regular weak performance of some physical replication ETF (especially sampling ETF), rather than the potential remote performance lag that would arise upon the simultaneous bankruptcy of the swap counterparty and its collateral value slippage.

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.

We believe that the UCITS collateral rules are sufficient, and we do not see any reason for additional constraints.

Securities lending activities

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

Please note that securities lending activity is not specific to index tracking funds, and the issues raised by ESMA should be considered for all UCITS funds.

We believe that securities lending activity does not introduce broader systematic risks. We do not understand ESMA's statement that "if securities lending is particularly prevalent, there could be a greater risk of market squeeze in the underlying securities if ETF providers were to reall on-loan securities on a large scale in order to meet redemptions" In case of material fund redemptions, the fund manager will recall its securities to sell them in the market. The borrower will hence either have to find another lender, or will buy the stocks in the market. On the contrary, we expect a countercyclical effect on the underlying securities market.

The collateral of the securities lending deals, in line with the rules of the counterparty risk applicable to UCITS, mitigates the risk of counterparty default.

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

We agree that any UCITS (not only ETFs) should inform investors in the prospectus of the intention to engage in securities lending, as part of its investment policies. This should include a description of the risks involved, but cannot include a detailed description of the impact on the tracking error, as it may be either positive or negative.

The extent to which fees arising from securities lending are earned by the UCITS should also be disclosed. Where an UCITS engages in fee sharing arrangements in relation to securities lending, this should be clearly disclosed together with the maximum percentage of fees payable to the securities lending agent or other third party.

However, the prospectus should not limit the management decisions and negotiation power of the fund manager by specifying information such as the policy in terms of collateral, re-investment policy and whether the securities lending agent is the investment manager or a connected party to the manager/investment manager. This information is a dynamic information and the prospective should therefore not be limitative. Only broad information could potentially be added.

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.

We believe the current rules are sufficient.

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.

In order to mitigate risks and harmonize risk policies, we do agree that collateral received in the context of securities lending activities should comply with the criteria for OTC derivatives set out in CESR's Guidelines on Risk Measurement.

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?

As long as the funds respect the UCITS guidelines and risk limits, we see no reasons why ESMA should set a limit on the amount of a UCITS portfolio which can be lent as part of securities lending transactions.

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

No.

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

N/A.

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?

No.

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

N/A.

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.

We agree that the prospectus for leveraged UCITS ETFs should disclose the leverage policy, how this is achieved and the risks associated with this policy.

The prospectus should also include a description of how the daily calculation of leverage impacts on investor's returns over the medium to long term , or provide investors with a link to a website where this information is publicly available.

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

No.

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

N/A.

Secondary market investors

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

The unique creation/redemption mechanism of ETFs is the innovation that made its success, allowing investors to benefit from optimal fund management and intraday liquidity. There are several reasons why we believe that the primary market should be reserved essentially to Market Makers and Authorised Participants :

- a) The current creation redemption process limited to Authorized Participants, imposes large minimum size orders (usually around 1-3M€). If retail investors were allowed to create and redeem for small sizes, the fund manager will lose operational efficiency and it will greatly impact the tracking error of the funds, as small fractions of the index are not possible to trade
- b) Authorized Participants are investment professionals who ensure the liquidity of the ETF on the secondary market. If retail investors could create and redeem on the primary market, the profitability of the Liquidity Providers would be impacted, which in return will impact the intraday market spreads.
- c) Creation and redemption costs may change as it corresponds to the actual execution costs, and are billed to the funds, so that existing shareholders are not impacted by new entrants or redeeming shareholders. This mechanism requires a good understanding of the underlying market to anticipate execution costs, and may sometimes lead to the payment of a separate invoice after the settlement of the ETF transaction when execution is delayed by a market disruption event. Such mechanism may not be implemented with retail investors, and the role of Authorized Participants as intermediaries simplifies the process for these investors.

However, if the secondary market is disrupted for operational reasons, for example because the market maker is unable to operate, then the final investor should have access to the primary market.

In a practical way, final investors should have the right to create and redeem shares, yet with dissuasive creation/redemption fees under normal circumstances, which would direct investors towards the secondary market and hence protect the unique nature of ETFs . In case the secondary market is disrupted for operational reasons or because the fund has been delisted, then the management company would have to accept orders with reasonable fees (execution cost level).

There will be three cases :

1. Under normal circumstances, high creation redemption fees will dissuade investors to trade on the primary market. Investors will trade on the secondary market.
2. Under exceptional market circumstances which affect the underlying market, the fund manager may suspend creation and redemption from all investors (including APs and MMs). Investors will not be able to trade.

3. If the secondary market is disrupted for operational reasons or because the fund has been delisted, then final investors may exercise their right to create or redeem on the primary market, and the management company must apply reasonable fees (execution cost level)

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

We believe investors should be aware that if they trade within a time period during which one or more of the underlying index composition markets are closed, than the risk of having an execution price that differs significantly from its theoretical value is higher. Indeed, the quotation prices of the liquidity providers depend on their proprietary valuation model.

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

A specific warning could be used in the UCITS documentation informing investors of this issue.

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?

Please refer to question 32.

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

ETF are regulated by the stock exchange, and the stock exchange requires that a least one Market Maker ensures the liquidity of the fund. The Market Maker has a contractual obligation with the exchange to provide liquidity in the units of the ETF, with minimum time presence and size and maximum bid-ask spread requirements.

If the ETF is delisted or the secondary market is disrupted, we agree that secondary market investors should have a right to request direct redemptions of their units from the fund.

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?

Stock exchange values are intraday values, and hence will always differ from the end of day Net Asset Value, with amplitude depending on market conditions.

STRUCTURED UCITS - 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.

No. . We do not agree with your analysis in paragraph 50, that TRS could be viewed as “passively managed” as it is simply the execution of the terms and conditions agreed in the swap documentation and as such should not be viewed as the performance of investment management services. We also consider that the UCITS and/or its management company should not sub-delegate any duty in respect of the choice of components of the assets or the underlying strategy. We agree, as pointed out in paragraph 53, that the UCITS have to ensure that the underlying assets of a strategy are eligible assets and that the derivatives has to comply with the criteria of the UCITS directive and related regulations.

We do not agree with your comments regarding the engagement or not of the counterparty in short selling and borrowing which remain under the counterparty own responsibility as per its hedging policy.

In respect of your analysis in paragraph 56, we consider that there is a no doubt to say that diversification test have to be made after the conclusion of derivatives. This is also in line, from our perspective, with the spirit of the UCITS regulation regarding diversification which has to be seen after the conclusion of derivatives.

From our perspective it is the role of the investment manager to ensure that the UCITS comply with the directive and as such the swap documentation should necessarily include provision according to which any change of assets, if any, shall be made with the approval of the UCITS and in compliance with the UCITS directive.

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

We support the proposals, subject to the following points :

- Regarding diversification, we do not believe that this is required. The purpose of the diversification requirements is to diversify the risks taken by investors. Risks taken by investors are the real exposure of the fund, after the effect of derivatives.
- We believe that the treatment of the swap counterparty as an investment manager is not appropriate:

If the UCITS can give to the swap counterparty some flexibility with regards to the choice of the underlying components of the swap where the UCITS pays the performance of portfolio it holds, this has to be made in any circumstance under the control of the UCITS in a defined framework and according to the terms and conditions of the swap documentation. The UCITS can give flexibility, in the above mentioned framework, to the swap counterparty, but this has to be allowed to the extent it is in interest of the investors, because this will allow for instance a better remuneration for the UCITS.

Flexibility granted to the swap counterparty [because this is made under a strict monitoring of the UCITS?] does not lead to treat the investment bank as an investment manager. An investment manager is an actor whose decisions have an effect on the return of the UCITS.

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

No, as we consider that the conclusion of derivatives is already highly regulated in Europe, especially since the CESR Guidelines on Risk Measurement.

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

N/A.

STRATEGY INDICES

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

For the sake of clarification, we believe that the proposed ESMA orientations regarding strategy indices should be applicable to all indices, not only strategy indices used by UCITS.

With regards to the specific requirements:

a) Sufficiently diversified

We agree with the proposal, except that we do not understand what ESMA means by "impact". We need some clarification on this. ESMA should also be explicit about whether the various components of a commodities index could be seen as offering sufficient diversification, to allow an index composed of different agriculture commodities or different metals, for example, to be considered as a diversified index.

b) Adequate benchmark

We do not have specific comments.

c) Rebalancing

We believe there is no relation between transparency and costs impacted on one hand and the average turn over of the allocation on the other hand. An index can have a very low average turn over and be completely non transparent with high costs. An index can have a very high turn over and be very transparent with low costs (Quarterly rebalancing on small caps versus daily rebalancing on large caps).

We agree with the disclosure of the rebalancing frequency in the prospectus.

d) Published in an appropriate manner

We agree with the principle of a disclosure of a summary of the calculation methodology. We consider indeed that in the best interest of the unitholders, a simplified description (which is validated by the regulator through the approval process of the fund) can often be more adapted. We believe that a relevant simplified description which highlight the basic mechanism of the index is more adapted for the good comprehension of the investors than just the full disclosure of the calculation methodology.

We consider that such kind of disclosure is conforms to what has been historically done for most major indices, where the methodology is not fully deterministic and includes undocumented elements like discretionary elements.

We believe that the proposed ESMA orientations as regards publication of the constituents of the index together with their respective weights after each rebalancing on a retrospective basis is relevant but as a matter of clarification, we believe that a reasonable delay should be respected between the rebalancing and the publication.

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

We believe that specific diversification requirements should be elected for the FX or interest rates category of assets.

When the exposure to interest rates or FX is combined with equity linked strategy, those exposure shouldn't be taken into consideration.

When the exposure to interest rates or FX represent the entire strategy, there should be at least 2 underlyings even if according to UCITS Directive, there is no specific constraints.

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

We do not see specific issue.

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

NA.