Amundi
ASSET MANAGEMENT

Amundi reply to ESMA's Consultation Paper
"ESMA's guidelines on ETFs and other UCITS issues"

Amundi welcomes this consultation of ESMA and the quality of the work of investigation which has been done. However, some aspects of these technical subjects are not so easy to comprehend in detail and we appreciate the possibility to contribute and provide what we consider better solutions for various topics.

III – Index-tracking UCITS

Q1: Do you agree with the proposed guidelines?

Yes. We agree with ESMA's analysis of index-tracking UCITS. We would particularly like to emphasize on the following points:

1. It would be necessary to give a clear definition of 'index-tracking funds' (index-tracking funds are UCITS whose investment policy is to replicate the performance of an eligible index)
2. Greater transparency in index-tracking funds is very welcome, especially regarding indices methodology and composition; nevertheless the degree of transparency relies on the ability and willingness of index providers to disclose such information.
3. We would favor an 'objective -or target- of tracking error' in the investment policy disclosed in the prospectus rather than a strict 'ex-ante tracking-error'. This target should be part of the index-tracking UCITS definition (as it has been already in force in France for some years).

Q2: Do you see merit in ESMA developing further guidelines on the way that tracking error should be calculated? If yes, please provide your views on the criteria which should be used, indicating whether different criteria should apply to physical and synthetic UCITS ETFs.

Yes. We encourage ESMA to establish and publish a clear tracking error formula (i.e. the mathematical formula) applicable to all index-tracking UCITS so as to:

- harmonize tracking error calculations across Europe (some asset managers calculate the tracking error using the data on one specific weekday while other use a weekly average)
- allow for a comparison of tracking error between European index-tracking funds UCITS

There is no different criteria to be applied to physical and synthetic UCITS ETFs since both funds should be submitted to the same tracking error rules. This will allow investors to compare correctly index-tracking UCITS and have a clear choice of the merits of the funds.

Q3: Do you consider that the disclosures on tracking error should be complemented by information on the actual evolution of the fund compared to its benchmark index over a given time period?

No since this information is already displayed in the KIID Nevertheless the tracking error could be complemented by the definition of the 'performance difference' since those two concepts are often mixed and confused. Giving that they refer to two distinct measures (with different explanation) they should be properly differentiated in the fund's documentation (both prospectus and annual report). IOSCO has recently given definitions of each measure which could be used in this documentation.

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IV – Index-tracking Leveraged UCITS

Q4: Do you agree with the proposed guidelines for index-tracking leveraged UCITS?

Yes. We agree with ESMA's willingness for additional disclosure on index-tracking leveraged UCITS.
However it is necessary to have a clear definition of what is an 'index-tracking leveraged UCITS'.
If it is an index-tracking fund based on a leveraged index then it is a specific 'index-tracking' ETF and therefore it is not necessary to differentiate this type of fund from the others 'index-tracking' funds.
If it is a fund that uses leverage in its management policy then it becomes an 'actively-managed' fund.
As a result we do not believe that it is necessary to differentiate those funds from other UCITS.

Q5: Do you believe that additional guidelines should be introduced requiring index-tracking leveraged UCITS to disclose the way the fund achieves leverage?

No. The proposals of Box 2 are appropriate enough in this respect.

V – UCITS Exchange Traded Funds

UCITS ETFs and identifier

Q6: Do you agree with the proposed definition of UCITS ETFs? In particular, do you consider that the proposed definition allows the proper distinction between Exchange-Traded UCITS versus other listed UCITS that exist in some EU jurisdictions and that may be subject to additional requirements (e.g. restrictions on the role of the market maker)?

We agree on the definition of the UCITS ETFs but we would like to add one requirement.
To carry the 'ETF' name a UCITS should be 'actively traded' on a regulated European exchange; this would require having at least one market maker acting on this regulated market / exchange, and complying with the three obligations of a market maker: offering a minimum size on the ETF trading, with maximum spreads and during a minimum of time presence.

Q7: Do you agree with the proposed guidelines in relation to the identifier?

We fully agree with the proposal to use an identifier.
This 'ETF label' has to be well defined and protected. It should be used exclusively for listed and actively traded UCITS funds.
Additionally for non-UCITS ETFs marketed in Europe, only funds that are equivalent to European UCITS ETFs (similar regulatory rules and actively traded on at least one regulated securities market) could use the 'ETF' label; US-based ETFs or specific Swiss commodities ETFs could not be sold in Europe using the 'ETF' acronym. Going forward, MiFID rules and disclosures in terms of distribution should be reviewed to enable better regulation. In this respect the PRIPs Directive would also be very welcome.
Lastly, companies and other entities could not use the 'ETF' label in their name (ETFS) or in any other financial product (like Exchanged Traded Futures, which are another class of non-regulated ETPs) that do not comply with the requirements listed above.

Q8: Do you think that the identifier should further distinguish between synthetic and physical ETFs?

We do not agree on a proposed approach to use an identifier in the UCITS ETFs name that would distinguish between synthetic and physical ETFs for the following reasons:

- An identifier would widen the ETF name; the main objective of the ETF name is to quickly identify the index tracked rather than the ETF replication method. Given that ETF names are already quite long enough, one can imagine that in order to comply with fund database constraints, ETFs providers would have to remove some current relevant information from the name to keep it within an acceptable length. Adding the identifier would be at the expense of overall product clarity
- Physical and synthetic ETFs are UCITS funds and as such must comply with the same regulatory constraints. Adding an identifier would be a very discriminating measure, bringing perceptions into clients' investment policies

- An identifier in the ETF name would not add any relevant information in terms of exposure, performance, tracking error or risks compared with the information stated in the fund's KIID and prospectus. Investors may have different constraints or expectations and should therefore be able to make their own investment analysis and choose ETFs with full knowledge of the performance and underlying risks
- It is harmful for the investor to require a fixed identifier on one type of replication. If market conditions so require, then in the best interests of funds' unitholders we should allow UCITS ETFs
    1. to switch from one replication technique (i.e. portfolio management) to the other,
    2. to use both replication techniques at the same time (i.e. 90% of the underlying Index owned by the fund through physical replication or unfunded swap structure and the remaining 10% of the index gained through a funded swap structure)

  What rules, portfolio management techniques and thresholds (% of the underlying index owned by the funds) would determine into which of the two categories ETFs are placed? This may be a hard task. Let us give the following examples: a 'physical' ETF that uses sampling replication and owns 'only' 70% of the index; a 'swap-based ETF' that owns more than 90% of the index through an unfunded swap
- Finally requiring an identifier only for synthetic ETFs would be unfair and totally misleading in terms of risks communicated to investors.

Q9: Do you think that the use of the words 'Exchange-Traded Fund' should be allowed as an alternative identifier for UCITS ETFs?

Yes although it would make the ETFs names longer and it would probably be difficult to translate into some European languages, leading to a confusion between listed products.

Q10: Do you think that there should be stricter requirements on the minimum number of market makers, particularly when one of them is an affiliated entity of the ETF promoter?

There are many advantages in having more than one market maker because this can improve liquidity and spreads on the exchange. There is no need for stricter requirements on the minimum number of market makers since most of the time ETFs have a large number of active market makers. Both 'independent' market makers and affiliated entity market makers have the same requirement rules (minimum size, max spread, minimum time of presence) to respect on the exchange. Given that having a market maker in an affiliated entity of the ETF promoter is not an issue.
The cases where there is a small number of market makers are those where the underlying basket is specific (e.g. commodities) and innovative. Therefore requiring more than one market maker would make the listing difficult to achieve in these specific niche markets. Instead of addressing a regulatory requirement on this issue it would be better maybe to ask for the ETF industry best practices and harmonize ETF listing rules in Europe in terms of maximum spreads, offered size, minimum time of presence and iNAV policy.

<u>Actively-managed UCITS ETFs</u>

Q11: Do you agree with the proposed guidelines in relation to actively-managed UCITS ETFs? Are there any other matters that should be disclosed in the prospectus, the KIID or any marketing communications of the UCITS ETF?

We agree on the proposed guidelines in relation to actively-managed UCITS ETFs but it would make sense to require the same distribution rules and listing requirements for other actively-managed ETFs (such as the US ETFs) in order to have the same level playing field and avoid any competitive distortions between ETFs from different jurisdictions.
Nevertheless a clear identifier in the actively-managed UCITS' names would be very much welcome because as of today most of the so-called 'ETFs' in Europe are index-tracking funds. If regulation allows actively-managed ETFs to be listed and distributed across Europe there should be no source of confusion between index-tracking ETFs (that investors are used to) and the new actively-managed funds.

<u>Secondary market investors</u>

Q12: Which is your preferred option for the proposed guidelines for secondary market investors? Do you have any alternative proposals?

Both options comply with the UCITS Directive since it allows investors to redeem their funds' units directly to the fund. However we strongly support the option 1 in Box 5 because it appears to be the most adapted to operational issues

Although all investors are allowed to place subscription/redemption orders for a UCITS ETF in practice, only Authorized Participants (i.e. market makers) place their orders into the fund and do not incur entry/exit fees. The aim of this is to direct orders to the secondary market in order to increase ETF liquidity, reduce the number of primary market trades on the fund (trades that would generate transaction and hedging operational costs for the fund) and protect ETF performance.
Additionally there are two important issues regarding investors' access to the primary market:

- the European clearing system is not suited to retail. From an operational point of view it is important to draw a parallel between UCITS ETFs and other UCITS in terms of retail distribution. The roles of market maker (for UCITS ETFs) and distributor (for other UCITS) are similar in the sense that both act as 'trades centralizing agents'. For UCITS ETFs, retail investors do not have direct access to custodians' accounts, while Paying Agents and Transfer Agents have no involvement in the ETF distribution process overseas (orders are placed directly through the exchange and do not go through these 'trades centralizing agents'). Given these constraints, it seems complicated and time-consuming from an operational point of view to allow direct orders from retail investors.
- The fees: the prospectus provides disclosures on redemption on the primary market. As stated in the prospectus, entry/exit fees (expressed in EUR-USD or as a percentage of the amount traded) can be charged by the management company to the investor. The level of fees applied (some independent on the size of the order) is at the discretion of the management company. These fees are aimed to limit subscriptions and encourage exchange trading as primary channel and cover the operational costs of the fund's hedging (like any other non ETF UCITS fund

Nevertheless, under exceptional circumstances both retail and institutional investors should be able to place their trades on the primary market provided that they pay subscription/redemption fees. These will cover the operational costs of the fund's hedging (like any other non ETF UCITS fund). The subscription/redemption order would be executed at NAV.
Exceptional circumstances should include those cases where the secondary market would not function properly but there would be no dysfunction on other markets (i.e. primary and underlying index markets). In order to accept direct redemptions from investors, the UCITS ETF must be able to trade the underlying hedging on the index's dedicated markets. If the fund is unable to hedge its position (by adjusting the OTC derivatives, substitute basket or collateral assets), then no direct orders could be allowed.
Events affecting the secondary market could, for example, include the absence of any market maker for a specific ETF. In case it occurs (and given what was said above) it is predictable that retail investors would place their orders through an "orders centralizing entity" (like a broker or an intermediary) that would have access to clearing systems channels and place a global order with the fund. The set-up to put in place should be part of a project discussed with all entities (ETF provider, depositaries, market makers, brokers etc.).

Q13: With respect to paragraph 2 of option 1 in Box 5, do you think there should be further specific investor protection measures to ensure the possibility of direct redemption during the period of disruption? If yes, please elaborate.

As stated in Q12, investors should be able to redeem at NAV if the secondary market is disrupted. The fund's legal documentation such as the prospectus should clearly describe the contingency plans in case of secondary market disruptions.

Q14: Do you believe that additional guidelines should be provided as regards the situation existing in certain jurisdictions where certificates representing the UCITS ETF units are traded in the secondary markets? If yes, please provide details on the main issues related to such certificates.

Certificates are not UCITS and therefore there should be detailed disclosure on their additional risks (such as counterparty risks). Moreover the use of such practice is not allowed in France.

Q15: Can you provide further details on the relationship between the ETF's register of unit-holders, the sub-register held by the central securities depositaries and any other sub-registers held, for example by a broker or an intermediary?

IV. Efficient portfolio management techniques

Q16: Do you agree with the proposed guidelines in Box 6? In particular, are you in favor of requiring collateral received in the context of EPM techniques to comply with CESR's guidelines on Risk Measurement and Calculation of Global Exposure and Counterparty Risk for UCITS?

We agree on the extension of Box 26 of CESR's Guidelines on Risk Measurement and the Calculation of Global Exposure and Counterparty Risk for UCITS. It is a favorable step towards harmonization of securities lending policies in Europe (while these rules are currently essentially national). The strengths of the Box 26 Guidelines are the constraints on collateral liquidity, valuation and issuer quality, as well as qualitative requirements on collateral diversification.

Therefore the proposed guidelines in Box 6 provide consistency with derivative regulation and we globally agree with the proposed guidelines, except on the following points:

Item #2: although we strongly support higher disclosure in relation to the risk involved in these activities, counterparties risk and potential conflicts of interest, and the impact that they will have on the performance of the UCITS, we think that the required information on the UCITS' collateral policy should not be too detailed in order to avoid frequent updates to the prospectus in case of minor amendments or periodic updates to the collateral policy. Securities lending parameters change over time depending on market conditions and therefore the prospectus might not be the right place to disclose appropriately this information. It should be possible to include in the prospectus a reference to an external source (like the provider's website) where the relevant policy would be disclosed in more details

Item #6: we broadly agree with the fact that collateral received in the context of EPM techniques should comply with the criteria for the collateral received in the case of OTC derivatives set out in Box 26 of CESR's guidelines on Risk Measurement, except for the requirement that cash collateral should be invested only in "risk-free assets". At least, cash collateral should be allowed to be invested in money market funds.

Item #7: we strongly support the proposal under which the collateral should be sufficiently diversified but we disagree with the requirement that the combination of the collateral received by the UCITS and the assets of the UCITS not on loan should comply with the UCITS diversification rule (please refer to our answer to question 20).

Regarding the fees sharing we strongly support the initiative to disclose in the prospectus the split % between entities involved in securities lending activities. The annual report could also mention the actual fee split after the year-period ended.

Q17: Do you think that the proposed guidelines set standards that will ensure that the collateral received in the context of EPM techniques is of good quality? If no, please justify.

The rules defined in Box 26 of the CESR's Guidelines on Risk Measurement as well as haircuts policies provide far than enough standards and answer to collateral requirements in terms of quality to reduce counterparty risk. The issue is rather to set a reasonable standard of quality which would not result as an excessive burden for the fund's asset manager.
Nevertheless we disagree on the requirement in Box 26 asking for cash-collateral being only invested in risk-free assets. This requirement seems excessive and inappropriate and would leave to side effects that would be damageable for securities lending activities. At least, cash collateral should be allowed to be invested in money market funds.

Please also refer to our answers to questions 19 and 20 with respect to collateral diversification.

Q18: Do you see merit in the development of further guidelines in respect of the reinvestment of cash collateral received in the context of EPM techniques (the same question is relevant to Box 7 below)?

Please refer to our answer to question 17.

Q19: Would you be in favour of requiring a high correlation between the collateral provided and the composition of the UCITS' underlying portfolio? Please explain your view.

No we fully disagree on this proposal.

First this approach is based on a wrong perception of the role of collateral. The purpose of collateral is to provide a secondary recourse with respect to the entitlement to retransfer of portfolio assets. In case of default, the collateral is used as a suitable substitute basket of assets that is immediately sold and the proceeds used to acquire new securities matching with the UCITS investment strategy. For these reasons, the first objective of regulatory requirements should be to ensure that the collateral received by the UCITS is both of a good credit quality and sufficiently liquid so as to warrant the possibility of smooth disposal and adequate pricing. Therefore good credit ratings and liquidity criteria for the collateral are much more important than correlation.
Secondly higher correlation does not always mean better collateral. For example following this proposal a UCITS investing in equities would be prevented from accepting AAA rated bonds in order to secure claims from the EPM techniques.
Third the correlation requirement seems inappropriate due to the fact that cash collateral is often used in EPM techniques.
Last but not least, such a correlation requirement would be very difficult and expensive to apply in EPM techniques. Correlation is not constant over time and is hard to follow.

Q20: Do you agree that the combination of the collateral received by the UCITS and the assets of the UCITS not on loan should comply with the UCITS diversification rules?

No. Collateral should be sufficiently diversified. However collateral diversification rules and UCITS fund assets diversification rules pursue two distinct objectives: the primary aim of the former is to reduce counterparty risks while the purpose of the latter is to diversify the exposures in the fund's assets (minimum number of securities preventing 'concentration' of the investment). In this respect, collateral quality and liquidity are more important than strict quantitative diversification ratios.

Additionally diversification constraints raise the following issues:

- 'Hard diversification ratios' would mean constant back and forth between the fund and the counterparties that would lengthen the adjusting of the collateral and finally reduce the operational efficiency of the measure
- Confidentiality issues (due to the requirement for the asset manager to disclose the portfolio of assets that are not lent)
- Fund's management policy that would be driven by collateral constraints (for example the manager would have to change the collateral composition before investing in some assets)
- Operational issues since it would be difficult for the fund's manager to monitor at the same time all collateral positions coming from various counterparties and the fund's assets
- The side effects of this measure would be to have less counterparties willing to do securities lending, to adjust less often, to have less attention to the nature and the quality of the collateral because it is already held in the portfolio… etc. At the end this would be probably not a significant progress for investors' protection.

Finally diversification rules would be as difficult and expensive for asset managers as the correlation provision and it is important to measure the cost / return of such requirement. We stress on the fact that the most important thing is the liquidity of collateral.

If diversification rules were required we would like to benefit from a grand-fathering clause for existing structured funds which do not accept any new subscription from the public. This type of grand-fathering clause has already been accepted by ESMA for the calculation of global exposure (see ESMA 2011/112 - Guidelines to competent authorities and UCITS management companies on risk measurement and the calculation of global exposure for certain types of structured UCITS).
Under such a grand-fathering clause, structured UCITS authorised prior to the implementation of the new guidelines would not need to comply with paragraph 7 of Box 6.
This is due to the fact that these new guidelines were not in place when these UCITS where launched and if the UCITS portfolio were adjusted to comply with the new guidelines, this would affect the pre-defined payoff to investors at maturity. This would not be in the best interests of investors as they invested in the UCITS on the basis of the pre-defined payoff. While these existing structured UCITS may continue to accept new subscriptions, they cannot actively market their units. Structured UCITS can only benefit from this grandfathering provision using their current payoff profile; where a UCITS makes any changes to the derivative which results in a new payoff profile or scenario it must comply in full with the guidelines.

Q21: With regards to eligibility of assets to be used as collateral, do you have a preference for a list of qualitative criteria (as set out in CESR's guidelines on risk measurement) only or should this be complemented by an indicative list of eligible assets?

It would be preferable to keep the CESR's guidelines in order to have consistency in the day to day management of these provisions. In this respect the qualitative criteria provide significant improvement in terms of investors' protection. A list of eligible assets could embed market risk depending of current market conditions.

Q22: Alternatively, do you see merit in prescribing an exhaustive list of assets eligible for use as collateral? If so, please provide comments on whether the list of assets in paragraph 52 is appropriate.

An exhaustive list would be too restrictive and inflexible which could result detrimental in case of market changes, for example in terms of liquidity of the various eligible assets. The eligible collateral should remain at the asset manager's discretion since the eligibility criteria depend on current market conditions, counterparties' rating, size of the transaction, fund's investment policy etc. A list of eligible assets could embed market risk depending of current market conditions.

Q23: Do you believe that the counterparty risk created by EPM techniques should be added to the counterparty risk linked to OTC derivative transaction when calculating the maximum exposure under Article 52.1 of the UCITS Directive?

Yes, it would make sense, when calculating the maximum exposure under the Article 52(1) of the UCITS Directive for a given counterparty, to add the counterparty net exposure created by the EPM techniques (net of haircuts and collateral) to the total counterparty exposure of the UCITS linked to OTC transactions (net of haircuts and collateral).

Q24: Do you agree that entities to which cash collateral is deposited should comply with Article 50(f) of the UCITS Directive?

Yes. We agree that the entities to which cash collateral is deposited should comply with the Article 50 (f) of the UCITS Directive. The condition of cash collateral being deposited in a registered bank in Europe or in a country with equivalent regulation as in Europe is recommended.

Q25: Do you believe that the proportion of the UCITS' portfolio that can be subject to securities lending activity should be limited? If so, what would be an appropriate percentage threshold?

We are not in favor of a hard limit because it is not in the interest of investors. Securities lending activities –like TRS- improve the returns of the fund and at the end benefit to investors.

Q26: What is the current market practice regarding the proportion of assets that are typically lent?
There is no general practice regarding the proportion of assets that are typically lent and the percentage can reach 100%. Each asset manager has its own policy and the ratio also depends on the fund itself (the fund's category, its investment objective and policy, its competitive positioning etc.).

Q27: For the purposes of Q25 above, should specific elements be taken into account in determining the proportion of assets (e.g. the use made by the counterparty of the lent securities)?
As explained above in question 25 we are not in favour of a quantitative threshold limiting the proportion of assets that could be lent.

Q28: Do you consider that the information to be disclosed in the prospectus in line with paragraphs 1 and 2 of Box 6 should be included in the fund rules?

The prospectus should disclose a description of the risks involved in EPM techniques, such as potential conflicts of interest and the impact of the EPM techniques on the fund's performance. As explained above in question 16 some parameters of securities lending may change over time and would make the update of the legal documentation difficult. Given that it is not necessary to have information related to securities lending in both the prospectus and the fund rules. It would be useful to include in the fund rules a general provision with regard to the intention to engage in EPM techniques but all the specific information should only form part of the prospectus.

Q29: Do you see the merit in prescribing the identification of EPM counterparties more frequently than on a yearly basis? If yes, what would be the appropriate frequency and medium?

No, an annual frequency seems appropriate.

Q30: In relation to the valuation of the collateral by the depositary of the UCITS, are there situations (such as when the depositary is an affiliated entity of the bank that provides the collateral to the UCITS) which may raise risks of conflict of interests?
If yes, please explain how these risks could be mitigated? The question is also valid for collateral received by the UCITS in the context of total return swaps

Since depositary relationship is regulated under MIFiD we do not see any risk of conflict of interest.
Conflicts of interest should also be addressed/disclosed in the context of the lending agent. To the extent that the lending agent has some discretion over the securities that are lent and the collateral that is received, any such discretion should be subjected to strong and effective risk controls from the asset manager.

Q31: Do you think that the automation of portfolio management can conflict with the duties of the UCITS management company to provide effective safeguards against potential conflicts of interest and ensure the existence of collateral of appropriate quality and quantity? This question is also relevant to Box 7 below.

No. Automation of portfolio management does not conflict with the duties of a UCITS management company. Under UCITS rules the asset manager has an obligation of preventing from any conflict of interest and following its duties of risk measurement and control. Any flexibility given to a counterparty should be subject to robust and effective risk controls from the asset manager. Regulations should not allow the counterparty to freely post collateral and the lending agent should not be allowed to choose freely the securities that are lent. It is the investment manager's role and duty to control all issues regarding securities according to its internal guidance related to securities lending. This means monitoring collateral, its quality and quantity before the operation being put in place.

V. Total Return Swaps

Q32: Do you agree with the proposed guidelines?

We agree with the proposed guidelines in Box 7, except on the following points:

Item #1: We do not consider that UCITS diversification rules should apply to the investment portfolio which is swapped in the TRS. Instead, Box 26 of CESR's guidelines should apply. Risks taken by investors are the real exposure of the fund, after the effect of derivatives.
UCITS diversification rules (on the fund's exposure) are meant to avoid the possibility that exposure to a given issuer would have too significant an impact on the performance of the fund. However, the portfolio swapped in a TRS has no impact on the performance of the UCITS, since it is swapped. Instead, the UCITS has counterparty risk on the counterparty to the TRS, and the risk is subject to a 10% limit. The investment portfolio should therefore be subject to Box 26 of CESR's guidelines.

Item #2: We agree that the collateral should be sufficiently diversified. However, due to its purpose to provide secondary recourse in case of a counterparty's default, the collateral should not be treated as part of the fund portfolio and thus not be subject to the UCITS diversification rules in combination with other assets.

Item #5: We do not consider that the information to be provided further to this should be fully included in the prospectus. In particular, details of counterparties and type of collateral are dynamic information and may change very frequently. We suggest that criteria for choice of counterparties and determination of eligible criteria should only be described in the prospectus in a generic manner, with further details being provided in the annual report (in accordance with paragraph 6 of Box 7).

About the question on whether to treat a counterparty as an **investment manager**, we agree if the counterparty has discretion and flexibility over investments that have an impact on the performance/NAV of the UCITS. But if the counterparty has discretion only over the collateral of the TRS (i.e. the investment portfolio that is swapped), it would be illogical to treat it as an investment manager. As for any swap, the investment manager of the UCITS sets guidelines for acceptable collateral and the counterparty has discretion within these guidelines to choose the securities it gives as collateral.

Regarding the investment management delegation agreement, we should consider two cases:

1. The assets exchanged through the swap have no impact on the fund's performance and risk profile (common to almost all European synthetic UCITS ETFs): the asset manager enters into an agreement with the swap counterparty by establishing and agreeing detailed and well defined asset eligibility rules. In this case the swap counterparty does not act as a 'fund manager' (although it manages the index hedge) and therefore, from our point of view, it should not be obliged to enter into any investment management delegation agreement.
2. The assets exchanged through the swap affect the fund's performance and risk profile (common to actively-managed UCITS ETFs): the swap-counterparty management decisions affect the performance of the fund and the management policy is similar to that of a normal fund's asset manager; in this case the swap-counterparty should enter into an advisory agreement with the asset manager.

With regard to point 2, some European jurisdictions (like France) do not allow a bank to become an asset manager. This would make the ESMA proposal non-applicable or if passed the regulation should be harmonized across Europe.

Q33: Do you think that the proposed guidelines set standards that ensure that the collateral received in the context of total return swaps is of good quality? If not, please explain your view.

Generally speaking, yes. However, see our remarks under question 32 above.

Q34: Do you consider that the information to be disclosed in the prospectus in line with paragraph 5 of Box 7 should be included in the fund rules?

No, we do not see the need for including this information in the fund rules, for the same reasons as under question 28 above.

Q35: With regards to eligibility of assets to be used as collateral, do you have a preference for a list of qualitative criteria (as set out in CESR's guidelines on risk measurement) only or should this be complemented by an indicative list of eligible assets?

We have a clear preference for qualitative criteria. These criteria could usefully be supplemented with an indicative list of collateral types (it should then however be clearly highlighted that such a list is only indicative, not exhaustive).

Q36: Alternatively, do you see merit in prescribing an exhaustive list of assets eligible for use as collateral? If so, please provide comments on whether the list of assets in paragraph 73 is appropriate.

We do not support the proposal of a list of assets eligible for use as collateral. Such an exhaustive list would indeed inflexible in case of market changes and therefore runs the risk of not adequately reflecting the market conditions in terms of liquidity at a given point in time.

Q37: Do you agree that the combination of the collateral received by the UCITS and the assets of the UCITS not on loan should comply with the UCITS diversification rules?

We agree that collateral should be sufficiently diversified. But we strongly disagree with the principle that the collateral received by the UCITS and the UCITS investments (the reference to "assets not on loan" is inappropriate in the context of TRS transactions) should, on aggregate, comply with the UCITS diversification rules.

If diversification rules were required we would like to benefit from a **grand-fathering clause for existing structured funds which do not accept any new subscription from the public**. This type of grand-fathering clause has already been accepted by ESMA for the calculation of global exposure (see ESMA 2011/112 - Guidelines to competent authorities and UCITS management companies on risk measurement and the calculation of global exposure for certain types of structured UCITS).

Under such a grand-fathering clause, structured UCITS authorised prior to the implementation of the new guidelines would not need to comply with paragraphs 1 and 2 of Box 7.

This is due to the fact that these new guidelines were not in place when these UCITS where launched and if the UCITS portfolio were adjusted to comply with the new guidelines, this would affect the pre-defined payoff to investors at maturity. This would not be in the best interests of investors as they invested in the UCITS on the basis of the pre-defined payoff. While these existing structured UCITS may continue to accept new subscriptions, they cannot actively market their units. Structured UCITS can only benefit from this grandfathering provision using their current payoff profile; where a UCITS makes any changes to the derivative which results in a new payoff profile or scenario it must comply in full with the guidelines.

Q38: Do you consider that the guidelines in Box 7 and in particular provisions on the diversification of the collateral and the haircut policies should apply to all OTC derivative transactions and not be limited to TRS?

We consider that there is no reason not to apply the same standards in terms of collateral requirements to all OTC derivatives transactions. But as explained above, we do not agree on some of the provisions of Box 7, in particular concerning provisions on diversification of the investment portfolio which is swapped and the collateral received by the UCITS (cf. answer to question 32 above).

VIII – <u>Strategy indices</u>

Q39: Do you consider the proposed guidelines on strategy indices appropriate? Please explain your view.
Comments on the proposed guidelines:

- Diversification: we do not understand the 'impact' concept; the definition (quantitative or qualitative) would need to be clarified
- For commodity indices different commodities must be considered: for metals what would be the correlation ratio above which two metals would be taken as a whole?
- Strategy index methodologies must be based on a model; therefore they must be systematic and non-discretionary

We agree with the proposed guidelines. Although a full and detailed transparency is in the best interest of investors, requirements on index providers might be considered as too demanding. Those entities might be reluctant to disclose the full strategy index data "live" through their internet website. Today on its 'vanilla indices' MSCI provides information with a 2-days delay and constituents weights such as details on the index calculation methodology are not available to investors.

Q40: Do you think that further consideration should be given to potential risks of conflict of interest when the index provider is an affiliate of the management company?
We consider there is no conflict of interest as soon as there is a full transparency on the strategy index methodology, costs and index rebalancing, independent valuation.

<u>IX – Transitional provisions</u>

Q41: Do you consider the proposed transitional provisions appropriate? Please explain your view.

Whilst we agree with many of the proposals, it is very important to recognize that the envisaged guidelines require huge implementation work in order to become operational. Therefore, we believe that it is neither reasonable nor practicable to bring the guidelines into effect in 2012.

Therefore, the guidelines should generally come into effect not less than twelve months after their final publication. Additional time should be available in order to reflect the content of the new policies in the marketing materials and fund documents.

Furthermore, as we have explained, it is not advisable to require additional rules on the collateral diversification (besides current Box 26 which is appropriate). If however it is decided to go further with proposals like hard diversification requirements on collateral, we believe that it should be granted a grandfathering clause to existing contracts, and at least to existing structured funds. If not, the funds' economy would be destructed and funds would have difficulty to fill their fiduciary duty.

In the second case, the perimeter of such a grand-fathering clause would be limited to existing structured funds which do not accept any new subscription from the public. This type of grand-fathering clause has already been accepted by ESMA for the calculation of global exposure (see ESMA 2011/112 - Guidelines to competent authorities and UCITS management companies on risk measurement and the calculation of global exposure for certain types of structured UCITS).

Under such a grand-fathering clause, structured UCITS authorised prior to the implementation of the new guidelines would not need to comply with paragraphs 6 and 7 of Box 6 and paragraphs 1 and 2 of Box 7.

This is due to the fact that these new guidelines were not in place when these UCITS where launched and if the UCITS portfolio were adjusted to comply with the new guidelines, this would affect the pre-defined payoff to investors at maturity. This would not be in the best interests of investors as they invested in the UCITS on the basis of the pre-defined payoff. While these existing structured UCITS may continue to accept new subscriptions, they cannot actively market their units. Structured UCITS can only benefit from this grandfathering provision using their current payoff profile; where a UCITS makes any changes to the derivative which results in a new payoff profile or scenario it must comply in full with the guidelines.