



BEAMA's Reply to Consultation paper: ESMA's guidelines on ETFs and other UCITS issues

BEAMA welcomes the opportunity to reply to ESMA's Consultation paper regarding guidelines on ETFs and other UCITS issues.

URL: <http://www.esma.europa.eu/news/ESMA-outlines-future-regulatory-framework-ETFs-and-other-UCITS-issues?t=326&o=home>

BEAMA, www.beama.be, the Belgian Asset Managers Association, is the professional association of Belgian fund and asset managers. BEAMA has 93 members (62 effective members - 31 associated members), representing €227 billion in assets under management as at the end of 2010. BEAMA is a member of Febelfin, the Belgian Federation of the Financial Sector.

Summary

- For index-tracking (leveraged) UCITS, the guidelines on the frequency of tracking error calculation could be more detailed and the mention of a maximum tracking error should be allowed.
- As far as UCITS Exchange Traded Funds are concerned, the identifier “ETF” should not be made compulsory in the name of the fund; from a level playing field perspective, financial products that are not funds should be prohibited to use the identifier “ETF”. For secondary market investors, both options have points in their favour. For Option 2, a frequency of regular points in time is preferred.
- Remarks on efficient portfolio management techniques and on total return swaps are similar. It is considered not correct to globalize both the collateral and the investment portfolio exposures. Moreover, collateral information should be made more qualitative, based on a dynamic list (ECB, f.i.) including cash. A European approach towards securities lending would be welcome; securities lending should clearly be distinct from naked short-selling.
- In the proposal for strategy indices, some investment strategies are excluded (Portfolio Insurance or Constant Volatility, f.i.) and proprietary indices might lose their own reason of being, which, in both occasions, is not desired.
- For the transitional provisions, the proposal should include the possibility to let existing products extinguish over time without additional constraints.

General comments

BEAMA also refers to the response of EFAMA (the representative association for the European Fund and Asset Management industry) on the consultation paper and supports the general comments on following aspects:

- BEAMA welcomes the decision to broaden the scope of these proposed guidelines in such a manner as to target not only UCITS ETFs but all UCITS that engage in the relevant activities (e.g. securities lending) or pursue the same type of investment policy (e.g. tracking an index);
- when considering investor protection and disclosure requirements, BEAMA strongly encourages ESMA – as well as other regulators and supervisors – to take a horizontal approach to funds and non-funds products alike in the spirit of MiFID and of the PRIps initiative;
- BEAMA supports ESMA's move towards greater transparency as it will further enhance investor's understanding and confidence in UCITS products. Transparency requirements should however be proportionate and bring real-added value in particular to retail investors allowing them to take well-informed investment decisions;
- BEAMA has significant objections in relation to the collateral requirements both in the context of Efficient portfolio management techniques and the use of Total return swaps (or other OTC derivatives) and disagrees with the proposed diversification rules for collateral;
- it will be important to clarify the scope of ESMA's proposed guidelines on Strategy Indices: there is no reason to restrict the scope of application of the proposed guidelines in Box 8 only to strategy indices;
- it is essential to recognize that the industry – but also national regulators – will need a reasonable period of time to put these guidelines into practice. Equally important is the fact that specific transitional provisions should be foreseen for existing products, including notably a "grand-fathering clause" for structured UCITS which do not accept any new subscriptions from the public.

Detailed answers

I. Index-tracking UCITS

Q1: Do you agree with the proposed guidelines?

A1. Yes.

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.

A2. There could be some more guidelines concerning the frequency of tracking error calculation. The opportunity should also be given to mention a maximum tracking error.

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?

A3. Yes.

II. Index-tracking leveraged UCITS

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

A4. Yes.

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

A5. No.

III. UCITS Exchange Traded Funds - Definition of UCITS ETFs and Title

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)?

A6. The definition is agreed upon. It is important, from a level playing field perspective, that other financial products that are not funds should be prohibited to use the name ETF. Further, from a practical perspective, funds that are ETF's should not always have to mention in their name the identifier ETF (However, the identifier ETF should be mentioned in the relevant documents).

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

A7. From a practical perspective, the fund should not always have to mention in its name the identifier ETF.

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

A8. From a practical perspective, the fund should not always have to mention in its name the identifier ETF, and e.g. also not always have to incorporate in its name the mention of 'synthetic' or 'physical'. There should also be flexibility to allow passages from one category to the other.

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

A9. This name should only be allowed for UCITS funds and not for other financial 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?

A10. No. The working of the stock exchanges / MTF's is not identical everywhere, some operate by volume-driven rules, some by market making (pricing rules). In Belgium, the Euronext-system is that of a liquidity provider not of market makers.

III. UCITS Exchange Traded Funds – Actively-managed UCITS

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?

A11. The proposed guidelines are fine in case the fund is clearly actively managed. There is no need for additional disclosures.

III. UCITS Exchange Traded Funds - Secondary market investors

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

A12. Both options have points in their favour. The most straightforward option is Option 2 provided that the notion “at any time” should be further detailed. Preference goes to a frequency of “regular points in time” (e.g. several times a day). Option 2 offers more security to end investors. For Option 1 to be valid, the relation with the market maker and the stock exchange should not be made explicit. An alternative proposal would be to leave both Options open.

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.

A13. No. The relation with the market maker and the stock exchange should again not be explicit.

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.

A14. No.

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 depositories and any other sub-registers held, for example by a broker or an intermediary?

A15. In view of differences between markets, a precise answer is hard to give.

IV. Efficient portfolio management techniques

Q16: Do you agree with the proposed guidelines in Box 6? In particular, are you in favour 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?

A16. No. There is a distinction to be made between securities lending and other techniques. Moreover, the globalization of collateral exposure and investment portfolio exposure is mixing two totally different exposures together, which is not correct.

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.

A17. No, rules might be made stricter, including more qualitative information about, for instance, the collateral itself. The globalization of collateral exposure and investment portfolio exposure is mixing two totally different exposures together, which is not correct.

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)?

A18. No.

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.

A19. No. The quality of the collateral is of much more importance. Worth mentioning as well is the particular Belgian situation (see 7 maart 2006 – Koninklijk besluit met betrekking tot de effectenleningen door bepaalde instellingen voor collectieve beleggingen / 7 mars 2006 – Arrêté Royal relatif aux prêts de titres par certains organismes de placement collectif).

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?

A20. No. These are totally different exposures.

In practice this rule is not feasible. When trading with different counterparties the implementation of this rule would mean each counterparty is required to know both outright exposure of the fund as collateral received by the other counterparties, before being able to post collateral that respects the UCITS diversification limits (more specifically in respect of the 5% / 10% / 40% rule).

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?

A21. There is a preference for a dynamic qualitative list (for instance the ECB list).

Q22: 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?

A22. No. There should be a dynamic qualitative list (for instance the ECB list), including cash deposits, obviously.

Q23: 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.

A23. Yes.

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

A24. Yes.

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?

A25. No. Important to mention is also to try and get a uniform European approach on the (ban on) short selling rules in this respect (particularly in periods where some countries are banning it and some other not).

Q26: What is the current market practice regarding the proportion of assets that are typically lent?

A26. This is variable. Important should be to give the opportunity to organize the initial transfer of collateral vs. loan of securities in a synchronized way (not one before the other).

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)?

A27. No. Important points of attention are: to coordinate European rules and to make a distinction between naked short selling and securities lending.

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?

A28. No. The disclosure in the prospectus is considered sufficient.

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?

A29. No. The yearly reporting via the annual report is fine.

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.

A30. No, provided a clear Marking to Market is applied to the valuation of the collateral.

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.

A31. No.

V. Total return swaps

Q32: Do you agree with the proposed guidelines?

A32. No. The globalization of collateral exposure and investment portfolio exposure is mixing two totally different exposures together, which is not correct.

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

A33. No, rules might be made stricter, including more qualitative information about, for instance, the collateral itself. The globalization of collateral exposure and investment portfolio exposure is mixing two totally different exposures together, which is not correct.

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?

A34. No.

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?

A35. There is a preference for a dynamic qualitative list (for instance the ECB list), including cash deposits, obviously.

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.

A36. There is a preference for a dynamic qualitative list (for instance the ECB list), including cash deposits, obviously.

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?

A37. No. The globalization of collateral exposure and investment portfolio exposure is mixing two totally different exposures together, which is not correct.

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?

A38. Yes, there should be harmonization in this respect.

VI. Strategy indices

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

A39. No. The proposal excludes funds like “Portfolio Insurance” or “Constant Volatility”, for example. Moreover, practical implications for proprietary indices are judged incompatible with their own reason of being.

Q40: Do you think that further consideration should be given to potential risks of conflict of interests when the index provider is an affiliated firm of the management company?

A40. No.

VII. Transitional provisions

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

A41. The proposal should include the possibility to let existing products extinguish over time without additional constraints, except, for instance, for stopping new subscriptions.

BEAMA, 30 March 2012.