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Register of Interest Representatives:  
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<p align="center"><b>BNP PARIBAS feedback to ESMA on Consultation paper “ESMA’s guidelines on ETFs and other UCITS issues” dated 30 January 2012 (ESMA/2012/44)</b></p>
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### **Contribution by BNP Paribas**

BNP Paribas (“BNPP”) is a European leader in global banking and financial services, with a broad international coverage and a strong presence in all key financial centres. Ranking as the first bank in Eurozone in terms of deposits, Standard and Poor’s rates the Group as one of the six strongest banks globally.

BNP Paribas is pleased to provide its views at the occasion of this consultation dealing with important issues related to its business.

#### **As regards to Strategies indices:**

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

Guideline 1:

The prospectus for an index replicating UCITS must, where relevant, inform investors of the intention to make use of the increased diversification limits together with a description of the exceptional market conditions which justify this investment:

BNP PARIBAS agrees with this proposed guideline, to the extent that the proposed diversification rules are those described in the 1<sup>st</sup> bullet point of the paragraph 79.

Guideline 2:

A single component of an index must not have an impact on the overall index which exceeds the relevant diversification requirement i.e. 20%/35%. In the case of a leveraged index, the impact of one component of the overall return of the index, after taking into account the leverage should respect the same limits.

BNP PARIBAS agrees on the fact that the diversification criteria within the strategy index should be always consistent with respect to the leverage embedded within the index.

BNP PARIBAS agrees with the guideline in general and that the diversification criteria within the strategy index should always be consistent with respect to the leverage embedded within the index. For the avoidance of doubt, BNP PARIBAS strongly recommends that ESMA

clearly confirms that diversification of indices of indices and indices based on futures can be assessed by looking through each index component or future component.

As an example, an index based on a diversified equity index and EONIA, balancing its exposure on cash versus equity according to market conditions with a resulting exposure on equity between 0 and 100%, needs to be eligible.

#### Guideline 3:

Commodity indices must consist of different commodities which respect the 20%/35% limit in order to be considered an eligible index.

BNP PARIBAS would like to remind that the UCITS regulation doesn't allow any investment in the physical commodities but only in indices of systematically rolled futures. As a matter of consequences, specificity of each index/commodity should be treated independently in respect of diversification.

BNP PARIBAS agrees with this guideline if by "commodity" (i) each single-commodity is taken into account separately, if (ii) a related product of a given commodity is considered as a separate commodity and if (iii) a given future of a commodity is not aggregated with the other existing futures.

As a matter of illustration,

- case (i), Brent and WTI shouldn't be considered as the same commodity
- case (ii), "soybeans" and "soybeans oil" shouldn't be considered as the same commodity.
- case (iii) : the 3 month WTI sub index versus front month WTI sub index shouldn't be considered as the same commodity

BNP PARIBAS considers for all the above illustrations, performances and market behaviors are different. Thus treatment should be different.

#### Guideline 4:

A strategy Index must be able to demonstrate that it satisfies the index criteria, including that of being a benchmark for the market to which it refers. For that purpose:

- An index must have a clear, single objective in order to represent an adequate benchmark for the market
- The universe of index components and the basis on which these components are selected for the strategy should be clear to investors and competent authorities
- If cash management is included as part of the index strategy, the UCITS must demonstrate that this doesn't affect the objective nature of the index calculation methodology

BNP PARIBAS agrees with this guideline.

#### Guideline 5:

The UCITS prospectus should disclose the rebalancing frequency and its effects on the costs within the strategy.

BNP PARIBAS considers important to distinguish between the two following cases:

- Case 1: the fund is exposed to an actively managed set of strategy indices
- Case 2: the fund is exposed to a strategy index

BNP PARIBAS would like to make clear that in the case of a fund using various strategy indices, the various rebalancing between the strategy indices should be disclosed in the usual reporting materials and not in the statutory document of the UCITS.

#### Disclosure of the rebalancing frequency:

BNP PARIBAS agrees to make this disclosure when the rebalancing mechanism embedded within the index makes it possible. Indeed and for some indices, the rebalancing mechanism depends on the fulfillment of certain conditions. For example for CPPI and/or Isovol indices, the rebalancing frequency can vary in time and thus, cannot be subject to a defined periodicity as it will depend on market conditions.

#### Disclosure of the effects of the rebalancing frequency on the costs within the strategy:

BNP PARIBAS would like to point out that there is no major interest to disclose this kind of information in the prospectus. Actually, BNP PARIBAS considers that the management company's role is to perform the necessary due diligences in order to determine if an index is suitable for a UCITS, to assess the rebalancing frequency, to analyze whether or not these rebalancing will negatively impact the costs' structure, the index performances. If this should be the case, investors should be informed through usual reporting materials of the costs of the rebalancing frequency of a strategy index.

Therefore, for case 1, as the allocation between the indices is actively managed, it is difficult to identify the costs' impacts: the indices can vary in time, the rebalancing frequency can also evolve in time....

However, in respect of case 2: BNP PARIBAS would agree with the principle of a broad disclosure in the prospectus of details about the nature of the various costs (replication costs, brokerage costs.....) and their potential impacts on the strategy according to circumstances.

#### Guideline 6:

The rebalancing frequency should not prevent investors from being able to replicate the financial index. Indices which rebalance on intra-day or daily basis do not satisfy this criterion.

BNP PARIBAS doesn't understand the reasons behind forbidding daily basis rebalancing for eligible indices. From our point of view, this guideline should be applied exclusively for high frequency trading indices. For daily rebalancing or even low intra-day rebalancing frequency (two per day for example), BNP PARIBAS doesn't see any problem preventing investors from an appropriate replication. Moreover, BNP PARIBAS would like to draw ESMA's attention that the daily rebalancing can be done within a strategy index for the investor's benefit, especially in case of rebalancing due to an 'isovol' mechanism within the index.

#### Guideline 7:

The index provider should disclose the full calculation methodology to, inter alia, enable investors to replicate the strategy. This includes information on index constituents, index calculation (including effect of the leverage within the index), re-balancing methodologies, index changes and information on any operational difficulties on providing timely or accurate information. This information should be easily accessible by investors, for example, via the internet. Information on the performance of the index should be freely available to investors.

#### Guideline 8:

A financial index must publish the constituents of the index together with their respective weightings. Weightings may be published after each rebalancing on a retrospective basis. This information should cover the previous period since the last rebalancing and include all levels of the index.

Answer 7 & 8:

BNP PARIBAS doesn't agree with this proposed guideline for the main following reason:

Intellectual property & innovation: the fact to disclose all the proprietary information stated above will prevent management companies from providing innovative index to our investors which can harm the "UCITS" brand. Indeed, BNP PARIBAS thinks that the index providers will not accept such disclosure as it will affect their intellectual property and competition advantage. In addition, qualified investors, wishing to invest in a dedicated fund with the UCITS branding exposed to a strategy index, have all the required skills to analyze the index and to understand its mechanisms. Thus, BNP PARIBAS considers that index provider will not appreciate the disclosure of the information related to the index at a large scale since it can harm their competitive and innovative power.

It seems to us that the aim of this guideline as the previous one (guideline 6) is to enable the investor to fully replicate the index for a better understanding of the mechanisms. BNP PARIBAS doesn't agree with such approach. Indeed, BNP PARIBAS considers that the management company has the full responsibility to make the necessary due diligences on the index, to determine for which category of investors this index can be used, to assess the complexity level of the index and this is finally submitted to the UCITS supervisory body for approval. BNP PARIBAS thinks that the important information from an investor point of view is more the index behavior in various markets conditions (bearish or bullish....) rather than its calculation methodology one in order to decide the suitability of the index strategy with its target investment.

However, BNP PARIBAS is of the view that the index mechanism should be for instance described in the prospectus. A UCITS should especially highlight the portfolio construction or the different constraints embedded within the index.

Guideline 9:

The methodology of the index for the selection and re-balancing of the components of the index must be based on a set of pre-determined rules and objective criteria.

Answer 9: BNP PARIBAS agrees with this proposal.

Guideline 10:

The index provider may not accept payments from potential index components for inclusion in the index.

BNP PARIBAS agrees with this proposal.

Guideline 11:

The index methodology must not permit retrospective changes to previously published index values (backfilling)

BNP PARIBAS agrees with this proposal.

Guideline 12:

The UCITS must carry out appropriate documented due diligence on the quality of the index. This due diligence should take into account whether the index methodology contains an adequate explanation of the weightings and classification of the components on the basis of the investment strategy and whether the index represents an adequate benchmark. The UCITS must also assess the availability of information on the index including whether there is a clear narrative description of the benchmark, whether there is an independent audit and the scope of such audit, the frequency of index publication and whether this will affect the ability of the UCITS to calculate its NAV. The due diligence should also cover matters relating to the index components.

In all cases, BNP PARIBAS thinks that the management company's role is to carry out the necessary diligences in order to determine the index suitability with the UCITS guidelines.

Nevertheless and regarding funds dedicated to qualified investors, BNP PARIBAS considers that an exception can be made (please refer to Answer 13 & 14 for more details).

For the avoidance of doubt and in order to fully understand this guideline, BNP PARIBAS would like to stress the need to get a clarification of the meaning of 'independent audit' and the scope of such audit in the context of a strategy index. is it process valuation audit, operational audit on the index provider...? BNP Paribas thinks that it should be clarified that the audit can be done by any entity that is arm's length with the index calculation agent.

Guideline 13 & 14:

UCITS must ensure that any valuation of the swap includes an independent assessment of the underlying index.

The financial index should be subject to independent valuation.

BNP PARIBAS would like to highlight the fact that in making any calculation of a financial index, an 'independent agent' would in practice only make the calculation of the index following the rules of the index established by the index provider as set out in the relevant rulebook. It would be very unusual for this 'independent agent' to perform some type of audit role regarding the valuation of the index that extends beyond calculation according to the existing rules.

With this in mind and to reduce potentially unnecessary costs arising from third party calculation of a provider's index which is likely to have a pricing impact for a UCITS, some index providers have put in place an organizational infrastructure which ensures total independence between the teams in charge of marketing, negotiating and closing transactions with UCITS linked to the indices and the teams in charge of the calculation of these indices. Provided that the management company has performed its own due diligence to assess the independence or the robustness of the organization of the index provider, BNP PARIBAS is of the view that that the independent valuation is achieved.

Moreover and if we take into account the practice of UCITS dedicated to institutional investors, BNP PARIBAS thinks that the independent valuation isn't necessary for the same reasons stated above. BNP PARIBAS considers however that the prospectus should contain appropriate disclosure regarding the various entities involved for a given strategy index as well as the potential interest conflict of interest that may arise in respect of the use of an index.

**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?**

BNP PARIBAS does not see any conflict of interest when the index provider is an affiliated firm of the management company itself as far as the affiliated firm is able to prove that it has the means to handle properly the calculation and the controls linked.

Moreover BNP PARIBAS thinks that the asset manager itself could be under certain circumstances the index provider. Indeed as a specialist of the investment decisions, the management company is one of the best entities to handle such a role and it thus should be encouraged to develop new indices.

#### **Transitional provisions**

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

BNP PARIBAS welcomes the fact that ESMA is recognizing the need for transitional provisions for the entry into force of the guidelines.

As a general remark, however, we wish to underline that the appropriateness of the transitional provisions can only be assessed once the extent of the changes to the regulatory framework will be clearly established. Indeed, since ESMA is seeking to harmonize issues which are currently regulated at national level, it may well be that national laws or regulations have conflicting requirements and would therefore need to be amended to be aligned on ESMA's guidelines. In such cases, there should first be sufficient time to adopt national laws/regulations and second appropriate time for market participants to adapt to such changes. Otherwise, market participants may be facing an uncomfortable situation in which they would have to choose between violating ESMA's recommendations or national regulations.

As a first step, we would therefore urge ESMA to check with national supervisors whether changes in national laws or regulations are needed to comply with ESMA's proposed guidelines and, as the case may be, how much time would be required for these changes to become effective. On the basis of that information, ESMA should then define accordingly the date of entry into effect of the proposed guidelines.

In addition to that, whilst BNP PARIBAS agrees with many of the proposals and general direction of ESMA's guidelines, it is very important to recognize that the envisaged guidelines require implementation of several policies such as collateral policy, haircut policy, reinvestment policy or policy in relation to tracking error which need considerable preparation in order to become operational.

Therefore, BNP PARIBAS believes that it is not reasonable or practicable to bring the guidelines into effect in 2012.

As a result, 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.

Moreover, BNP PARIBAS believes that it would be very important to clarify the meaning of “new investments” in paragraph 2 of Box 9.

In this respect, we believe in particular that a grandfathering clause should be granted to contracts already in place when guidelines will set in force, or, in any case, to Structured UCITS (within the meaning of Regulation 583/10 (KIID)) which do not accept any new subscriptions 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 authorized prior to the implementation of the new guidelines would not need to comply with paragraph 7 of Box 6 and paragraphs 1 and 2 of Box 7.

Such grand-fathering clause would be granted in recognition of the fact that these new guidelines were not in place when these UCITS were 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.