RESPONSE TO THE CONSULTATION PAPER: ESMA'S GUIDELINES ON ETFS AND OTHER UCITS ISSUES

This response is submitted jointly on behalf of MSCI Inc., The McGraw-Hill Companies, Inc., and FTSE International Limited and is confined to the Questions 1, 39 and 40 of the "Consultation Paper: ESMA's guidelines on ETFs and other UCITS issues" ("Consultation").

Please see below for a brief description of the business interests of the signatories to this response. The response is set out in full below in the format prescribed by the Consultation.

MSCI INC.

MSCI Inc. is a provider of investment decision support tools to investors globally, including asset managers, banks, hedge funds and pension funds. MSCI products and services include indices, portfolio risk and performance analytics, and governance tools.

The company's flagship product offerings include the MSCI indices; Barra multi-asset class factor models, portfolio risk and performance analytics; RiskMetrics multi-asset class market and credit risk analytics; ISS governance research and outsourced proxy voting and reporting services.

MSCI is headquartered in New York, with research and commercial offices around the world.
www.msci.com

THE MCGRAW-HILL COMPANIES, INC.

The McGraw-Hill Companies is a leading global financial information and education group with interests in both the provision of energy and commodities price assessment and information services for the oil, natural gas, electricity, emissions, nuclear power, coal, petrochemical, shipping, and metals markets, and in the provision of globally-recognised benchmark portfolio indices.

The group is headquartered in New York and has more than 280 offices in 40 countries.
www.standardandpoors.com/**indices**

FTSE INTERNATIONAL LIMITED

FTSE International Limited ("FTSE") is a world-leader in the creation and management of indices. With offices in London, Beijing, Dubai, Frankfurt, Milan, Mumbai, Hong Kong, New York, Paris, San Francisco, Sydney, Shanghai and Tokyo, FTSE works with investors in 77 countries globally. It calculates and manages a comprehensive range of equity, fixed income, real estate, currency, commodity and non market-cap indices, on both a standard and custom basis. The company has collaborative arrangements with a number of stock exchanges, trade bodies and asset class specialists around the world.

FTSE indices are used extensively by investors world-wide for investment analysis, performance measurement, asset allocation, portfolio hedging and for creating a wide range of index tracking funds.

FTSE is an independent company-owned by the London Stock Exchange Group.
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Q1: Do you agree with the proposed guidelines?

Guideline 1a): The prospectus of an index-tracking UCITS should include:
a) A clear description of the index including details of its underlying components. In order to avoid the need to update the document frequently, the prospectus can direct investors to a web site where the exact composition of the index is published.

We would require clarity on what constitutes the "underlying components" of the index and would question the reasons for such broad disclosure of the underlying index data.

The relevant data for the purposes of the ETF is the fund holdings data, not the underlying index data.

Currently, for ETFs, the fund holdings data necessary for clearing, settling and redemption is already published in the portfolio composition file ("PCF") that is made available by the ETF issuer directly to authorized participants of the fund as well as via the ETF issuers' websites with a delay. The PCF file includes the following data: fund holdings with identifiers, weights of these holdings, and the numbers of shares.

While there is overlap of certain fund holdings data and index data (e.g., with respect to the list of constituents in the fund based on the index), index providers already permit those limited disclosures in the PCF, as it is a requirement of the market and our clients.

Requiring the disclosure of underlying components of an index beyond what is in the PCF seems excessive, as it is unnecessary for any clearing, settlement and redemption of the fund shares.

Further, we would be concerned about, and would object to, the underlying components of an index being made publicly available for the following reasons:

- The security/constituent level data of an index is an aggregation of derived data points created by the index providers and third party data providers who aggregate raw data necessary for the construction of indexes. This data comprises valuable intellectual property that is licensed on a subscription basis to clients for a fee. Requiring publication of proprietary data on websites would negatively impact index providers and third party data providers whilst not presenting a real benefit to investors.
- Index providers enter into license agreements with many different third party data providers and pay license fees for the right to use their data to calculate indices. These license agreements very often prohibit index providers from publicly distributing their raw data. Consequently, consideration should be given to the requirement to make their data public as it will reduce the value of the data providers' data and may also cause the index providers to breach their contracts with those data providers.

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

We believe that strategy indices should meet the same standards of disclosure and transparency as any other index. Therefore we endorse all proposed guidelines contained in Box 8 of the Consultation, to the extent that they apply to index providers, except as described below.

Guidelines in Box 8	*Response*
Guideline 4a: ***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:*** ***a) An index must have a clear, single objective in order to represent an adequate benchmark for the market;***	Indices are created based on rules, and aim to measure a market or define an opportunity set. The decision with respect to whether the investment objective is met by the index is taken by the financial institution that wishes to launch the UCITS. Further, the Consultation seems to have been written with a view to allowing indices that are not long only or beta based to be eligible for UCITS. However, this paragraph still refers to the need to be "an adequate benchmark for the market". Strategy indices may seek to capture alpha, or alternative betas associated with harvestable risk premia such as value or momentum. They may do so through long-short strategies with positions determined by objective criteria. We believe such indices should be eligible and the guidelines should explicitly allow long-short indices to be eligible.
Guideline 4b: ***b) The universe of the index components and the basis on which these components are selected for the strategy should be clear to investors and competent authorities;***	Index providers currently disclose the index components to subscribers. However, the disclosure of the universe of index constituents (i.e., securities) in an index goes beyond the actual securities in the index. The universe includes the potential securities that could be included in the index and should not be subject to disclosure requirements. Our objection to broad disclosures of index components is described above in the response to Question 1, Guideline 1(a). Our response regarding the availability of index methodologies is provided below.
Guideline 5: ***The UCITS' prospectus should disclose the rebalancing frequency and its effects on the costs within the strategy.***	With respect to index rebalancing, we agree that the prospectus should disclose the rebalancing rules of the index. With respect to costs, index calculations typically do not include rebalancing costs. However, strategy indices will involve higher trading costs than buy-and-hold, capitalisation weighted indices, and there may be a desire from product providers for the index to be calculated net so as to take account of the costs entailed in managing the strategy. We propose that where this is the case, the index methodology should disclose on a historical basis the index turnover (i.e., changes to the index and weights resulting from the rebalancing). The index providers will not have access to the UCITS costs resulting from the index turnover.
Guideline 6: ***The rebalancing frequency should not prevent investors from being able to replicate the financial index. Indices which rebalance on an intra-day or daily basis do not satisfy this criterion.***	We agree that the rebalancing frequency should not prevent the replication of the financial index. However, we disagree with the provision that strategy indices should not be rebalanced daily. Many suitable investment strategies (such as systematic strategies or investment processes) may require daily rebalancing and should be considered eligible. Examples of widely used existing strategy indices that rebalance daily include Daily Hedged Indices, Short and Leveraged Indices, and Risk Control Indices. Daily rebalancing is an inherent feature of the underlying investment processes that these indices aim to reflect. Therefore we feel it would be excessively restrictive to prevent UCITS funds from using indices that rebalance daily. In fact, investors have in the past requested increased

	frequency of the currency rebalancing in certain indices (e.g., from monthly to daily), to correctly hedge the currency exposures of their investments at a time when currency movements are more volatile.
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 leverage within the index), re-balancing methodologies, index changes and information on any operational difficulties in 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***	It is important clarify two points. First, it is not investors in general who need to be able to replicate the index, but instead the providers of the UCITS, who have licensed the rights to use the index for their fund. Second, such licensees do not use the methodology to replicate the strategy. Rather, the providers of UCITS apply the index changes (additions/deletions of securities to/from the index) and their weights) to ensure the UCITS fund holdings are "in synch" with the index itself. Trying to replicate the underlying index would require not only the methodology, but also all of the underlying third party raw data as well as the structures in place to ensure consistency in the application of the methodology. Specifically, with respect to each of the items listed in the Guideline: • Methodologies: The disclosure of index calculation methodologies on their websites is a current practice of index providers. However, if a strategy index used an underlying proprietary financial risk model, we would object to the public disclosure of that risk model's methodology. Risk models primarily serve a different client base and are primarily licensed to clients for risk management purposes. Making the methodologies public would negatively impact a different segment of the market. • Index constituents and underlying data: The disclosure of index constituents and underlying index data is covered above. • Index changes: The disclosure of summaries of index rebalancing and changes due to corporate events are (and should) only available to subscribed clients and we would object to making this data publicly available for the same reasons outlined above with respect to index constituents and underlying data. • Index performance: The disclosure of index level performance on their websites is a current practice of index providers.
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.***	As discussed above, for ETFs the relevant disclosures are currently accomplished through the publication of the PCF. Index providers also already allow limited disclosures of certain index data as required by clients on a delayed basis.
Guideline 11: ***The index methodology must not permit retrospective changes to previously published index values ('backfilling').***	Index providers publish their restatement policy for the indices they calculate. We agree that ad-hoc retrospective changes to previously published index values should not be permitted. However, retrospective changes to previously published index values may be

	warranted for a variety of valid reasons. These reasons include incorrect dividends, incorrect prices, corporate events, data errors, etc. Most index providers have publicly available guidelines and policies with respect to index corrections. Generally, index corrections are made when the impact of the correction on the index exceeds a certain threshold. Therefore we believe that it would be excessively restrictive to prevent UCITS funds from using indices that may be subject to retrospective corrections, based on clear policies specified in advance.
Guideline 14: ***The financial index should be subject to independent valuation.***	If "independent valuation" refers to "independent audit", we believe independent audits of indices are unnecessary if the indices are calculated by independent index providers. However, if an index is calculated in-house by the UCITS fund provider, we believe it may be appropriate that the index calculation be independently evaluated and audited. If "independent valuation" refers to the pricing source that is used to value index constituents when the index level is calculated, then we believe that index providers should use an independent pricing source, such as an exchange or recognized provider of bond valuation services.

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 believe that the current model of having an independent index provider, responsible for designing, maintaining and publishing the index, and a separate asset manager, responsible for replicating or tracking this index by purchasing securities in the market is a superior model from a governance perspective. Independent index providers have acquired over the years the required expertise and infrastructure to develop, maintain and publish indices. Index provision is their core business. Any potential errors, lax procedures, low quality data, lack of full disclosure, or other problems associated with the maintenance of the index could have a severe impact on the independent index provider's reputation and could potentially present serious franchise risks. As a result, independent index providers have developed policies and procedures to ensure full disclosure and appropriate public dissemination of their data and methodologies. Also, the indices published by independent index providers tend to receive a significantly higher level of public scrutiny by several market participants. This process ensures that any issues when they arise tend to be spotted early and tend to be corrected fast and through appropriate public disclosures. Proprietary indices produced by another division of the asset manager for the sole purpose of managing portfolios against these indices are less likely to benefit from the same disclosure requirements and public scrutiny that independent index providers are subjected to.

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