

INDEX INDUSTRY ASSOCIATION

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The European Parliament Committee on Economic and Monetary Affairs

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Response to the European Securities and Markets Authority consultation paper on the treatment of repurchase and reverse repurchase agreements (the "Consultation") and comments on the proposed guidelines on ETFs and other UCITS issues

On behalf of the Index Industry Association ("IIA"), we are pleased to respond to the Consultation. The IIA, founded in 2012, was created to represent, develop and promote the indexing industry for its members and for the benefit of institutional and individual investors. Founded by S&P Dow Jones Indices, LLC, MSCI Inc., and the FTSE Group and attracting a growing number of additional members, including Barclays, the NASDAQ OMX Group Inc. and the Russell Index Group, the IIA promotes transparency, sound operational practices, intellectual property rights, education, and effective index management practices. The members have developed extensive expertise and knowledge and a reputation for reliability and integrity in their indices over a period of decades. In the aggregate, they currently calculate over 1 million indices for their clients, covering a number of different asset classes, including equities, fixed income and commodities.

In addition to addressing those aspects of the Consultation of direct relevance for the index industry, this response seeks to provide ESMA background on the IIA and the index industry. Part of the IIA's mission is to consider ways to promote best practice for the index industry, which makes it a natural supporter of appropriate and proportionate industry standards. Consequently, the IIA is keen to provide input to ESMA's regulatory reform programme and assist its decision takers in developing targeted regulation without causing unintended detriment to the index industry and investors.

The financial index provider industry has successfully developed into a highly competitive industry that provides high quality indices, which are calculated accordingly to transparent index methodologies available on publicly accessible websites. Consequently, we would suggest that working together as an industry to address any perceptions of potential deficiencies would produce any desired outcome for improvement in a proportionate way with respect to the types of indices produced by our members.

In the vast majority (if not all cases) an index methodology clearly explaining the way an index is calculated, is made available to users of the index. Methodologies are often posted on the index providers' websites and accessible to the public. Finally, IIA members believe that there are robust governance arrangements already in place within their index construction and maintenance processes.

IIA follow-up responses to the questions posed in ESMA's January 2012 consultation and addressed in the current Consultation

In the following paragraphs, we set out our thoughts with respect to specific aspects of the proposed guidelines. Overall, our main comment is that whilst we appreciate ESMA's policy purpose in developing

the proposed guidelines, we are concerned that various statements within the proposed guidelines are vague and, as a result, may create significant uncertainties.

Question 1: Do you agree with the proposed guidelines?

We note that guideline 1(a) set out in Box 1 of the January 2012 consultation states that “*The prospectus of an index-tracking UCITS should include: (a) a clear description of the indices including details of their 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 indices are published*”.

In response to the above guidance, we would seek greater clarification from ESMA as to what is meant by the phrase “underlying components”. We consider that for exchange traded funds (“ETFs”) the data of most relevance is that for the fund holdings.

Key ETF holdings data (i.e. clearing, settlement and redemption data) is already published. The data is made available by an ETF issuer directly to authorized participants of the fund as well as via the ETF issuers’ websites.

In light of the detailed data already available for ETFs, we do not consider that mandatory disclosure of underlying index data is necessary or helpful to investors. Furthermore, as elements of underlying index data are proprietary in nature, (e.g. security/constituent level data) mandatory public disclosure would be detrimental to index providers whilst not providing a necessary or proportionate benefit to investors.

Question 39: Do you consider the proposed guidelines on strategy indices appropriate? Please explain your view.

<i>Guidelines in Box 8 of the January 2012 Consultation document</i>	<i>Response</i>
<i>Guideline 4a:</i> <i>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:</i> <i>a) An index must have a clear, single objective in order to represent an adequate benchmark for the market;</i>	The IIA notes that whilst the consultation implies that ESMA wishes to permit strategy indices including those operating long-short strategies, the guideline does not make this clear. In the interests of promoting regulatory certainty, we believe the guidelines should explicitly allow long-short indices to be eligible. Furthermore, the current proposed wording of guideline 4a appears to envisage that an index would have a single objective set by the index provider. In practice, the decision as to whether the investment objective is achieved is taken by the financial institution that wishes to launch the UCITS and not the index provider. Therefore, we would suggest that the focus of the guideline is amended accordingly. We are concerned that the reference to “adequate benchmark” in the guideline is unclear, as there are no criteria which define what “adequate” constitutes for these purposes. The application of this aspect of the guideline is also unclear, for example, would custom indexes be considered “adequate benchmarks”? In the event that custom indexes are not considered “adequate benchmarks”, we would be concerned that this would materially affect the ability for new, innovative indexes to be developed and made available to investors.

Guideline 4b: <i>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;</i>	The IIA wishes to highlight to ESMA that index providers already disclose index components and, where appropriate, detailed construction methodologies to subscribers. However, as with our response above regarding guideline 1(a) (of box 1 of the January 2012 consultation), the IIA is keen to ensure that before making additional disclosures mandatory, appropriate consideration is given to balance perceived investor benefits with actual detriment to index providers.
Guideline 5: <i>The UCITS' prospectus should disclose the rebalancing frequency and its effects on the costs within the strategy.</i>	With respect to index rebalancing, the IIA welcomes the proposal to require the prospectus to disclose an index's rules on rebalancing. However, we would welcome clarification from ESMA as to what is meant in paragraph 51 of the Consultation when it states that "technical adjustments" should not be considered as rebalancing..
Guideline 6: <i>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.</i>	The IIA welcomes the proposal that the rebalancing frequency should not prevent the replication of the financial index. However, the IIA does not support 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. Furthermore, it would seem to us unnecessarily restrictive to prevent UCITS funds from using indices that rebalance daily.
Guideline 7: <i>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), rebalancing 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</i>	The IIA appreciates ESMA's policy grounds for promoting transparency to create benefit for investors. However, in the context of guideline 7, the IIA is concerned that the proposed mandatory disclosures would be costly for the index industry, diminish index providers' intellectual property rights and stifle innovation but be of little or no benefit to investors. As each index provider uses raw data differently, requiring disclosure of an index's calculation methodology would not be of material benefit for investors. Trying to replicate an underlying index requires not only disclosure of calculation methodology but also: (i) all underlying third party raw data; and (ii) information on the structures in place to ensure consistency in the application of the methodology.

Guideline 8: <i>A financial index must publish the constituents of the index together with their respective weightings.</i> <i>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.</i>	As detailed elsewhere in our response, we note that for ETFs the relevant disclosures are currently accomplished through the publication of the composition file. Furthermore, index providers already allow limited disclosures of certain index data as required by clients on a delayed basis. On the basis of the guideline as currently drafted, it is unclear as to how frequently it is intended for the weightings to be published. The provision of overly frequent information would be of minimal practical benefit for investors.
Guideline 11: <i>The index methodology must not permit retrospective changes to previously published index values ('backfilling').</i>	We agree that ad-hoc retrospective changes to previously published index values should not be permitted. However, we note that retrospective changes to previously published index values may be warranted in certain circumstances (e.g. to correct: incorrect dividends, incorrect prices, corporate events, data errors, etc.). 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: <i>The financial index should be subject to independent valuation.</i>	We are unclear as to what is meant by "independent valuation" in this context. If the meaning is the same as "independent audit", we believe that an audit of indices would be unnecessary where the indices are calculated by independent index providers. Notwithstanding this, we agree that where an index is calculated in-house by the UCITS fund provider, it may be appropriate that the index calculation be independently evaluated.

Summary

The IIA is keen to work with relevant regulatory authorities and would be pleased to provide further, detailed information about our industry and its practices. Our aim is to ensure that they are provided with a thorough and accurate understanding of the index provider industry, so as to inform discussions, such as the ESMA Consultation. The IIA strongly believes that improvements in best practice standards, to which the IIA is committed, is the appropriate method to provide clients and investors sufficient protections. Such improvement will further supplement existing structural protection such as the independence of our membership and a firm commitment to high governance standards. Before any guidelines are put in place there needs to be sufficient lead in time for the UCITS industry to enable it to provide an appropriately high-level of customer service to investors who otherwise might be confused by such changes.

Kind regards



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