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ESMA  
European Securities and  
Market Authority  
103 Rue de Grenelle  
75007 Paris

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**Reply to ESMA's policy orientations on guidelines for UCITS Exchange-Traded Funds and Structured UCITS**

Assogestioni is grateful for the opportunity to comment on ESMA's policy orientation to the European Commission on possible implementing measures on Exchange-Traded Funds and Structured UCITS.

Here below the Assogestioni responds to the consultation documents.

**RETAILISATION OF COMPLEX PRODUCTS**

**FINANCIAL STABILITY AND SYSTEMIC RISK**

**1. Do you agree that ESMA should explore possible common approaches to the issue of marketing of synthetic ETFs and structured UCITS to retail investors, including potential limitations on the distribution of certain complex products to retail investors? If not, please give reasons.**

**2. Do you think that structured UCITS and other UCITS which employ complex portfolio management techniques should be considered as 'complex'? Which criteria could be used to determine which UCITS should be considered as 'complex'?**

We strongly believe that ESMA should not follow a single-out approach to the fundamental issue of marketing of financial products to retail investors, be they complex or not. In fact, we don't see any reasonable argument why ESMA should limit its analysis to two specific types of product instead of taking a truly comprehensive approach encompassing, at least, all the products covered by MiFID, with due regard to the PRIIPs initiative.

Indeed, from a level-playing field perspective – which is the one we are more keen on – ensuring the widest possible scope of the ESMA regulatory initiative comes first and before a detailed assessment of how complexity should be measured.





As a consequence we believe that any potential limitation on the marketing to retail investors of any type of product should be developed and discussed in the context of the MiFID review process which is currently under way.

In this context and regarding the complexity issue we take a strong position in favour of an approach based on the assessment of the simplicity of the financial payoffs for the end investor (products leading to easy-to-understand results should never been considered “complex”) rather than on the degree of sophistication of the management techniques this payoffs are dependent upon.

The UCITS Directive imposes on the management company very detailed and state-of-the-art constraints and risk management requirements linked to the nature of assets held in the portfolio and the investment techniques employed. It is to be noted that this differentiates UCITS from all other financial services products, which are only indirectly affected by regulation of the service provider, for example the credit institution issuing a structured note or the insurance company issuing a unit-linked life insurance policy. This robust product regulation is at the heart of the high level of investor protection UCITS provide and of their global success as high reliable and carefully designed investment products.

For these reasons we believe that if ESMA should draft rules or guidelines on the complexity issue based on the content of the management techniques employed, UCITS should be given specific consideration and, if necessary, a sort of safe-harbour provision, based on the high level of investor protection the Directive already provides both with reference to investment limits and risk management process.

**3. Do you have any specific suggestions on the measures that should be introduced to avoid inappropriate UCITS being bought by retail investors, such as potential limitations on distribution or issuing of warnings?**

Any concern regarding the marketing of inappropriate financial products, including but not limited to UCITS, should be addressed in the context of the MiFID where ensuring a correct combination of the product risk/return features with investor's preferences is key.

To this end a further improvement of disclosure requirements of risk factors, strategies and techniques in the context of UCITS prospectus might help both the self-directed (execution-only) investor and the distributors to which retail investors might ask for advice.

In general we do not understand how a UCITS could be “inappropriate” for all investors. Appropriateness must be evaluated on a case by case basis. In this perspective any marketing limitation to UCITS would eventually result in an unreasonable restriction of investment choice and consequently in a potential harm to the final investor.





**4. Do you consider that some of the characteristics of the funds discussed in this paper render them unsuitable for the UCITS label?**

No, we do not. As long as a UCITS complies with all the current regulation, including but not limited to investment limits and risk management provisions, we deem absolutely important that it may retain the “UCITS label”.

If ESMA feels uncomfortable with specific investment techniques used by some ETFs or structured funds, then it should address them in the more general context of UCITS regulation where the consequences of changing the current rules should be carefully assessed and where the resulting potential harm to UCITS product innovation capabilities should be appropriately weighted.

**6. Do you agree that ESMA should give further consideration to the extent to which any of the guidelines agreed for UCITS could be applied to regulated non-UCITS funds established or sold within the European Union? If not, please give reasons.**

As we already pointed out above, we believe that the ESMA initiative should not be limited to UCITS, and even not to funds, but be extended to all financial products that are sold to retail investors within EU.

Including institutional products in the scope of ESMA action should be carefully considered with a view to the potential risk of harming innovation and flexibility.

**7. Do you agree that ESMA should also discuss the above mentioned issues with a view of avoiding regulatory gaps that could harm European investors and markets? If not, please give reasons.**

It is of the utmost importance that regulatory gaps are avoided. To this end we encourage ESMA to extend the content of its discussion paper to all products falling under MiFID and also to take into consideration the approach envisaged in the context of PRIIPs initiative. See also our answer to Q1 & 2 above.

## **EXCHANGE TRADED FUNDS**

**8. Do you agree with the proposed approach for UCITS ETFs to use an identifier in their names, fund rules, prospectus and marketing material? If not, please give reasons.**

We agree with the proposed approach for UCITS ETFs to use an identifier. We deem important to define the type of funds that can use such identifier to avoid a misuse of it and protect the label. For example, the use of this acronyms by index tracking funds listed on an exchange but not actively traded should be avoided.

**9. Do you think that the identifier should further distinguish between synthetic and physical ETFs and actively-managed ETFs?**

We disagree that the identifier should give information on the technicalities used from ETFs to track the performance of an index (synthetic/physical ETFs) or on the discretion of ETFs investment manager in relation to the composition of the portfolio (actively-managed ETFs). This information would give too much emphasis on technical aspects or management techniques that are not specific to ETFs, but





concern all UCITS. In fact almost all UCITS managed and are exposed to counterparty risk and to collateral risk coming from the use of derivatives contracts or securities lending activities. As indicated later in the document in consultation, we agree that the information that is suggested to be synthesized in an identifier will be clearly stated and explained in the prospectus.

**10. Do you think that the identifier should also be used in the Key Investor Information Document of UCITS ETFs?**

Yes, we agree.

## **INDEX TRACKING ISSUES**

**11. Do you agree with ESMA's analysis of index-tracking issues? If not, please explain your view.**

**12. Do you agree with the policy orientations identified by ESMA for index-tracking issues? If not, please give reasons.**

In general we support the policy orientations identified by ESMA, but we have some comments on the following policy orientations:

- Policy orientation: "A clear description of the index including details of the underlying index components. In order to avoid frequent updates of the document, the prospectus can provide investors with a link to a web site where the exact composition of the index can be found;" We do not support the general request of disclosing all index constituents with their respective underlying for the following reasons:
  - o the disclosure of the detail of the index is not under control of the investment management, but depends on the index provider policies. Some index providers give this information for free directly on their web site, other require a previous identification. In other cases index providers allow such disclosure only upon payment, while others do not give at all this possibility. We believe that the proposed advice is not in many case feasible or will generate cost within management company that will probably reflects on the cost of the UCITS.
  - o we do not believe necessary disclosing the exact component of the index since it does not help investors to assess the risk/return profile of the fund. In particular, we do not believe that for the investor is really important to know if a particular share is in the index where is available a broad description of all its relevant element and of the techniques used to replicate the performance of the index (for example index objective, dividend re-investment assumption and dividend tax enhancements, full or sampling replication, rebalancing).

We propose therefore to allows the fund manager to give more general information on the index that explain the main characteristics and refer the investor to other sources if it is possible to find further detailed information. Should detailed disclosure be regarded essential for ESMA, we propose that this should be made via web site of the investment management and only when the index provider give it for free.





More in general, to improve disclosure on index constituents, we suggest further ESMA's commitment to prevent index provider from maintaining dominant position and price control descending from the obligations set by the Regulators.

- Policy orientation: "The policy of the index-tracking UCITS ETF regarding the tracking error including its maximum level;" We disagree on disclosing to investors the tracking error, as identified by ESMA (difference between the portfolio and index returns).

We believe that the use of such measure of TE does not permit an exact comparison between index-tracking UCITS ETFs that use:

- different types of index (price index, total return index, total return net or gross dividend index): the TE could be positive if the UCITS ETF replicates a price index but does not distribute dividends;
- the same index but implement an active management: a actively-managed UCITS ETF that accepts some risk with the aim to outperform the index will probably have a higher tracking error giving in this way a wrong signal to investors;
- different methodologies to replicate the performance of an index (physical or synthetic or a combination of both): for physical ETF cash drags could influence the TE.

Further, this indicator could be misunderstood from investors because the most common measure of tracking error is the tracking error volatility (TEV) and not the difference between returns (TE), as set in the ESMA's discussion paper.

In any case, if ESMA believes that it should be used an indicator we suggest further technical work to identify which indicator suits best needs considering benefits and drawbacks. In particular, we believe essential define a standardized calculation method.

We suggest also that such indicator should be supplemented by a narrative explanation of its meaning and of its main limitations, reducing in this way the possible misunderstanding and confusion of investors.

Finally, the disclosure of such indicator in the prospectus should not considered by investors as an additional limit on the fund management. We suggest to modify the paragraph as follows: "*The policy of the index-tracking UCITS ETF regarding the tracking error including its expected maximum level*".

### **13. Do you think that the information to be disclosed in the prospectus in relation to index-tracking issues should also be in the Key Investor Information Document of UCITS ETFs?**

We do not find appropriate to disclose detailed information in the KIID. Please see our answer to Q. 12 above.





**14. Are there any other index tracking issues that ESMA should consider?**

**15. If yes, can you suggest possible actions or safeguards ESMA should adopt?**

We have no further suggestion.

## **SYNTHETIC ETFS – COUNTERPARTY RISK**

**16. Do you support the disclosure proposals in relation to underlying exposure, counterparty(ies) and collateral? If not, please give reasons.**

We agree with the policy orientation on the information to be indicated in the annual report, but we have some observation on those one that should be included in the prospectus.

Regarding the disclosure of detailed information on the counterparty(ies) used in the prospectus it should be clarified whether the names of the counterparty(ies) are to be detailed. We believe that such detailed disclosure could cause problems during the negotiation in the selection on the counterparty(ies): often the counterparty(ies) is not known when a fund is launched. Further the change of one counterparty would cause a cost in the updating of the prospectus. As alternative proposal we suggest to give only general information on the characteristics of the counterparty(ies) such as the type of counterparty and its eventually connection to the management company.

We disagree on giving information in the prospectus on the risk of the counterparty default and its effect on investor return. Like all UCITS, these funds have to manage counterparty risk and for these reason rules have been set by CESR (Box 26 of *CESR Guidelines* 10/788) defining the characteristic of the collateral to be used to reduce the exposure versus a counterparty.

**17. For synthetic index-tracking UCITS ETFs, do you agree that provisions on the quality and the type of assets constituting the collateral should be further developed? In particular, should there be a requirement for the quality and type of assets constituting the collateral to match more closely the relevant index? Please provide reasons for your view.**

We think that the Box 26 of CESR Guidelines 10/788 has already identified the relevant characteristics of collateral set for OTC counterparty risk exposure. We do not think further work on this issue is necessary.

In particular, regarding the type of assets constituting the collateral we disagree on the close consistency between the collateral and the index. The guarantee function of the collateral is not necessarily achieved if the assets used as guarantee are highly correlated with the performance of the underlying of the financial derivatives. Indeed a strong positive correlation could potentially have a negative effect on the guarantee function. In our view and as indicated in art. 43 of Directive 2010/43, collateral received should be sufficiently liquid so that it can be sold quickly at a price that is close to its pre-sale valuation. This could not be the case for example for an UCITS ETF that tracks an emerging markets index and has, as collateral, equities of an emerging market issuer.





The risks that the proceeds of the collateral sale do not cover the loss arising from the default of the counterparty have to be managed through the quality of the assets, the identification of appropriate haircut other than with qualitative principles of diversification.

**18. In particular, do you think that the collateral received by synthetic ETFs should comply with UCITS diversification rules? Please give reasons for your view.**

No, we do not think that collateral should comply with UCITS diversification rules.

The assets constituting collateral have a guarantee function; only if the counterparty default these assets constitute the guarantee to cover the losses. We think that the qualitative principles outlined by the CESR in Box 26 of CESR Guidelines 10/788 in terms of assets received as collateral characteristics are been identified precisely on the consideration that those assets constitute a secondary guarantee.

In addition, CESR already ask to investment management to consider together the characteristics of the direct investments and the collateral thorough definition of appropriate discount rules. In fact the point 82. of the explanatory text of CESR Guidelines 10/788 indicates that for the collateral presenting a risk of value fluctuation, prudent discount rates can be determined by simulating the valuations of both securities held in portfolio and collateral over multiple holding periods.

Further, frequently in the contractual agreement between UCITS and the counterparty there are clauses obliging the counterparty to replace the collateral in case of loss, over time, of the minimum acceptable solvency characteristics (such as an investment grade credit ratings). In other cases the collateral is constantly updated by a third part (Tri-Party Agents) based on certain characteristics of solvency and diversification established by contract (Tri-Party Agreement) between the UCITS, the counterparty and the custodian. These types of contract allow to maintain a collateral in line with its guarantee function.

Finally, for avoiding any doubt, if ESMA consider that collateral should necessarily comply with UCITS diversification rules, it should be cleared that the collateral securities are not assimilated to portfolio position and, to comply with diversification rules, the collateral securities should not be added to those ones included in the portfolio.

## **SECURITIES LENDING ACTIVITIES**

**19. Do you agree with ESMA's analysis of the issues raised by securities lending activities? If not, please give reasons.**

**20. Do you support the policy orientations identified by ESMA? If not, please give reasons.**

In general we support the policy orientations identified by ESMA, but we have some comments on the following policy orientations:

- policy orientation: *"The prospectus should also clearly inform investors of policy in relation to collateral. This should include permitted types of collateral, level of*





*collateral required and, in the case of cash collateral, re-investment policy, including the risks attached to the re-investment policy.* ” Giving information on the risks associated to the re-investment policy should not be necessary if the collateral received in the context of securities lending complies with the criteria for OTC derivatives set out in CESR’s Guidelines on Risk Measurement. In that guidelines it is indicated that cash collateral can only be invested in risk-free assets.

- policy orientation: *“The extent to which fees arising from securities lending are earned by the UCITS ETF should be disclosed. Where an UCITS ETF engages in fee sharing arrangements in relation to securities lending, this should be clearly disclosed together with the maximum percentage of fees payable to the securities lending agent or other third party.”* We agree with the requirement about different level of disclosure. The consultation is also an important occasion to draw to the ESMA attention that there are different views as considering correct the inclusion in the on-going cost of the cost of lending activity which is borne by the fund in term of less proceeds. Considering the reduction in proceeds as “costs” could give investors an incorrect information of the real management cost and influence investment manager to be less active in securities lending activities with potential deprival effect on the profit of the fund and of the final investor. We encourage a further work with the aim of harmonizing the disclosure and maintaining a level playing field.

**21. Concerning collateral received in the context of securities lending activities, do you think that further safeguards than the set of principles described above should be introduced? If yes, please specify.**

No, we believe it is not necessary to introduce further rules.

**22. Do you support the proposal to apply the collateral criteria for OTC derivatives set out in CESR’s Guidelines on Risk Measurement to securities lending collateral? If not, please give reasons.**

We agree with the proposal.

**23. Do you consider that ESMA should set a limit on the amount of a UCITS portfolio which can be lent as part of securities lending transactions?**

No, we believe that ESMA should not set a limit on the amount that can be lent. A possible limitation may also have adverse effects on the performance received by the final investors.

**24. Are there any other issues in relation of securities lending activities that ESMA should consider?**

**25. If yes, can you suggest possible actions or safeguards ESMA should adopt?**

We have no further suggestion.

## **ACTIVELY MANAGED UCITS ETFs**

**26. Do you agree with ESMA proposed policy orientations for actively managed UCITS ETFs? If not, please give reasons.**

We agree with the proposed policy orientations.





**27. Are there any other issues in relation to actively managed UCITS ETFs that ESMA should consider?**

**28. If yes, can you suggest possible actions or safeguards ESMA should adopt?**

We have no further suggestion

## **LEVERAGED UCITS ETFs**

**29. Do you agree with ESMA analysis of the issues raised by leveraged UCITS ETFs? If not, please give reasons.**

We agree.

**30. Do you support the policy orientations identified by ESMA? If not, please give reasons.**

Yes, we support the policy orientations, but we have some general consideration.

UCITS ETFs as all UCITS are subject to the limits and rules on global exposure set out in the UCITS directive and Level 2 and 3 measures. As indicated in the CESR Guidelines on Risk Measurement (CESR 10/788) UCITS using a relative VaR approach to calculate global exposure have a limitation of the global leverage ratio to 2. We believe therefore that the requirement to disclose additional information with respect the leverage policy and in particular with the risks associated with this policy should remain consistent within all UCITS. In this contest, such disclosure should be limited to disclose the expected level of leverage accordingly and in line with the indicated Guidelines. Further, description in the prospectus of the impact of reverse leverage and clarification regarding the daily replication's impact on the investors' return should be cover all UCITS, so long as it is relevant.

**31. Are there any other issues in relation leveraged UCITS ETFs that ESMA should consider?**

**32. If yes, can you suggest possible actions or safeguards ESMA should adopt?**

We have no further suggestion

## **SECONDARY MARKET INVESTORS**

**33. Do you support the policy orientations identified by ESMA? If not, please give reasons.**

**34. Are there any other issues in relation to secondary market investors that ESMA should consider?**

**35. If yes, can you suggest possible actions or safeguards ESMA should adopt?**

**36. In particular, do you think that secondary market investors should have a right to request direct redemption of their units from the UCITS ETF?**

**37. If yes, should this right be limited to circumstances where market makers are no longer providing liquidity in the units of the ETF?**

**38. How can ETFs which are UCITS ensure that the stock exchange value of their units do not differ significantly from the net asset value per share?**

We think that an investor should have the right to request direct redemption to a





ETF only in exceptional circumstances. To have an harmonised approach we suggest further technical work.

## **STRUCTURED UCITS - TOTAL RETURN SWAPS**

### **39. Do you agree with ESMA analysis of the issues raised by the use of total return swaps by UCITS? If not, please give reasons.**

In general, we agree with ESMA analysis, but we have the following observation:

- point 56: *"While it may be considered that the composition of the physical assets held by a UCITS is not relevant to the asset diversification test, by virtue of the diversification provided through the swap, it is not clear that Article 52 of the Directive would allow for this interpretation."* We believe that diversification test has to be implemented after derivatives. We think that the aim of art. 52 of Directive is to diversify the exposure of the fund also through the use of derivatives.

### **40. Do you support the policy orientations identified by ESMA? If not, please give reasons.**

We disagree with treating and disclosing the swap counterparty as an investment manager, unless the decision of the counterparty has effects on the exposure on the exposure and on the performance of the fund. If the assets held by the fund are UCITS eligible and than the UCITS enter in a total return swap to receive an exposure, for example, to the return of an index, the cash position hold by the fund has not effect on the exposure of the fund. In this case, the swap counterparty should not be considered as an investment manger.

Regarding the disclosure of information on counterparty(ies), we believe that only general information should be required, avoiding the disclosure of the name(s) of the counterparty(ies). Please see our answer to Q. 16.

### **41. Are there any other issues in relation to the use of total return swaps by UCITS that ESMA should consider?**

### **42. If yes, can you suggest possible actions or safeguards ESMA should adopt?**

No, we have not further suggestion

## **STRATEGY INDICES**

### **43. Do you agree with ESMA's policy orientations on strategy indices? If not, please give reasons.**

In general we agree with policy orientations, but we have some comments:

- policy orientation – *"Sufficiently diversified"*. We agree with the orientation and we suggest further work to explain how should be in practise calculated "the impact" on the index return to verify if it is compliant with the diversification requirement.
- policy orientation – *"Rebalancing"*. Regarding the frequency of rebalancing, we believe that if the intra-day or the day rebalance comes from a model base strategy, it should be considerate compliant.





- policy orientation – “*Published in appropriate manner*”. We believe that the level of transparency required constitute a general issues not only for strategy indexes, but also for the majority of the index providers. Please see, for general consideration on the transparency of the index, our answer to Q. 11/12. With specific regards to strategy indexes we believe also that if the provider of strategy indexes will not allow to disclose the information indicated there will be the risk that the UCITS cannot use these types of indexes.

**44. How can an index of interest rates or FX rates comply with the diversification requirements?**

We believe that the diversification requirements should not be applied to index of interest rates or FX rates. The underlying of this index should be treated equally to the underlying of financial derivatives on interest rates, FX, notional where is possible to disregard the diversification rules on issuer concentration.

**45. Are there any other issues in relation to the use of total return swaps by UCITS that ESMA should consider?**

**46. If yes, can you suggest possible actions or safeguards ESMA should adopt?**

No, we have not further suggestion.

The Director General