European Securities and Markets Authority

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PRESS RELEASE

ESMA outlines future regulatory framework for ETFs and other UCITS issues

Stakeholders encouraged to comment on draft guidelines

ESMA publishes today a consultation paper (ESMA/2012/44) setting out future guidelines on UCITS Exchange-Traded Funds (UCITS ETFs) and other UCITS-related issues. The proposals cover both synthetic and physical UCITS ETFs and detail the obligations to come for UCITS ETFs, index-tracking UCITS, efficient portfolio management techniques, total return swaps and strategy indices for UCITS.

ESMA's proposals therefore go wider than ETFs and cover such areas as the use of total return swaps by any UCITS, for which ESMA envisages additional obligations with respect to the collateral to be provided, or UCITS investing in strategy indices, where the requirements on eligibility of such indices have been tightened. The proposals also include placing an obligation on UCITS ETFs to use an identifier and facilitating the ability of investors to redeem their shares, whether in the secondary market or directly with the ETF provider.

Steven Maijoor, ESMA Chair, said upon publication**:**

"In outlining the draft future rules for investment funds today, ESMA is proposing to reinforce the legal framework applicable to ETFs and other types of UCITS. The aim of these guidelines is to enhance investor protection and limit the risk of certain practices by strengthening, in particular, the standards applicable to collateral received in the context of activities such as securities lending. Moreover, the proposed guidelines improve the quality of the information provided to investors to allow them to make informed investment decisions. Furthermore, the draft guidelines help address concerns arising from the increase in the number of complex products sold to retail investors and will contribute to the convergence of the regulatory framework for these products."

Guidelines to cover all UCITS, not only ETFs

ESMA took account of the 65 contributions to its July 2011 discussion paper when developing these draft guidelines. Respondents to the discussion paper generally recognised that the issues identified by ESMA were valid but that the guidelines should not only target UCITS ETFs but all UCITS that engage in the relevant activity (e.g. securities lending) or pursue the same type of investment policy (e.g. tracking an index). In the light of this feedback, ESMA has broadened the scope of the guidelines.

ETFs will need labelling, more transparency requirements overall

For UCITS ETFs, ESMA proposes the obligatory use of an identifier for all funds that fall within the scope of the harmonised definition. In addition, investors should be provided with more information when the

UCITS ETFs does not track an index and is actively managed. Finally, ESMA is seeking stakeholders' feedback on the appropriate regime for secondary market investors (see section 4 of the consultation paper), and in particular the possibilities for them to dispose of their shares.

Concerning index-tracking UCITS, ESMA proposes additional disclosure requirements on such issues as the index to be tracked and the method of replication and the tracking error (see section 3 of the consultation paper).

Requirements for securities lending and collateral management are introduced

With regard to securities lending, ESMA proposes that collateral posted to mitigate counterparty risk should comply with the criteria set out in the CESR Guidelines on Risk Measurement and Calculation of Global Exposure and Counterparty Risk for UCITS of July 2010 (CESR/10-788), while recommending that the diversification and haircut criteria be strengthened. These requirements would also apply to repo and reverse repo activities. Therefore, according to the draft guidelines, collateral posted in the context of efficient portfolio management techniques should respect the UCITS diversification rules and UCITS should have a documented and appropriate haircut policy for each category of assets received as collateral.

Following the feedback received from the first public consultation[1], ESMA decided to address certain of the proposed guidelines to all UCITS investing in total return swaps and strategy indices respectively. For total return swaps, ESMA proposes to apply the same obligations on collateral management as for securities lending. Finally, regarding strategy indices, ESMA confirms most of the policy orientations presented in the discussion paper on eligibility of indices, disclosure to investors and the due diligence to be carried out by the UCITS.

Retailisation of complex products remains a concern

In the discussion paper published in July 2011 (ESMA/2011/220), ESMA expressed its concerns about the increasing number of complex products sold to retail investors and the lack of regulatory convergence in relation to the manufacturing and management of such products. ESMA reiterates the need to tackle these issues and will continue to contribute actively to the regulatory response to these problems.

Next steps

ESMA will take into account responses to this consultation in finalising the guidelines. Stakeholders are encouraged to comment on the draft guidelines by 30 March 2012. ESMA expects the final guidelines to be ready for adoption by mid-2012.

[1] Discussion paper on ESMA's guidelines on UCITS ETFs and Structured UCITS (ESMA/2011/220)

Notes for editors

1. In July 2011, ESMA published a first discussion paper on policy orientations on guidelines on UCITS ETFs and Structured UCITS (ESMA/2011/220). In that paper, ESMA examined the possible measures that could be introduced to mitigate the risk that particularly complex products, which may be difficult to understand and evaluate, are made available to retail investors. ESMA also highlighted the potential systemic risk caused by these types of fund and their impact on financial stability.

2. ESMA is an independent EU Authority that was established on 1 January 2011 according to EU Regulation No. 1095/2010 as published on 15December 2010, in the Official Journal of the European Union (L 331/84). The Authority contributes to safeguarding the stability of the European Union's financial system by ensuring the integrity, transparency, efficiency and orderly functioning of securities markets, as well as enhancing investor protection. In particular, ESMA fosters supervisory convergence both amongst securities regulators, and across financial sectors by working closely with the other European Supervisory Authorities competent in the field of banking (EBA), and insurance and occupational pensions (EIOPA).

3. ESMA's work on securities legislation contributes to the development of a single rule book in Europe. This serves two purposes; firstly, it ensures the consistent treatment of investors across the Union, enabling an adequate level of protection of investors through effective regulation and supervision. Secondly, it promotes equal conditions of competition for financial service providers, as well as ensuring the effectiveness and cost efficiency of supervision for supervised companies. As part of its role in standard setting and reducing the scope of regulatory arbitrage, ESMA strengthens international supervisory co-operation. Where requested in European law, ESMA undertakes the supervision of certain entities with pan European reach.

4. ESMA also contributes to the financial stability of the European Union, in the short, medium and long-term, through its contribution to the work of the European Systemic Risk Board, which identifies potential risks to the financial system and provides advice to diminish possible threats to the financial stability of the Union. ESMA is also responsible for co-ordinating actions of securities supervisors or adopting emergency measures when a crisis situation arises.

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