association of the luxembourg fund industry

Luxembourg, 30 March 2012

To ESMA

Re: Consultation paper – ESMA's guidelines on ETFs and other UCITS issues (ESMA/2012/44)

Introduction

ALFI represents the Luxembourg investment management and fund industry. It counts among its membership asset management groups from various horizons and a large variety of service providers. According to the latest CSSF figures, on 29 February 2012, total net assets of undertakings for collective investment were EUR 2.2 trillion. There are 3,847 undertakings for collective investment in Luxembourg, of which 2,430 are multiple compartment structures containing 11,917 compartments. With the 1,417 single-compartment UCIs, there are 13,334 active compartments in Luxembourg.

According to December 2011 EFAMA figures, Luxembourg's fund industry holds a market share of 31.2% of the European Union fund industry, and according to 2011 Lipper LIM and PWC analysis , 72% of UCITS that are engaged in cross-border business are domiciled in Luxembourg. As one of the main gateways to the European Union and global markets, Luxembourg is the largest cross-border fund centre in the European Union and, indeed, in the world.

General Comments

ALFI welcomes the ESMA's consultation paper – ESMA's guidelines on ETFs and other UCITS issues dated 30. January 2012 and would like to thank the ESMA for the opportunity to participate in this consultation.

1. ALFI welcomes as well ESMA's decision to broaden the scope of these proposed guidelines in such a manner as to target not only UCITS ETFs but all UCITS alike that engage in the relevant activities (e.g. securities lending) or pursue the same type of investment policy (e.g. tracking an index).
2. Furthermore, ALFI supports ESMA's move towards greater transparency as it will further enhance investor's understanding and confidence in UCITS products. The proposed guidelines reflect industry best practice in terms of transparency and disclosure. Transparency requirements should however be proportionate and bring real-added value in particular to retail investors allowing them to take well-informed investment decisions. For instance, we believe that the transparency

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requirements should be proportional to the extent that certain techniques are being used and should not apply to immaterial techniques and instruments.

3. When considering investor protection and disclosure requirements, we strongly encourage ESMA to take a horizontal approach to funds and non-fund products alike, in the spirit of MiFID and of the PRIPs initiative. Any consideration regarding the marketing of UCITS ETFs cannot be dissociated from a review of other products which are also subject to MiFID, therefore any action should be taken within the MiFID Review, maintaining a level playing field vis-à-vis other financial instruments. In this context, we very much support ESMA's statements that "*further consideration should be given to the development of harmonized definitions at European level of all exchange-traded products*" and that "*products with broadly similar characteristics should be subject to the same level of regulatory requirements and that investors in such products should be able to rely on an equivalent level of regulatory protection*" (Consultation Paper, p. 11, paragraph 20).

4. As further explained in our detailed answers below, ALFI supports ESMA's intention to harmonise the rules in relation to collateral management and the alignment with the list of qualitative criteria as set out in CESR's guidelines on risk measurement. However, we disagrees with the proposed guidelines that the aggregation of collateral received by the UCITS and the UCITS assets not on loan should comply with the UCITS diversification rules.

5. ALFI believes that it will be important to clarify the scope of ESMA's proposed guidelines on Strategy Indices and to clarify that these only apply to index replicating UCITS.

6. Lastly, even if ALFI largely supports most of ESMA's proposals, it is essential to recognize that the industry – but also national regulators – will need a reasonable timeframe to comply and to put these guidelines into practice. The proposed guidelines will significantly impact existing UCITS funds. Some of them will have to go through a material restructuring. Therefore we believe that specific transitional provisions should be foreseen for existing products, including notably a "grand-fathering clause" for structured UCITS which do not accept any new subscriptions from the public. Existing products with a set maturity date should be grand-fathered until their maturity.

I. Index Tracking UCITS

Q1: Do you agree with the proposed guidelines?

ALFI generally agrees with the proposed guidelines which meet best practice in terms of transparency and disclosure. However, we believe that the disclosure of actual ex-post figures should be sufficient and the decision to disclose a target tracking error should be the UCITS' decision, depending on its investment strategy and peculiarities... Prospectus disclosures may indeed create confusions instead of providing information, in particular for retail investors who may not be able to adequately understand the precise meaning of such information. The tracking-error may vary from time to time depending on a range of circumstances (liquidity in the market, taxes applied on the underlying securities, etc.). In practice, it would be difficult to explain any divergence between target and actual tracking-errors given the very broad range of variables which affect tracking error. The flexibility should be offered to the UCITS to provide updates of ex-post figures to investors through websites.

ALFI also believes that it will not always be possible to direct investors to a website where the exact composition of the index is published. Indeed, index providers may not be willing to publish the exact index composition on a real time basis in order to protect their proprietary information (for which their clients usually pay). One way to circumvent this difficulty would be to foresee the possibility to delay the publication of information about the composition of the index.

Finally, we understand that the ESMA guidelines do not prevent index-tracking UCITS from either using mixed approach (full replication/ sample) or to changing their strategy from a full replication model to a sampling policy provided that this is adequately disclosed in the prospectus.

Q2: Do you see merit in ESMA developing further guidelines on the way that tracking error should be calculated? If yes, please provide your views on the criteria which should be used, indicating whether different criteria should apply to physical and synthetic UCITS ETFs.

There are merits in developing an approach to show investors the deviation from the index to be tracked for comparability. However, it does not need to be a computation. Graphs might be more beneficial as easier to understand by common retail investors.

In order to compute a (ex-ante or ex-post) tracking error ("TE"), one formula is to be selected. Unfortunately, all formulas have some weaknesses and it might be difficult for a normal retail investor to understand what the formula exactly means and where the drawbacks are.

Q3: Do you consider that the disclosures on tracking error should be complemented by information on the actual evolution of the fund compared to its benchmark index over a given time period?

ALFI believes that a graphical comparison would be most useful to investors. It would improve the investors' understanding of tracking errors (refer also to responses above).

<u>II. Index tracking leveraged UCITS</u>

Q4: Do you agree with the proposed guidelines for index-tracking leveraged UCITS?

ALFI generally agrees with the proposed guidelines. With regards to ESMA´s statement under 1 c) of BOX 2, we understand that the information that is sought is "a description of how the *<u>adjustment/reset</u>* of the calculation of leverage, impacts on investors' returns over the medium to long term", rather than a description of how the "frequency of calculation" impacts on investors' return.

Q5: Do you believe that additional guidelines should be introduced requiring index tracking leveraged UCITS to disclose the way the fund achieves leverage?

ALFI believes that the proposed guidelines are sufficient and adequate.

III. UCITS ETFS

Q6: Do you agree with the proposed definition of UCITS ETFs? In particular, do you consider that the proposed definition allows the proper distinction between Exchange- Traded UCITS versus other listed UCITS that exist in some EU jurisdictions and that may be subject to additional requirements (e.g. restrictions on the role of the market maker)?

ALFI believes that adding “ETF” in the name of UCITS ETFs will indeed ensure that investors will understand that such UCITS are ETFs, and we agree with the proposition. However, this will not prevent the confusion between UCITS ETFs and other types of exchange traded products. Moreover, ALFI does not believe that the identifier should be mentioned in the fund rules or instruments of incorporation as these are not systematically updated every time a new sub-fund or share class is launched. Disclosure in the prospectus, KIID, and other marketing documentation should be sufficient from an investors’ information standpoint. Moreover, we believe that the identifier, if any, should be at the level of the sub-fund and/ or share class, if applicable.

Regarding the ETF definition, ALFI believes that the proposed wording may include funds that do not operate as ETF’s and thus suggests the following wording:

“*A UCITS exchange traded fund (UCITS ETF) is a UCITS at least one unit or share class of which is continuously tradeable on at least one regulated market or multilateral trading facility (MTF)* ***at the initiative or with the consent of the UCITS or its management company*** *with at least one market maker which takes action to ensure that the stock exchange value of its units or shares does not significantly vary from its* ***indicative*** *net asset value* ***without being restricted by the UCITS in this action*****”.**

Q7: Do you agree with the proposed guidelines in relation to the identifier?

Yes, ALFI agrees with the proposed guidelines in relation to the identifier. However, the objective of an identifier is also to avoid/to stop non-UCITS vehicles from presenting themselves as ETFs. Unfortunately the proposed guidelines, box 3, do not fulfill this important target. So the interest of the proposed guidelines remains limited.

Q8: Do you think that the identifier should further distinguish between synthetic and physical ETFs?

No, ALFI does not believe that the identifier should further distinguish between synthetic and physical ETFs. Currently, there is no such classification of investment funds in Europe; classifications exist by type of strategy, not by the way the strategy is achieved.

Moreover, it could lead to confusion to investors, particularly when there are mixed situations. For instance, when an ETF replicates an index by purchasing the constituents of the index, for 60%, and with some swaps for 40% of the index, which category should be considered “physical” or “synthetic” replication? If such regulation is adopted there should be some guidelines about how to deal with such mixed situations.

Q9: Do you think that the use of the words ‘Exchange-Traded Fund’ should be allowed as an alternative identifier for UCITS ETFs?

ALFI considers that UCITS Management Companies should be given the flexibility to use indifferently the words “ETF” or “Exchange-Traded Fund” in the identifier of the UCITS ETF.

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Please also refer to Question 7. The objective pursued should be to prevent other exchange traded products (“ETPs”) from using the terminology “Exchange-Traded Fund”.

Q10: Do you think that there should be stricter requirements on the minimum number of market makers, particularly when one of them is an affiliated entity of the ETF promoter?

No, ALFI does not believe that imposing a minimum number of market makers would automatically ensure liquidity of the products. In the absence of clear and harmonized rules/ requirements, it is the Fund’s/ Management Company’s/ Promoter’s responsibility to ensure that sufficient liquidity is achieved.

In addition, ALFI believes that UCITS IV regulations already adequately address corporate governance and conflict of interest issues.

Q11: Do you agree with the proposed guidelines in relation to actively-managed UCITS ETFs? Are there any other matters that should be disclosed in the prospectus, the KIID or any marketing communications of the UCITS ETF?

ALFI generally agrees with the proposed guidelines.

Q12: Which is your preferred option for the proposed guidelines for secondary market investors? Do you have any alternative proposals?

Article 1. 2. second paragraph of the UCITS directive states that “UCITS shall be undertakings — the units of which are, at the request of holders, re-purchased or redeemed, directly or indirectly, out of those undertakings' assets. Action taken by a UCITS to ensure that the stock exchange value of its units does not significantly vary from their net asset value shall be regarded as equivalent to such re-purchase or redemption.” As a result, under the current regime as per the Directive, UCITS have the choice between offering direct redemption and ensuring liquidity on the secondary market.

Therefore, ALFI believes that, in accordance with the UCITS Directive, both options should remain available to accommodate for various operating or market constraints.

Q13: With respect to paragraph 2 of option 1 in Box 5, do you think there should be further specific investor protection measures to ensure the possibility of direct redemption during the period of disruption? If yes, please elaborate.

ALFI believes that this situation is adequately covered by the article 1.2 of the UCITS Directive and the paragraph 2 of the option 1 of Box 5.

Q14: Do you believe that additional guidelines should be provided as regards the situation existing in certain jurisdictions where certificates representing the UCITS ETF units are traded in the secondary markets? If yes, please provide details on the main issues related to such certificates.

ALFI believes in general that additional requirements should apply to certificates sold to retail investors in order to ensure a level playing field between UCITS and other retail investors (regardless of the nature of the underlying certificate); we hope that this will be addressed in the coming EU Commission “PRIPS” initiative. However, this is outside the scope of this consultation.

Q15: Can you provide further details on the relationship between the ETF's register of unit-holders, the sub-register held by the central securities depositaries and any other sub-registers held, for example by a broker or an intermediary?

The ETF's register of unit holders books the global position issue on the primary domestic market and initially transferred to the "primary" / "lead" Central securities depositary. The "lead" Central securities depositary holds the accounts of all different positions of each central securities depositaries of each domestic markets the ETF's is listed on. Each domestic central securities depositary holds the accounts of each domestic participating member (custodian, brokers with direct access to CSD,…). And each domestic participating member hold accounts of their final beneficiary accounts (bearers, brokers, intermediaries, final investors…).

It is to be noted that this set up is not unique to ETFs.

<u>IV. Efficient portfolio management techniques</u>

Q16: Do you agree with the proposed guidelines in Box 6? In particular, are you in favor of requiring collateral received in the context of EPM techniques to comply with CESR's guidelines on Risk Measurement and Calculation of Global Exposure and Counterparty Risk for UCITS?

ALFI generally agrees with the proposed guidelines except for the disclosure of fee sharing arrangements and UCITS diversification rules with respect to collateral.

From a practical perspective, we do not believe it is appropriate for a document such as the prospectus to disclose the fee sharing agreement, since the information may not be available when issuing the prospectus, different sub-funds may have different fee arrangement structures and these fee arrangements may evolve from time to time.

In addition, with regards to collateral management, we believe that there should be harmonized rules in relation to collateral rules imposed on other types of transactions as for example foreseen in Box 26 of CESR's guidelines on Risk Measurement and the Calculation of Global Exposure and Counterparty risks for UCITS. In addition, we believe that quality and liquidity should prevail over diversification of collateral and fundamentally disagrees with the requirement that the combination of the collateral received by the UCITS and the assets of the UCITS not on loan should comply with the UCITS diversification rule as daily access to information regarding the composition of collateral may not be practical; also, in practice, in case of a default from the counterparty, the UCITS would sell the assets held as collateral, so no investment restriction should be breached.

Furthermore, we do not agree with ESMA's statement (in footnote 7 on page 20 of the Consultation Paper, following which "*collateral received (excluding cash collateral) has to be held by the depositary*". This question is currently not being addressed by the Directive and is being discussed in the context of the adoption of the AIFMD Level 2 implementing measures and is only expected to be tabled at a later stage in the context of the UCITS V review. We therefore urge ESMA not to anticipate on the outcome of these legislative debates. We also note that, in the context of OTC derivative transactions, Box 26 of CESR's guidelines on Risk Measurement explicitly allows for collateral to be held with a third party custodian (thus, not necessarily with the depositary).

Finally, it is to be noted that the requirements in Box 6 are likely to lead to additional complexity and costs to UCITS structures that would not be borne by other ETP's also available to retail investors.

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Q17: Do you think that the proposed guidelines set standards that will ensure that the collateral received in the context of EPM techniques is of good quality? If not, please explain.

Yes, as explained above, we generally welcome the proposed approach to align EPM collateral rules to the OTC derivatives rules.

Q18: Do you see merit in the development of further guidelines in respect of the reinvestment of cash collateral received in the context of EPM techniques (the same question is relevant to Box 7 below)?

No, ALFI believes that the BOX 26 of CESR/10-788 provides an adequate framework.

Q19: Would you be in favour of requiring a high correlation between the collateral provided and the composition of the UCITS' underlying portfolio? Please explain your view.

ALFI disagrees with the principle following which there should be a high correlation between the collateral received and the composition of the UCITS portfolio.

ALFI believes that this approach is based on a wrong perception of the role of collateral in the context of EPM techniques. Indeed, it seems to assume that the collateral should be a suitable substitute to the portfolio assets on loan which, in case of default of the counterparty would be directly transferred to the UCITS portfolio. In the prevailing market practice, however, the collateral is provided as means of secondary recourse with respect to the entitlement to retransfer of portfolio assets. In case of default, the collateral is being immediately liquidated and the proceeds used to acquire new securities matching with the UCITS investment strategy.

For these reasons, the first objective of regulatory requirements should be to ensure that the collateral received by the UCITS is both of a good credit quality and sufficiently liquid so as to warrant the possibility of smooth disposal and adequate pricing.

ALFI believes that UCITS should have the choice to either focus on liquidity (that can be easily liquidated on the market) or focus on correlation with the fund's investment objective and policy (less liquidity is acceptable as collateral would give you the performance expected).

It should be the responsibility of the management company to select the most suitable approach, based on the Fund's investment strategy, taking into consideration the interests of the shareholders.

Q20: Do you agree that the combination of the collateral received by the UCITS and the assets of the UCITS not on loan should comply with the UCITS diversification rules?

ALFI disagrees with the proposed guidelines that the aggregation of collateral received by the UCITS and the UCITS assets not on loan should comply with the UCITS diversification rules for several reasons, even though ALFI appreciates the proposition from a conceptual point of view.

We note the complexity of the implementation of such controls as a result of the difficulty to access the information on securities on loan on a daily basis, the required IT system enhancement and costs associated to this requirement and would like to draw the attention of ESMA to the fact that increase in costs could disfavor UCITS ETFs in comparison to other similar products sold to retail investors (that offer less investor protection such as non EU ETFs listed in Europe or ETCs).

Indeed, the application of such rules would significantly increase the complexity of fund controlling since the proposed combination of UCITS' assets not on loan and the collateral received would lead to a new virtual portfolio. This would raise the following questions for controlling purposes:

(a) What does this virtual portfolio consist of, i.e. what are the "other investments" mentioned in the guidelines (Derivatives, Collateral for other Derivatives, etc.)

(b) What is the denominator for controlling, if the new virtual portfolio has a different value than the UCITS' NAV?

Moreover, if the Fund is involved in more than one EPM transactions (i.e. a combination of collateralized TRS and/or other collateralized OTC derivatives dealt with different counterparties with EPM transaction with various counterparties), this would increase the collateral management complexity immensely if, based on a virtual portfolio, collateral received has to be assessed and collateral movements have to be coordinated.

From our perspective the application of Box 26 of CESR's guidelines on Risk Measurement and the Calculation of Global Exposure and Counterparty risks for UCITS should grant a sufficient diversification for the received collateral and would bring a harmonization concerning all collaterals received independent of the instrument/technique.

Q21: With regards to eligibility of assets to be used as collateral, do you have a preference for a list of qualitative criteria (as set out in CESR's guidelines on risk measurement) only or should this be complemented by an indicative list of eligible assets?

ALFI has a preference for a list of qualitative criteria as set out in CESR's guidelines on risk measurement. Indeed, market conditions evolve and it should be the responsibility of the management company (the fund in the case of a self-managed SICAV) to ensure that the collateral received is adequate based on a list of qualitative criteria rather than the regular setting of a list of static list of eligible assets.

Q22: Alternatively, do you see merit in prescribing an exhaustive list of assets eligible for use as collateral? If so, please provide comments on whether the list of assets in paragraph 52 is appropriate.

No, please refer to ALFI's responses to Q21.

Q23: Do you believe that the counterparty risk created by EPM techniques should be added to the counterparty risk linked to OTC derivative transactions when calculating the maximum exposure under Article 52(1) of the UCITS Directive?

Whilst we note that this proposal goes beyond the UCITS requirements and CESR's guidelines 10-788, we do not have strong objection as long as the fund is allowed to net the position with the collateral received in order to calculate the counterparty exposure.

Q24: Do you agree that entities to which cash collateral is deposited should comply with Article 50(f) of the UCITS Directive?

We agree.

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Q25: Do you believe that the proportion of the UCITS' portfolio that can be subject to securities lending activity should be limited? If so, what would be an appropriate percentage threshold?

No. ALFI does not believe that limits would be appropriate as those limits would also mean limiting efficient portfolio management which is contradictory to the objective to act in the best interest of investors.

ALFI believes that it would be more beneficial for the investor to receive information about the size, objective and the economical risk of such securities lending activities.

Q26: What is the current market practice regarding the proportion of assets that are typically lent?

There is no "typical" situation but a variety of situations depending on how the Fund's strategy is set up.

Q27: For the purposes of Q25 above, should specific elements be taken into account in determining the proportion of assets (e.g. the use made by the counterparty of the lent securities)?

N/A. Please refer to our response to Q25.

Q28: Do you consider that the information to be disclosed in the prospectus in line with paragraphs 1 and 2 of Box 6 should be included in the fund rules?

ALFI strongly disagrees with the requirement to incorporate this type of information in the fund rules as the details of the Funds' strategy is subject to change without a systematic requirement of a change in the fund rules. Moreover, this requirement might even prove to be prejudicial to investors as the fund would then prevented to take some action at short term, to adapt to changes in circumstances for instance - would be beneficial to the investors but not foreseen/described in the fund rules.

Q29: Do you see the merit in prescribing the identification of EPM counterparties more frequently than on a yearly basis? If yes, what would be the appropriate frequency and medium?

No, ALFI does not believe that more frequent disclosure would add value to the investors. However, if more frequent disclosures are to be imposed, we believe that the most practical solution would be to do it via the website of the investment manager.

Q30: In relation to the valuation of the collateral by the depositary of the UCITS, are there situations (such as when the depositary is an affiliated entity of the bank that provides the collateral to the UCITS) which may raise risks of conflict of interest? If yes, please explain how these risks could be mitigated? The question is also valid for collateral received by the UCITS in the context of total return swaps.

The situation described above is not an issue in Luxembourg as the valuation of collateral is the responsibility of the management company or the self-managed SICAV and is subject to UCITS requirements in relation with organization, conflict of interest... The current UCITS IV set up therefore prevent conflict of interest in terms of collateral valuation.

Q31: Do you think that the automation of portfolio management can conflict with the duties of the UCITS management company to provide effective safeguards against potential conflicts of interest and ensure the existence of collateral of appropriate quality and quantity? This question is also relevant to Box 7 below.

No, the automation is deemed to enhance the process and reduce manual intervention and related risk of operational error, as long as adequate collateral management process is in place.

V. Total return swaps

Q32: Do you agree with the proposed guidelines?

Generally, we understand these guidelines as a discrimination of TRS in relation to other OTC derivatives, which could lead to an instrument substitution; potentially resulting in higher costs and risks for the investor or a product structuring arbitrage since the terminus TRS has no clear unique definition (e.g. set-up as an Excess Return Swap).

Moreover, ALFI believes that these requirements only make sense when for Funds using one or few TRS as part of the structuring of the investment strategy. There are a lot of UCITS which use a high number of total return swaps, amongst other instruments, which are regularly modified and replaced as part of an active portfolio management decision during the lifetime of a UCITS. It would not make any sense for these UCITS to be required to:

- Consider the compliance of the underlying of each TRS with the UCITS diversification rules individually. Compliance with diversification rules should be assessed at the portfolio level;
- Require the disclosure of all the information required under point 5 (for instance, counterparties...) in the prospectus as it would de facto prevent funds to use TRS as part of an actively managed portfolio.

Q33: Do you think that the proposed guidelines set standards that ensure that the collateral received in the context of total return is of good quality? If not, please justify.

Please refer to response to Q17.

Q34: Do you consider that the information to be disclosed in the prospectus in line with paragraph 5 of Box 7 should be included in the fund rules?

No, ALFI disagrees with the disclosure requirements in the Fund rules and to some extent, in the prospectus.

Prospectus:

We understand that these guidelines have been developed for ETF-UCITs originally and UCITS deriving their performance from one TRS structure... We support the idea to extend these guidelines to all UCITS. However, as mentioned above, we disagree to disclose the information of paragraph 5 of Box 7 in such a detailed way in the prospectus. As there are a lot of UCITS which use a high number of total return swaps which are regularly modified and replaced as part of an active portfolio management decision during the lifetime of a UCITS, it would not be practicable to disclose the underlying strategy and the portfolio of each total return swap in the prospectus. Moreover the counterparty is not the same for each total return swap and counterparties will change during the lifetime of the UCITS so that the disclosure of all potential counterparties in the prospectus would not be possible. As a consequence of the proposed disclosure requirements we understand that the prospectus would change very often which involves high costs which have to be supported by the investor at the end.

Fund rules:

ALFI disagrees with the requirement to incorporate this type of information in the fund rules as the details of the Funds' strategy is subject to change without a systematic requirement of a change in the fund rules

Q35: With regards to eligibility of assets to be used as collateral, do you have a reference for a list of qualitative criteria (as set out in CESR's guidelines on risk measurement) only or should this be complemented by an indicative list of eligible assets?

Due to the remarks given under Q33 we would suggest to have a list of qualitative criteria to be defined by the UCITS' management company instead of having a restrictive list of eligible assets. Given that market conditions could quickly change a qualitative list would allow ensuring high quality collateral instead of having certain asset types which could massively suffer from negative market conditions.

Q36: Alternatively, do you see merit in prescribing an exhaustive list of assets eligible for use as collateral? If so, please provide comments on whether the list of assets in paragraph 73 is appropriate.

No.

Q37: Do you agree that the combination of the collateral received by the UCITS and the assets of the UCITS not on loan should comply with the UCITS diversification rules?

ALFI does not agree. Please refer to ALFI's response to Q20

Q38: Do you consider that the guidelines in Box 7 and in particular provisions on the diversification of the collateral and the haircut policies should apply to all OTC derivative transactions and not be limited to TRS?

As laid down, we understand the main purpose of rules surrounding collateral to ensure liquidity and being of good quality (based on the UCITS' own assessment/ collateral policy) irrespective of any diversification rules and irrespective of the instrument for which it is used. As far as the hair-cut policy on collaterals is concerned we propose to have a consistent approach for all OTC-derivatives and not only for total return swaps.

<u>VI. Strategy indices</u>

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

The scope of Box 8 remains unclear to us.

We would like ESMA to confirm that the guidelines are only applicable to "strategy indices" qualifying as financial indices subject to Article 53 of the Directive, whereas "strategy indices" which exclusively invest in eligible assets, comply with diversification rules laid down in Article 52 or Article 54 of the Directive (adherence is strategy-immanent) and are appropriately disclosed to investors in the prospectus, are out of the scope of these guidelines.

<u>Moreover we assume, based on point 1, that Box 8 only applies to index replicating UCITS. Our answer is based on this assumption. If Box 8 was to be applicable to UCITS getting exposure to indices for diversification purposes, we would disagree with these requirements which we consider as being inadequate and disproportionate.</u>

"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; 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; c) If cash management is included as part of the index strategy, the UCITS must demonstrate that this does not affect the objective nature of the index calculation methodology."

We believe that based on its "sui generis" characteristics, the benchmark feature of a strategy index may in many cases be hardly to prove. A less restrictive treatment as it is given in the CESR advice from January 2006 (Ref: CESR/06-005) would be less conflicting.

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

This information is requested so that investors are in a position to understand the costs. We agree as long as qualitative disclosures are accepted as quantitative figures cannot be reasonably assessed in advance.

Points 6 and 7

ALFI agrees, as long as the term "investor" refers to the UCITS itself and not to the shareholders or unitholders of the UCITS. Indeed, ALFI would not expect a retail investor to be able to replicate an index.

"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."

ALFI agrees as long as the term "publish" can be understood as being made available to the UCITS and not to the UCITS investors. Indeed, in practice, index providers may not be willing to publish the exact index composition in real time to the public in order to protect their proprietary information.

Point 13. UCITS must ensure that any valuation of the swap includes an independent assessment of the underlying index.

An "independent assessment of the […] index" has not to /should not necessarily be interpreted as a revaluation of the index, the set frequency ("<u>any</u> valuation of the swap") is seen as too high in this context. Regular Due Diligence processes regarding swap valuation procedures and including discrete test calculations in an appropriate frequency should be seen as sufficient.

Point 14. The financial index should be subject to independent valuation.

Verification of this attribute should be part of the process described under 12.

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 Risks of potential conflicts of interest are adequately prevented/managed by an effective conflicts of interest policy established and implemented by the management company, as required under UCITS IV.

VII. Transitional provisions

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

Box 9 – item 1

The new guidelines will significantly impact existing UCITS funds. Some of them will have to go through a material restructuring. Investors will have to be informed properly about the implications of the new guidelines on their investments. Assuming that the new guidelines are adopted by ESMA by the end of Q2 (as announced on page 6 of the ESMA Consultation Paper), ALFI's view is that the new guidelines should not come into effect before 12 months, so before 30 June 2013.

Box 9 – item 2

It is unclear what the precise implications of the concept of "new investments" are. That concept can be construed as referring to new investments made by the UCITS (i.e., in case of rebalancing of the portfolio). Alternatively it can refer to new investments by the UCITS resulting from new investments (subscriptions) by investors. Should the first interpretation be retained, it would result in the early termination of some existing UCITS funds because it may not be possible to comply with the new rules and/or because the required restructuring would make the UCITS fund no longer attractive for investors, in particular for funds where the pay off has been set up in advance such as capital protected UCITS and structured UCITS. Such an early termination may not be the best solution for the investors invested into those funds (where some UCITS funds may have a maturity date and a capital protection/guarantee feature). ALFI is of the opinion that the new rules should be applicable only to new investments by the UCITS resulting from new investments (subscriptions) by investors. In other words, existing products with a set maturity date should be grand-fathered until their maturity. ESMA's comment in section 89 seems to suggest that ESMA has the same view. The transitional provisions should however be further clarified for the sake of clarity.

Box 9 – item 3

Under a), it should be 30 June 2013.

Under b), it should be 30 June 2013.

Box 9 – item 4

Under a), it should be 30 June 2013.

Under b), it should be 31 December 2013.

Box 9 – item 5

Under a), it should be 30 June 2013.

Under b), it should be 31 December 2013.

Box 9 – item 6

Referring to the answer to item 1, requirements to publish information in the report and accounts of an existing UCITS should not apply in respect of any accounting period that has ended before 31 December 2013.

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