European Securities and Markets Authority

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PRESS RELEASE

ESMA seeks preliminary views on the potential shape of future regulation of exchange-traded funds and structured UCITS

ESMA publishes today a discussion paper (ESMA/2011/220) setting out policy orientations on guidelines for UCITS Exchange-Traded Funds (ETFs) and structured UCITS. The Authority has reviewed the current regulatory regime applicable to such funds and considers that the existing requirements are not sufficient to take account of the specific features and risks associated with these types of fund. In the discussion paper, ESMA examines 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. In this document, ESMA also raises the potential systemic risk caused by these types of fund and their impact on financial stability. ESMA will use the feedback received to this paper to develop draft guidelines for such funds.

Steven Maijoor, Chair of ESMA, said:

"Investor protection is one of the core missions of ESMA. With the publication of this discussion paper, we seek views on policy orientations to improve the transparency and quality of information provided to investors buying UCITS ETFs and structured UCITS. Also, specific safeguards need to be developed for activities like securities lending used by UCITS ETFs or for complex strategies pursued by some structured UCITS. However, in order to preserve the integrity of the UCITS brand and to protect investors, it cannot be excluded that it may be necessary for ESMA to issue warnings to retail investors about the risks of these products or even to limit the distribution of certain of such funds to retail investors. In this context, ESMA may need to ask for appropriate powers for inclusion in the relevant sectoral legislation."

For ETFs, ESMA has identified the following topics for which guidelines should be developed and on which feedback is sought:

Use of an identifier

ESMA believes that UCITS ETFs should use an identifier, in their name and in their fund rules, prospectus and marketing material, which identifies them as an Exchange-Traded Fund.

Index-tracking issues

The Authority is of the view that the prospectus of index-tracking ETFs should contain a clear and comprehensive description of the index to be tracked and the mechanism used to gain exposure to the index.

Synthetic ETFs

ESMA proposes that the information provided to investors in the prospectus of synthetic ETFs should at least include information on the underlying of the investment portfolio or index, the type of collateral which may be received from the counterparty and the risk of counterparty default and the effect on investors' returns.

Securities lending activities

For securities lending activities, ESMA suggests that the collateral received should comply with the criteria for OTC transactions set out in CESR's Guidelines on Risk Measurement and Calculation of Global Exposure and Counterparty Risk for UCITS (Ref. CESR/10-788). Also, the Authority is of the view that investors should be informed about the policy in relation to collateral, e.g. permitted types of collateral and the level of collateral required by the UCITS.

Disclosure of main risks of actively-managed ETFs

For this type of ETF, ESMA proposes that investors should be clearly informed of the fact the fund is actively managed and of the main sources of risks arising from the investment strategy.

Disclosure of the leverage policy when used by ETFs

The prospectus of leveraged ETFs should disclose the leverage policy and the risks associated with it, as well as a description of how the daily calculation of leverage impacts on investors' returns over the medium to long term.

Secondary market investors

ESMA is considering the possibility to require UCITS ETFs to give all investors, including those who acquire units on the secondary market, the right to redeem their units directly from the UCITS.

For structured UCITS, ESMA considers that guidelines should be developed with regards to total return swaps and strategy indices.

For structured UCITS gaining exposure to complicated investment strategies, ESMA believes that both the structured UCITS' investment portfolio, which is swapped, and the underlying to the swap to which the UCITS obtains exposure, should comply with the relevant UCITS diversification rules. Also, the Authority thinks that the role of the counterparty of the total return swap should be subject to specific safeguards. Concerning strategy indices, ESMA proposes policy orientations on, inter alia, the appropriate frequency of rebalancing the index and how their composition should be disclosed.

Next steps

Responses to this discussion paper will help ESMA in narrowing down its policy approach. Based on the responses to this discussion paper, that are due by 22 September, ESMA will develop draft guidelines for UCITS ETFs and structured UCITS. The proposed guidelines will be subject to a public consultation, the results of which will be used by ESMA to finalise the guidelines.

Notes for editors

1. 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).

2. 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.

3. 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.

4. ESMA replaced the Committee of European Securities Regulators (CESR), an advisory body comprised of EU securities regulators that advised the European Commission from 2001 to 2010 on policy issues around securities legislation.

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