
October 18, 2012
Response by ETF Securities

This paper responds to the European Commission’s (the Commission) consultation document on Undertakings for Collective Investment in Transferable Securities (UCITS): Product Rules, Liquidity Management, Depositary, Money Market Funds and Long Term Investments dated July 26, 2012. This response is jointly from ETF Securities Limited and ETF Securities (UK) Limited, the latter being a wholly owned subsidiary regulated by the Financial Services Authority of the United Kingdom.

Introduction to the ETF Securities group

ETF Securities group

The ETF Securities group is a leading, independent exchange-traded products provider with particular expertise in commodities. Our pioneering work in this asset class is complemented by specialist capabilities in currencies and some thematic equity products. We are dedicated to developing liquid, transparent investment solutions that can be traded on global stock exchanges.

We have a strong history of product innovation and independence, and these remain key tenets of our philosophy. Our management team developed the world’s first exchange-traded commodity (ETC), listing gold in Australia and the UK in 2003, and many other market-leading investment solutions have since followed. Today, ETF Securities offers what we believe to be the world’s most comprehensive range of exchange-traded commodities and, as of September 30, 2012, is responsible for more than US$30 billion in global investor assets.

We are the leading provider in Europe of ETCs– undated, non-interest bearing debt securities issued by special purpose vehicles, which are not considered collective investment undertakings (as explained in more detail below). ETCs are used by many investors (including UCITS funds). We believe that many of the questions in the Consolations around the eligibility of transferable securities linked to traditionally ineligible assets, the question of embedded derivatives and the questions around a “look through” approach are inextricably linked to the use of our ETCs by UCITS funds. As a result, we are keenly interested in being involved in the discussion on eligible assets and UCITS.

What is an ETC?

We believe it is helpful to explain briefly the structure of an ETC. ETCs enable investors to obtain exposure to commodity prices in a low cost, transparent, efficient manner and have become a popular form of investment for asset managers, pension funds, institutions and sophisticated, professional investors. ETF Securities created the ETC structure and is the market leader; it is currently ranked (by AUM) the 4th largest provider of exchange traded products in Europe and 9th globally. Other providers (e.g., Blackrock/Ishares, Deutsche Bank/db X-trackers and Source) also use the same structure to provide commodities exposure. Total funds invested in European ETCs is in approximately USD$35 billion as at September 2012, with ETF Securities ETCs representing approximately USD$24bn of that AUM1.

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1 ETFS internal data and Bloomberg Finance LP
ETCs are non-interest bearing, limited recourse, secured debt instruments issued by special purpose vehicles (each, an “ETC Issuer”) and can be broadly classified as follows:

- ETCs that track the price of physical metal and are backed by an entitlement to allocated metal held with a custodian (each a “Physically Backed ETC”); and
- ETCs that track the return of commodities using indices linked to futures contracts. These ETCs are backed by fully funded OTC contracts (“Commodity Contracts”) entered with a counterparty (each a “Futures Backed ETC”). The majority of Futures Backed ETCs are collateralised on a daily basis by the counterparty posting securities equal to the last reported outstanding exposure into an account held with a collateral custodian.

ETCs also embed an English-law trust structure, whereby the ETC Issuer assigns its rights in the underlying assets (e.g., the physical metal or the relevant commodity contracts) to a trustee. The debt securities are constituted under a Trust Instrument, which involves an independent trustee holding a security interest in the underlying assets in trust for the holders of the debt securities.

ETCs do not involve any active or discretionary management, and there is no investment policy. Each ETC is a passive product that directly tracks the price of one or more commodities. The pricing of each ETC is highly transparent and based on a fixed pricing formula or entitlement to physical metal. For Physically Backed ETCs, the investor has a fixed entitlement to metal less a daily management fee which is deducted from the metal held. For Futures backed ETCs, the price is equal to the value of the underlying index less a daily management fee, swap spread and any other applicable fee.

As ETCs are intended to track a reference underlying and are exchange traded, they have authorised participants (“APs”) who are involved in the primary market creation and redemption process and market makers who help ensure liquidity on exchange.

Physically backed ETCs are only issued and redeemed against the delivery of physical metal to or from the ETC Issuer’s segregated account with the relevant custodian. For example, to issue an ETC physically backed by gold, the relevant ETC Issuer must receive the amount of gold that each ETC represents. Upon redemption, the relevant amount of gold is returned to the AP.

Futures-backed ETCs are issued and redeemed against the delivery of cash equal to the relevant closing price of the underlying index. The ETC Issuer does not receive or invest any cash. Each Futures-Backed ETC involves fully funded exposure, with cash delivered from the AP directly to the counterparty. For example, to issue an ETC backed by the DJ-UBS All Commodities Index, the AP will deliver the cash directly to the counterparty, and upon receipt of confirmation from that counterparty, the Issuer will engage in the administrative task of ensuring that an appropriate Commodities Contract is executed.

**ETF Exchange**

ETF Exchange is a Dublin-domiciled UCITS platform developed by ETF Securities to provide investors with access to a range of thematic investment solutions through an independent (non-vertically integrated) swap-based model using multiple swap providers and authorised participants / market-makers.

First introduced in September 2008, ETF Exchange uses total return swaps to replicate index performance whilst credit exposures are collateralised in excess of UCITS requirements. The platform is designed to mitigate credit risk, disperse counterparty exposure and improve tracking error and liquidity. Participant banks on ETF Exchange act
as authorised participants and swap providers, and comprise Bank of America Merrill Lynch, Barclays Capital, and Citibank.

Scope of Our Response

We focus our response on the questions raised in Box 1 related to UCITS funds and Eligible Assets. In light of the fact that our products focus on commodities and because questions around the eligibility of commodities and transferable securities linked to commodities have traditionally driven the discussion on many of the points raised in the consultation, we direct our responses primarily to commodities as an eligible asset. We have also responded to some of the questions in Boxes 2 and 3 as they relate to our platform of exchange traded funds.

Further questions from the Commission

If ESMA has any questions in relation to this response, please contact Townsend Lansing, Head of Regulatory Affairs at ETFS UK, on +44 20 7448 4356 or townsend.lansing@etfsecurities.com.
Eligible Assets

1. Do you consider there is a need to review the scope of assets and exposures that are deemed eligible for a UCITS fund?

- We understand that there may be a variety of reasons driving a review of the assets that are eligible for purchase by UCITS, including, but not limited to, (i) the possibility that UCITS may be able to access assets that the Commission, from a policy perspective, does not believe are suitable for UCITS investors, (ii) concerns about the impact that derivatives may have on the UCITS brand, and (iii) concerns about potential uncertainty or lack of harmonisation among the EU member states with respect to the eligibility of certain assets.

- We would like to emphasize, however, that any review of the scope of eligible assets should be specifically tailored to addressing policy concerns but not so general as prevent UCITS from gaining access to assets (such as commodities) that have become a fundamental part of the investment landscape. We also believe that any review should be balanced and should recognize that financial markets (and in particular, the commodity markets) have changed over the past 25 years. Furthermore, we believe that any review should take into consideration the investments that UCITS are currently making, why UCITS are making those investments and the fact that those investments may be made in a format appropriate for UCITS. Finally, we believe that the review and any ultimate guidelines or rules should be as clear as possible and allow for transparent harmonisation across member states.

- With respect to commodities, we recognize that there are a variety of policy reasons behind the restrictions in the UCITS Directive on direct commodity investment. We believe, however, that any review of eligible assets should consider how the investing landscape has changed and the commodities markets have developed since 1985. Investors continue to place value on diversified portfolios, and many believe that a truly diversified portfolio should include commodities. Commodities are popular for a variety of reasons, e.g., as a hedge against inflation, as exposure to non-correlated asset class or as a play on emerging markets. As commodities have become more popular, commodity markets have improved as well. For example, transparency and liquidity around gold have improved from the days when gold was primarily traded by a few select banks at unpublishable reference prices or by coin dealers at high premiums. The London Bullion Market Association (the leading trade association responsible for coordinating wholesale trading for gold) provides two daily fixing prices that are used as global reference prices. It has also established a globally accepted standard for quality and fineness of gold. Both of these developments have led to a robust and liquid OTC market, evidenced by a recent study showing that gold had an average daily trading volume in Q1 2011 of 173,713,000 ounces ($240.8bn worth of gold). On the back of that study, gold has been approved as eligible collateral for central counterparties under EMIR and is in final stages of agreement for approval as a high quality liquid asset for CRD IV. Gold is not the only example of developments in commodity markets. Commodities futures markets have changed as well, seeing dramatic increases in flows; a 2008 CFTC report indicated that the markets had seen a five-fold increase in volumes between 1998 and 2007. Increased regulation, such as the CFTC requirements on more reporting, is leading the way towards greater transparency.

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2 See “Commodity Index Investing and Commodity Futures Prices” by Hans R. Stoll and Robert E. Whaley, September 10, 2009.
• At the same time, commodity investing is being made more accessible for a wide variety of investors. Much of that accessibility comes from commodity index investments and in particular, commodity exchange traded products (ETPs). Global commodity ETPs have increased from ca. $40bn in January 2007 to ca. $200bn in March 2012. In Europe, the predominant commodity exchange traded product is the ETC, which was first introduced in 2003. Like the traditional commodity markets, the ETC market has experienced solid growth. Over the last decade, investment in European ETCs has risen to ca. $35bn. $27bn of that AUM is in physically backed gold products. We estimate that UCITS funds hold approximately $5bn of ETCs (based on our estimates, $4bn of that is in ETF Securities ETCs). Average daily trading in ETF Securities more popular ETCs has reached over $100mm in the same time frame. Clearly, this is a growing and liquid market.

2. Do you consider that all investment strategies currently observed in the marketplace are in line with what investors expect of a product regulated by UCITS?

• This is a difficult question to answer, because one cannot be certain of knowing all of the investment strategies or what investors expect of a product regulated by UCITS. We believe that the majority of investment strategies used by UCITS meet the expectations of an investor relying on sophisticated investment professionals to provide risk-appropriate capital growth.

• With respect to commodities, we believe that investors both want and expect UCITS to be able to provide access to a variety of commodity exposures. Commodities have developed as an important asset class for a wide variety of investors. The significant growth in commodity ETPs over the past 10 years is clear evidence of this trend. Whether they are looking to gold as a hedge against inflation or insurance against dramatic declines in other assets or to other commodities to express views on emerging markets and cyclical growth, investors clearly want exposure to commodities.

3. Do you consider that there is a need to further develop rules on the liquidity of eligible assets? What kind of rules could be envisaged? Please evaluate possible consequences for all stakeholders involved.

• We are not convinced that it is necessary to develop further liquidity rules for eligible assets beyond the current requirements for transferable securities and money market funds. Particular liquidity buffers on eligible assets could have wide ranging implications for a variety of traditional asset classes, such as fixed income and certain emerging market equities. Having said that, liquidity rules could be used as one criterion among many for examining what types of assets should be eligible. Those criteria could examine whether an asset has (i) sufficient liquidity, (ii) sufficient transparency, (iii) sufficient independent valuation inputs, (iv) appropriate volatility and (v) an appropriate risk profile (based, for example, on a risk metric such as a sharp ratio).

4. What is the current market practice regarding the exposure to non-eligible assets? What is the estimated percentage of UCITS exposed to non-eligible assets and what is the average proportion of these assets in such a UCITS’ portfolio? Please describe the strategies used to gain exposure to non-eligible assets and the non-eligible assets

3 Source: ETF Securities, Bloomberg
involved. If you are an asset manager, please provide also information specific to your business.

- We will focus our response on commodities, as that is the area in which we have the most experience. UCITS have gained exposure to commodities in two ways: via ETCs as eligible transferable securities and via derivatives or transferable securities embedding derivatives referencing diversified (and until the recent ESMA guidelines published in 2012, single) commodity indices. We set forth below the current analysis on how these are eligible:

- **ETCs as Eligible Transferable Securities**

  The UCITS rules provide the criteria for transferable securities, which are generally satisfied by ETCs. For transferable securities that are backed by or are linked to “ineligible assets”, UCITS generally believe that they are allowed to invest in such transferable securities as long as they do not embed a derivative, irrespective of the underlying asset.

  The possibility that a transferable security could itself be eligible even if it referenced an ineligible asset was first supported by CESR in 2006.

  Further support was provided by Article 2(2)(c) of The Commission Directive 2007/16/EC, which specifically defined as transferable securities (and by extension, eligible assets) certain “financial instruments” that are “backed by, or linked to the performance of, other assets, which may differ from those referred to in Article 19(1) of the Directive (85/611/EEC).” The meaning of “backed by or linked to” is not entirely clear. While we recognize that the Commission has the better insight into its own legislative history around the meaning of “backed by or linked to,” we would submit that the language specifically addresses the question of physically backed gold ETCs. We are aware that prior to the publication of The Commission Directive 2007/16/EC, the eligibility of Gold Bullion Securities (an ETF Securities ETC backed by physical gold) was being discussed by UCITS providers and regulators. Indeed, in 2006, the Luxembourg regulator declared Gold Bullion Securities an eligible asset for Luxembourg-domiciled UCITS.

  The Commission Directive 2007/16/EC further supported the possibility by introducing the idea of an embedded derivative in the context of structured financial instruments. An structured financial instrument that embeds a derivative contains a component that (i) “by virtue of that component some or all of the cash flows that

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4 The criteria are as follows:
- the potential loss which the UCITS may incur with respect to holding these instruments is limited to the amount paid for them;
- their liquidity does not compromise the ability of the UCITS to comply with the ability of the UCITS to comply with Article 37 of the UCITS Directive;
- reliable valuation is available for them;
- appropriate information is available for them;
- they are negotiable;
- their acquisition is consistent with the investment objectives or the investment policy, or both of the UCITS, pursuant to the UCITS Directive; and
- their risks are adequately captured by the risk management process of the UCITS.

5 This view was first supported by the CESR Background Note (ESC/44/2006 Rev 2):

“The categorisation of these instruments (often referred to as “structured financial products”) gives rise to uncertainties among competent authorities, particularly if the backing or linked assets are not themselves eligible under the UCITS Directive, e.g. instruments referring to oil price or to commodities. The implementing directive clarifies that such instruments are transferable securities if they comply with the criteria it sets out. Whether these other assets are themselves eligible for a UCITS in accordance with Art 19(1)(a) of the UCITS Directive is not relevant for this qualification. This approach is based on the consideration that the UCITS Directive does not require such type of “looking through approach”

otherwise would be required by the transferable security which functions as a host contract can be modified according to a specified interest rate, financial instrument price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, and therefore vary in a way similar to a stand-alone derivative; (ii) its economic characteristics are not closely related to the economic characteristics and risks of the host contract and (iii) it has a significant impact on the risk profile and pricing of the transferable security.” This standard is by and large taken from the IAS 39 accounting standards, which require the bifurcation of an embedded derivative (which would be marked to market daily for accounting purposes), from a host debt instrument (which would be amortized over the life of the note). The “embedded derivative” standard makes perfect sense for the majority of structured products that involve simple and exotic derivative exposure (which are economically equivalent to a zero-coupon bond plus a call or put option). Its application, however, becomes more difficult when applied to a variety of ETCs, which provide “delta 1” exposure to precious metals and commodity indices. With Delta 1 exposure, it is difficult to identify a “host contract” from the overall exposure of the reference underlying or to see any modification of cash flows; the value of the ETC is at all times linked to the value of the reference underlying. It is therefore difficult to argue that the economic characteristics of any supposed embedded derivative are not “closely related” to the economic characteristics and risks of the host contract.

Many UCITS market participants and regulators have agreed that a UCITS may acquire transferable securities that provide delta 1 exposure to commodities (i.e. ETCs), on the basis that such instruments do not embed a derivative and therefore, do not require the look through approach to the underlying asset. This Delta 1 interpretation was first introduced by CESR in 2006 and then codified by the German regulator BaFin then codified this so-called Delta 1 approach in its FAQs on The Commission Directive 2007/16/EC. Since then, this interpretation has become accepted within the UCITS investment and regulatory communities, with one main exception. The French regulator does not accept it and therefore it is not used by French-domiciled UCITS funds.

• Derivatives Referencing Financial Commodity Indices

Derivative must reference an eligible asset, such as equities, debt, currencies or financial indices. Financial indices are accepted as eligible assets as long as they meet certain criteria with respect to their transparency and diversification; this includes financial indices on ineligible assets such as commodity futures. For example, there are numerous UCITS funds that provide exposure to fully diversified commodity indices. Prior to the recent ESMA Guidelines, UCITS funds were also obtaining exposure to non-

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7 See the Background Note on the ESC Working Document (ESC/14/2006): “not all forms of linkage to other assets should be construed as embedding a derivative element. There is only an embedded derivative element if the linkage amounts to an embedded derivative in accordance with the criteria developed for the identification of embedded derivatives in Article 10 of the implementing directive. If, for instance, the instrument merely replicates the performance of a certain underlying (e.g., the oil price) at a ratio of 1:1, there would be no embedded derivative in accordance with these criteria. The instrument has to be considered a plain transferable security…”

8 See the BAFIN’s Fragenkatalog zu Erwerbbaren Gegenständen:

• “Produkte, die die Entwicklung des Basiswertes 1:1 abbilden (“1:1 Produkte”) stellen mangels eines eingebetteten derivativen Elements keine strukturierten Produkten mit derivativer Komponente dar. Ein eingebettetes Derivat ist bei derartigen Produkten nicht zu erkennen, da es fuer die Annahme einer derivativen Komponente insbesondere an einer Hebelwirkung und die Voraussetzungen des Art. 10 Abs. 1a) bis c) der Richtlinie 2007/16/EG nicht vorliegen”

• Eine Ausnahme von den zuvor dargestellten Grundsatzen gilt jedoch fuer Delta 1 oder 1:1 Zertifikate auf Rohoel, die die Wertentwicklung von Rohoel durch die Bezugnahme auf Rohoel-Futures abbilden. Da bei diesen Zertifikaten der Rohoelpreis ueblicherweise durch eine Bezugnahme auf Rohoel-Futures abgebildet wird und zudem mit der Bezugnahme auf die Futures keine Hebelwirkung verbunden ist, werden solche Zertifikate weder als Derivate noch als Finanzinstrument mit derivativer Komponente … angesehen.
diversified commodity indices on the basis of previous CESR guidance. With the proposed guidance, UCITS will only invest in financial indices on commodities that have a minimum of 5 components (with a maximum 20% weighting per component) and subject to certain correlation analyses. In order to avoid any regulatory arbitrage, the rules regarding transferable securities that embed derivatives are the same; the underlying reference asset must itself be eligible. As a result, for those ETCs that do embed derivatives, such as leveraged ETCs, UCITS funds have traditionally applied the “look through” to determine the eligibility of the underlying financial index.

5. Do you consider there is a need to further refine rules on exposure to non-eligible assets? What would be the consequences of the following measures for all stakeholders involved:

- preventing exposure to certain non-eligible assets (e.g., by adopting a “look through” approach for transferable securities, investments in financial indices, or closed ended funds.)

- Defining specific exposure limits and risk spreading rules (e.g., diversification) at the level of the underlying assets.

- As mentioned in above, we understand that there are concerns around the eligible assets. However, we feel this question in particular cannot be answered until those concerns are highlighted with specific examples. Furthermore, the investigation should look closely at the current investment environment and at the assets that UCITS managers feel are necessary to provide appropriate risk-adjusted returns. We feel that any refining of those rules should define clear policy objectives for what should and should not be eligible. We believe that there must be an examination as to whether the assets in question (i) lack sufficient liquidity, (ii) lack sufficient transparency, (iii) lack sufficient independent valuation inputs, (iv) are too volatile or (v) involve too much risk. In addition, there may be different approaches to the eligibility of the asset depending on how the exposure is achieved. For example, the Commission may identify certain policy concerns around commodities, which would restrict the trading of futures (e.g., due to concerns around leverage or physical delivery requirements) or the holding physical gold in a vault (e.g., due to concerns about liquidity and cost), but that does not mean that exposure to futures or physical gold cannot be obtained in wrappers (such as ETCs) that eliminate those specific policy concerns. Finally, the ultimate rules should be tailored as narrowly as possible to achieve the policy objectives.

- With respect to the proposal for a “look through” requirement, we submit that the requirement currently exists for derivatives and transferable securities that embed derivatives (although the application to closed ended funds is an area of some uncertainty). Indeed, it would be far more important to harmonise the definition of what constitutes an embedded derivative and to codify the delta 1 exemption with respect to embedded derivatives. We believe that the majority of questions in this

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9 D9(1)(a)(iii) Where derivatives on an index composed of non-eligible assets are used to track or gain high-exposure to the index, in order to avoid undue concentration the index should be at least as diversified as set out under the diversification ratios according to Article 22a of Directive 85/611/EEC. If derivatives on the index are used for risk-diversification purposes, provided that the exposure of the UCITS to the individual indices complies with the 5/10/40% ratios, there is no need to look at the underlying components of the of the individual indices to ensure that they are sufficiently diversified. (See “CESR Guidelines concerning eligible assets for investment by UCITS” March 2007 - http://www.esma.europa.eu/system/files/07_044.pdf.)

space arise in the context of ETCs (indeed, as we mention above, we believe the "delta 1 exemption" was developed very much in response to the question of the eligibility of ETCs backed by physical gold.) Finally, we very much believe that commodities have a place in UCITS portfolios and that changes to current market practice preventing UCITS from purchasing ETCs would deny them access to an growing and important asset class.

- We believe that any new rules should first emphasize the minimum diversification requirement for assets held at the portfolio level, irrespective of the manner in which the exposure is obtained. Consistent with current rules, this would mean that UCITS should have a minimum of 5 assets, with no single asset representing more than 20% (35% under exceptional circumstances). Once that is done, specific exposure limits or diversification requirements may be appropriate but only in cases where such limits or requirements directly address the additional risks posed by the asset. For example, if an ETC and the commodity it references have a similar profile in terms of (i) liquidity, (ii) transparency, (iii) valuation, (iv) volatility and (v) risk to an equity, it is not entirely clear why the commodity ETC would require diversification or an exposure limit whereas the equity would not.

6. Do you see merit in distinguishing or limiting the scope of eligible derivatives based on the payoff of the derivative (e.g., plain vanilla vs. exotic derivatives). If yes, what would the consequences of introducing such a distinction? Do you see a need for other distinctions?

- We have no comment.

9. Do you consider that market risk is a consistent indicator of global exposure relating to derivative instruments? Which type of strategy employs VaR as a measure for global exposure? What is the proportion of funds using VaR to measure global exposure? What would be the consequence for different stakeholders of using only leverage (commitment method) as a measure of global exposure? If you are an asset manager, please provide also information specific to your business.

- We have no comment.

10. Do you consider the use of derivatives should be limited to instruments that are traded or would be required to be traded on multilateral platforms in accordance with legislative proposals on MiFIR? What would be the consequences for different stakeholders of introducing such an obligation?

- We do not believe that it would be appropriate to introduce such a requirement until it is clear that the market had accepted and implemented the proposals on central clearing and trading of derivatives. Only after market participants have relevant experience with the types of derivatives that (i) are accepted for trading by the multilateral platforms and (ii) successfully trade on such platforms would it be worth considering such a proposal.

- Furthermore, we do not believe that central clearing is necessarily superior to the existing counterparty exposure limits imposed by the UCITS rules.
Efficient Portfolio Management (EPM)

1. Please describe the type of transactions and instruments that are currently considered as EPM techniques. Please describe the type of transactions and instruments that, in your view, should be considered as EPM techniques

- In the ETF space, reverse repo transactions are used by issuers to manage cash efficiently. Essentially, an ETF issuer using a reverse repo has an unfunded synthetic structure, but instead of purchasing a basket of securities and swapping its performance for the performance of the underlying index, the issuer delivers the cash to the counterparty of the reverse repo (generally the counterparty of the swap) that in turn provides collateral. It is important to note that such reverse repo transactions do not provide any net interest income to the ETF issuer, and as a result, we do not believe they constitute lending.

2. Do you consider there is a specific need to further address issues or risks related to EPM techniques?

- We have no comment.

3. What is the current market practice regarding the use of EPM techniques: counterparties involved, volumes, liquidity constraints, revenues and revenue sharing arrangements?

- We have no comment.

14. Please describe the types of policies generally in place for the use of EPM techniques. Are any limits applied to the amount of portfolio assets that may, at any given time, be the object of EPM techniques. Do you see any merits in prescribing limits to the amount of fund assets that may be subject to EPM. If yes, what would the appropriate limit and what consequences would such limits have on all the stakeholders affected by such limits. If you are an asset manager, please provide information specific to your business.

- We do not have any limits to our use of reverse repos as EPM techniques in our ETF platform as they are a cost efficient method of managing the case raised from the issuance of ETF units. We do not believe that this EPM technique raises any real risks for our investors or that any limits changing our ability to manage cash in this fashion would be helpful.

5. What is the current market practice regarding collateral received in EPM?

- All of our reverse repos are fully collateralised. We have a robust policy around eligible collateral, including haircuts for certain assets, and the eligible collateral criteria comply with UCITS rules. We publish our criteria and the collateral we hold on a daily basis. We do not engage in any collateral swaps.

6. Do you think there is a need to define criteria on the eligibility, liquidity, diversification and re-use of received collateral. If yes, what should such criteria be?

- We have no comment.
7. What is the market practice regarding haircuts on received collateral? Do you see merit in prescribing mandatory haircuts on received collateral in EPM?

- We have a robust haircut policy that we believe protects investors and ensures the quality of our collateral. While we could see the requirement that certain assets be subject to a haircut, we do not believe that regulators should directly impose haircut levels.

8. Do you see a need to apply liquidity considerations when deciding the term or duration of EPM transactions? What would the consequences be for the fund if the EPM transactions were not recallable at any time? What would the consequences of making all EPM transactions recallable?

- We apply such liquidity considerations as our EPM techniques have to take into account that ETFs are liquid, trade daily on exchange and redeemable.

9. Do you think EPM transactions should be treated according to their economic substance for the purpose of assessing risks arising from such transactions?

- We have no comment.

10. What is the current market practice regarding collateral provided by UCITS through EPM transactions? More specifically, is the EPM counterparty allowed to reuse the assets provided by a UCITS as collateral. If so, to what extent?

- We do not provide collateral to our counterparties and therefore, we have no comment.

11. Do you think that there is a need to define criteria regarding the collateral provided by UCITS?

- We have no comment.

12. What is the market practice in terms of information provided to investors as regards EPM? Do you think there should be greater transparency related to risks inherent in EPM techniques, collateral received in the context of such techniques or earnings achieved thereby as well as their distribution?

- We disclose our EPM techniques to investors as well as our collateral holdings.

OTC Derivatives

1. When assessing counterparty risk, do you see merit in clarifying the treatment of OTC derivatives cleared through central counterparties? If so, what would be the appropriate approach?

- We have no comment.

2. For OTC derivatives not cleared through central counterparties, do you think collateral requirements should be consistent between the OTC and EPM transactions?

- Yes, we believe UCITS collateral requirements should be consistent across the board.
3. Do you agree that there are specific operational or other risks resulting from UCITS contracting with a single counterparty? What measures could be envisaged to mitigate those risks?

- ETF issuers often use OTC swaps to gain exposure to certain indices. In this space, we believe the greatest operational risks arise when the ETF issuer has a sole swap provider that is an affiliate/member of the same group company. Such affiliation can lead to real operational risks in the event of insolvency.

4. What is the current market practice in terms of frequency of calculation of counterparty risk and issuer concentration and valuation of UCITS assets? If you are an asset manager, please provide information specific to your business?

- We calculate exposure on a daily basis and that exposure is collateralised on a daily basis for our ETF platform.

5. What would be the benefits and costs for all stakeholders involved of requiring calculation of counterparty risk and issuer concentration of the UCITS on a daily basis?

- We have no comment.

7. How could such a calculation be implemented for assets with less frequent valuations?

- We have no comment.