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European Securities and Markets Authority
103 rue de Grenelle
75007 Paris
France

Submitted via www.esma.europa.eu

Re: ESMA's policy orientations on guidelines for UCITS Exchange-Traded Funds and Structured UCITS

Dear Sirs,

Markit is a financial information services company with over 2,200 employees in Europe, North America, and Asia Pacific. The company provides independent data, valuations, and risk analytics for financial products across asset classes in order to increase transparency, reduce risk and improve operational efficiency.[1] We are also a service provider to the Exchange-Traded Funds ("***ETFs***") market, where we offer products and services that increase transparency and efficiency and provide a more comprehensive view of these markets.

Introduction

Global ETF markets have experienced significant growth and innovation in recent years and, with these advancements, this market may have areas that are vulnerable. We support ESMA's initiative to develop guidelines that are applicable to UCITS ETFs and structured UCITS, as well as the examination of possible measures to mitigate investor risk in this area.

We believe that requirements to provide more frequent and detailed updates of composition and risk characteristics of UCITS ETFs and structured UCITS could help address many of the identified regulatory concerns as long as they are appropriately designed. Markit has worked with ETF providers for many years to enhance transparency in the ETF markets and we are familiar with the appropriate tools. We launched Markit ETF Services last year,[2] a feed that contains details of ETF providers, daily portfolio composition, net asset value, assets under management and dividend forecasts for all of the more than 3,800 ETFs that are currently available worldwide. The service consists of the Markit ETF Encyclopedia, Markit ETF Trade Data, Markit ETF Dividends, and Markit ETF Analytics.[3]

[1] Please see www.markit.com for additional information.

[2] Please note that, in addition to ETFs, Markit ETF Services also cover Exchange Traded Vehicles (ETVs), Exchange Traded Certificates (ETCs), Exchange Traded Notes (ETNs) and Exchange Traded Products (ETPs). However, for the sake of simplicity, we will reference all of those products as ETFs throughout this letter.

[3] Markit ETF Encyclopedia is a reference database of ETFs that are categorized by asset class, type, region and structure. It is updated daily for new product launches and cross-listings, includes key ETF data such as authorised participants, key market dates, the tax domicile of funds, swap counterparties, creation and redemption details and fees, and additional key data points that have been extracted from filing documents. Markit ETF Trade Data provides daily composition data for the creation, redemption and calculation baskets for ETFs, allowing authorised participants and market makers to know the exact composition of a fund in order to price the ETF in real-time, make markets, and manage risk accordingly. Markit ETF Dividends provides forecasts by utilizing single-stock dividend forecasts which are based on direct company guidance, fundamental analysis, peer group trends, historical patterns, consensus aggregate estimates, and stock exchange guidelines. Markit ETF Analytics provides a single source of all key statistics that are required for analyzing ETFs, such as performance data, various risk measures, dividend information, general pricing information, average assets under management, bid-ask spread, asset flows, and premium/discount based on the consolidated close.

Please find below our answers to the questions that ESMA asked in its Discussion Paper.

1. ETFs

1.1. Identifiers

- **Question 8: Do you agree with the proposed approach for UCITS ETFs to use an identifier in their names, fund rules, prospectus and marketing material?**
- **Question 9: Do you think that the identifier should further distinguish between synthetic and physical ETFs and actively-managed ETFs?**
- **Question 10: Do you think that the identifier should also be used in the Key Investor Information Document of UCITS ETFs?**

We agree with ESMA's observation that investors are often confused about the exact nature of European ETFs as these products have unique features that are not present in traditional open-ended funds while they are also often mistaken for other types of exchange-trade products. This is especially the case because, unlike for other UCITS, investors in ETFs do not always receive the fund documentation when they acquire UCITS ETF units directly on-exchange or through dedicated websites. We believe that, given the specific features and risks that are associated with these types of funds, regulatory requirements that enhance their transparency might be appropriate. Although there are a number of existing rules and regulations that may have relevance for ETFs, we believe that classification guidelines should be developed and tailored to the specifics of the UCITS market in order to mollify the confusion surrounding the UCITS products.

We therefore support ESMA's policy recommendation to require ETFs to use an identifier in their name, fund rules, prospectus and marketing material that would classify them as an exchange-traded fund. We believe that such requirement will facilitate greater transparency, and therefore greater investor understanding in the ETF market. We further believe that ESMA's policy recommendation for a clear classification of an UCITS should be introduced and used across all funds, not just for UCITS ETF, and in all materials, including the Key Information Document ("***KID***"). This classification could include the type of ETP and an indication of the replication method.[4]

1.2. Index Tracking

- **Question 12: Do you agree with the policy orientations identified by ESMA for index-tracking issues?**

We believe that in relation to its policy orientations for index-tracking ETFs ESMA should take the following factors into account.

Firstly, although most of the indices are "public" in that their rulebooks must be accessible to the general public, the methodology and maintenance of the composition of these indices are protected intellectual property rights. This is important to stimulate the development of high-quality and innovative products in this area. In order to avoid complex issues, fees, and burden for what we view as having limited value, we recommend that ESMA requires ETF issues to make index information available only by a public link and on a high level.[5]

[4] Replication methods could be, for example, synthetic, physical, full or sampling, or actively managed.
[5] For example the information could be displayed in modules such as sectors or countries.

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Secondly, we believe ESMA should be aware of the fact that services are currently provided to market participants that collate and aggregate official data on commercially available equity indices in a single feed and format.[6] The relevant data is sourced directly from index providers and exchanges, and is checked and validated ahead of market open. We believe that such services already assist issuers in providing the exact composition of the tracked indices to many authorized participants.

- **Question 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 agree with ESMA's view that index-tracking UCITS ETF should include their tracking error in both the prospectus and the KID. However, we believe that to provide greater transparency and avoid confusion, a maximum level and/or policy for tracking error should be established by ESMA rather than by the individual ETF issuer. The provision of such standardized measure of tracking difference would allow investors to perform a like-for-like comparison between different ETFs. It would also allow ESMA to identify and monitor those index-tracking ETFs that consistently do not meet the set standards.

1.3. Synthetic ETFs

- **Question 16: Do you support the disclosure proposals in relation to underlying exposure, counterparty(ies) and collateral?**

In recent years synthetic ETFs have become increasingly popular as a cost-efficient alternative to physical replication. We believe that it is important to address potential risks that may originate from the lack of transparency about the assets that are backing synthetic ETF structures. The annual report of synthetic ETFs should therefore contain details of the underlying exposure that is obtained through the use of financial derivatives as well as about the identity of the counterparties to these transactions.

We support ESMA's recommendation that details of the underlying exposure, the identity of the counterparties and the collateral held by UCITS to reduce counterparty exposure should be included in their annual reports. However, ESMA should consider that collateral baskets can change over time and investors should be aware of these changes not just on a yearly basis. We therefore believe that to further ESMA's goals of mitigating risk in the complex products that are made available to retail investors, information about the collateral exposure should be made available more frequently than annually. ESMA should note that that a number of ETF providers already provide such updates on a weekly or monthly basis to their authorized participants. We believe that, as long as the format of these updates is left to the discretion of the ETF providers, the cost to disclose such information on, for example, a monthly basis should not be significant.

1.4. Securities lending activities

- **Question 20: Do you support the policy orientations identified by ESMA?**

We agree with ESMA's recommendation that a UCITS ETF should, in its prospectus, clearly inform investors of its intention to engage in securities lending activities. We believe that by including a detailed description of the risks that are involved in this activity investors will be able to develop a better understanding of the risks that are taken by the UCITS ETF. These risks include counterparty risk and the impact that securities lending will have on the tracking error of index tracking ETFs.

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[6] Provided by Markit Index Management Service

Further, we believe that UCITS ETFs should disclose the fees that they generate from securities lending. This is because it is not always clear to investors what the role of securities lending agents is and whether the UCITS ETF is indeed receiving a fee from the lender. We believe that it is important for investors to have a full understanding of the parties that are involved and their incentives. The UCITS ETF should therefore disclose any fee-sharing arrangements that it has entered into with the lender and whether the lending agent is a related party to the UCITS ETF. We recommend that the revenue generated by securities lending activities is specified as a separate line item in the financial statements of the ETF.

ESMA should note that ETFs in the United States already disclose their securities lending relationships. Also, Markit currently provides the above type of information for a number of ETF providers as part of the Markit ETF Encyclopedia. However, this type of data is currently not always available in a straightforward, easy to understand manner. We would therefore welcome the opportunity to discuss with ETF issuers and ESMA how to best discover and utilize this information.

1.5. Actively-Managed UCITS ETFs

- **Question 26: Do you agree with ESMA's proposed policy orientations for actively managed UICTS ETFs?**

We agree with ESMA's proposed policy orientations for actively managed UCITS ETFs. We believe that, in order to fully pursue ESMA's policy goal of risk mitigation surrounding complex products, it will be essential for investors to be clearly informed not only of the fact that the fund is actively managed but also of the main sources of risks that arise from the fund's investment strategy.

Additionally, the UCITS ETF should clearly disclose how the indicative net asset value ("***iNAV***") is calculated, including details of portfolio turnover. This is because such disclosure will clearly indicate to investors how closely the iNAV that is published via third parties tracks the actual value of the portfolio during the day.[7]

1.6. Leveraged UCITS ETFs

- **Question 30: Do you support the policy orientations identified by ESMA?**

Leveraged UCITS ETFs seek to achieve a daily return that is a multiple or an inverse multiple of the daily return of a securities index by pursuing a range of investment strategies. However, their performance over longer periods of time can differ significantly from the multiple or inverse multiple of the index performance and can be magnified in volatile markets.

It is therefore important for investors to fully understand the risks that are associated with leveraged UCITS ETFs. We believe that disclosing the UCITS ETF's leverage policy will help achieve greater understanding and transparency in this respect. We therefore support ESMA's policy recommendation for the prospectus for leveraged UCITS ETFs to disclose the leverage policy, an explanation of how it is achieved, and a description of the risks that are associated with this policy.

2. Structured UCITS

2.1. Total Return Swaps

[7] iNAVs are calculated either using the performance of the underlying index or through a "bottom up" approach based on the fund's constituents. A bottom up approach will be most appropriate for actively managed funds as the composition of the fund will most likely vary from the underlying index. We believe that the cost to disclose how this iNAV is calculated would be limited.

- **Question 39: Do you agree with ESMA's analysis of the issues raised by the use of total return swaps by UCITS?**

We believe that the UCITS' investment portfolio and the underlying to the swap should comply with the relevant UCITS diversification rules. Additionally, the prospectus and annual report should include details of the underlying strategy and exposure, the counterparties and their roles and discretion over the portfolio and any collateral.

We agree with ESMA's policy recommendation that the UCITS' annual report should contain details of the underlying exposure that is obtained through financial derivative instruments, the counterparties to these financial instruments, and the collateral held by the UCITS to reduce counterparty exposure. We further believe that for complicated investment strategies both the structured UCITS' investment portfolio, which is swapped, and the underlying to the swap to which UCITS obtains exposure, should comply with the relevant UCITS diversification rules.

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As a provider of transparency services to the global ETF markets, we are open to working with ETF issuers, investors, and regulatory authorities to ensure that the desired additional transparency of the UCITS ETF and Structured UCITS markets can be made available in an appropriate, cost-efficient and timely manner.

We hope that our comments will be of value to you. Please do not hesitate to contact the undersigned or Marcus Schüler at marcus.schueler@markit.com if you require any additional information or if you want to discuss our comments further.

Sincerely,

Kevin Gould
President
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