**Press Release** **Nice, London, Singapore, April 10, 2012**

# In response to ESMA consultation paper on ETFs, EDHEC-Risk Institute calls for improved transparency, governance and auditability of indices

In commenting on the ESMA Consultation Paper entitled "ESMA's guidelines on ETFs and other UCITS issues" (ESMA/2012/44, January 2012), EDHEC-Risk Institute has welcomed the broadened focus of this new consultation, which goes a long way towards approaching important issues in a horizontal way across all UCITS, rather than in a vertical way limited to UCITS ETFs, but regrets that the consultation paper has not gone further in several key areas:

- While underlining the differences between passively and actively managed funds and proposing more disclosures on tracking error, **the consultation paper falls short of giving a definition of passive management that would be framed in terms of a limit on the maximum level of tracking error acceptable**.
- EDHEC-Risk strongly believes that for an index-tracking vehicle to be considered a passive investment vehicle, it is also necessary that the underlying index be a financial index whose composition is dictated by a set of pre-determined rules and objective criteria allowing for strict systematic implementation. **For an index to be considered representative of passive management, its ground rules should leave no room for implicit, let alone explicit, discretionary choices**.
- While the guidelines recommend that information on the performance of indices should be freely available to investors, **EDHEC-Risk regrets that the proposed guidelines stop short of requiring that all information concerning indices–notably, their historical composition–be made freely available to the public**. This information is difficult to obtain for traditional indices, even though the rules of the latter are typically simple, and in the case of strategy indices, it is almost impossible to procure at reasonable cost.
- Free public disclosure of this information, **for all types of indices**, would not only allow UCITS and end-investors to perform their due diligence at minimal cost, but also foster the development of independent research on indices that would contribute to market efficiency.
- More attention should be given to the quality of index governance and the auditability of decisions made by index committees.
- Ground rules may be ambiguous enough to implicitly allow for discretionary decisions and they may also explicitly provide for the possibility of discretionary choices. Such decisions can have a very significant impact on the composition of an index and **there are many more dimensions to conflicts of interest in this regard than recognised in the consultation**.
- The exercise of discretion in the implementation of ground rules blurs the distinction between passive and active management. **EDHEC-Risk's recommendation is for ESMA to start working on these issues and launch a consultation on indices that will pave the way for major progress in the information of UCITS and end-investors with respect to the quality, governance, and auditability of indices**.

A copy of EDHEC-Risk Institute's comments on the ESMA consultation paper can be found here:

EDHEC-Risk Institute Comments on ESMA Consultation Paper, ESMA/2012/44

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A copy of the recent EDHEC-Risk study on the risks of European ETFs can be found here:

EDHEC Position Paper What are the Risks of European ETFs?

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## About EDHEC-Risk Institute

Since 2001, EDHEC has been pursuing an ambitious policy in terms of international research. This policy, known as "Research for Business", aims to make EDHEC an academic institution of reference for the industry in a small number of areas in which the school has reached critical mass in terms of expertise and research results. Among these areas, asset and risk management have occupied privileged positions, leading to the creation in 2001 of a major research facility: EDHEC-Risk Institute. This institute now boasts a team of 80 permanent professors, engineers and support staff, as well as 18 research associates from the financial industry and 6 affiliate professors.

EDHEC-Risk Institute is located at campuses in Singapore, which was established at the invitation of the Monetary Authority of Singapore (MAS), the City of London in the United Kingdom, and Nice, France. In addition, it has a research team located in the United States. The philosophy of the institute is to validate its work by publication in prestigious academic journals, but also to make it available to professionals and to participate in industry debate through its Position Papers, published studies and conferences.

Each year, EDHEC-Risk organises two conferences for professionals in order to present the results of its research, one in London (EDHEC-Risk Days – Europe) and one in Singapore (EDHEC-Risk Days – Asia), attracting more than 2,000 professional delegates. To ensure the distribution of its research to the industry, EDHEC-Risk also provides professionals with access to its website, www.edhec-risk.com, which is entirely devoted to international risk and asset management research. The website, which has more than 50,000 regular visitors, is aimed at professionals who wish to benefit from EDHEC-Risk's analysis and expertise in the area of applied portfolio management research. Its monthly newsletter is distributed to more than 1,000,000 readers.

EDHEC-Risk Institute also has highly significant executive education activities for professionals. In partnership with CFA Institute, it has developed advanced seminars based on its research which are available to CFA charterholders and have been taking place since 2008 in New York, Singapore and London. EDHEC-Risk Institute has an original PhD in Finance programme which, in addition to its highly selective residential track for young talents worldwide, has an executive track for high level professionals who already have masters degrees from prestigious universities and significant industry experience. Complementing the core faculty, this unique PhD in Finance programme has highly prestigious affiliate faculty from universities such as Princeton, Wharton, Oxford, Chicago and CalTech.

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