Press Release **Nice, London, Singapore, July 30, 2012**

EDHEC-Risk Institute strongly welcomes ESMA's ETF guidelines

EDHEC-Risk Institute has strongly welcomed the ETF guidelines released by the European Securities and Markets Authority (ESMA) on July 25, 2012, which are consistent with the conclusions of EDHEC-Risk Institute's research on ETF risks and ESMA's consultation paper, which were both published earlier this year (please find references to relevant press releases here and here).

These guidelines go further than the consultation document in two notable areas:

The first is **securities lending**, where ESMA indicates clearly that all profits from securities lending should be returned to the fund. It is clear that this subject comes as a surprise to industry participants. EDHEC-Risk had brought up the problem of transparency in its research, but nobody thought that ESMA would go as far as it did on the subject. This new rule clearly changes the situation and the business model of ETF providers who have chosen physical replication because securities lending represented considerable sources of revenue for the asset management firms.

These revenues did not correspond to disproportionate profits but allowed ETFs to show lower management fees. As a result of receiving all of the lending profits, the ETF can now expect its management fees to increase; the arrangement will nonetheless have the merit of clarifying the real costs of replication and the profits associated with the risk taken in the area of securities lending.

It also seems that the new rules on securities lending by UCITS will have a strong impact on the volumes handled on the securities lending market. This market is an important factor in ensuring a good level of liquidity and improving the efficiency of equity markets. It would therefore be important for an impact study to be produced in order to reinforce ESMA's decision.

The second area is the **new requirements in the domain of financial indices**. EDHEC-Risk Institute is very satisfied that the European regulator has taken a major step towards transparency in an industry which up until now, with some exceptions, was characterised, under the pretext of protecting intellectual property, by the low level of information given to investors on index methodologies and compositions.

ESMA, through these recommendations, is putting a logical end to these practices, and is allowing all stakeholders to access details on the methodology, which should allow the investor to replicate the index and the composition of the indices without any additional cost.

ESMA's position is quite logical given the importance of indexed investment and the fact that it seems difficult for a provider to claim that their indices are a reference without giving exhaustive information on that reference. From that perspective, EDHEC-Risk Institute feels that it is important that any financial index that is marketed on the basis of its track record, which itself is produced on the basis not only of live performance but also of historical simulation, be able to justify that track record both through systematic ground rules that leave no room for ambiguity or discretionary decisions and through compositions that correspond to those ground rules.

It is clear that ESMA's desire to make the compositions of indices freely available, if it materialises through the availability of all of the historical compositions of the indices, will have significant consequences for the business model of index providers, some of whom draw a considerable share of their revenues from the sale of data.

EDHEC-Risk Institute's technical analysis of ESMA's guidelines is available here:

Guidelines on ETFs and other UCITS issues

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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 85 permanent professors, engineers and support staff, as well as 45 research associates from the financial industry and 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 55,000 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 1,300,000 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 master's 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.