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Re: ESMA Guidelines on ETFs and other UCITS issues ("the ESMA guidelines") – index related issues

Dear Kieran

I refer to your letter of 21 October to Martina Kelly in relation to the above matter.

You consider that a distinction should be made in relation to "*indices*" and "*financial indices*" and conclude that Section IX of the ESMA guidelines should only apply to those indices which can be regarded as "financial indices". However the use of the terms *indices* and *financial indices* have been used interchangeably throughout the various European Commission and ESMA texts on UCITS. No distinction has been drawn between the terms in the ESMA Guidelines and this is confirmed in the ESMA Q&A related to these guidelines (*ref: ESMA 2013/1547)*. Question 7(b) clarifies that the guidelines apply to any UCITS investing in financial indices including index tracking UCITS. There are no grounds to consider that Section IX is applicable only to those indices which provide exposure to ineligible assets or avail of increased diversification limits.

I confirm that the policy applied by the Central Bank to review of certain indices in which a UCITS proposes to invest is unchanged since the publication of the ESMA guidelines.

Finally you are concerned with the possible inconsistency between the ESMA Guidelines and the Commission Directive 2007/16 ("the Eligible Assets Directive"). I note that Guideline 49, ("*A UCITS should not invest in a financial index which has a single component that has an impact on the overall* *index return which exceeds the relevant diversification requirements i.e. 20%/35%. In the case of a leveraged index, the impact of one component on the overall return of the index, after having taken into account the leverage, should respect the same limits"),* could be queried for consistency with Article 9(2) of the Eligible Assets Directive.

However we do not consider that there is any inconsistency. In our view Article 9(2) of the Eligible Assets Directive provides that where an index does not meet with the applicable criteria for indices set out in Article 9(1), but is composed of UCITS eligible assets, investment by a UCITS in the index is not regarded as a derivative on an index but is regarded as a derivative on the combination of assets (i.e. in the same way as a derivative on a basket of assets.). Therefore as long as the UCITS eligible assets and diversification requirements are applied to the underlying combination of assets the investment can be permitted.

Yours sincerely

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