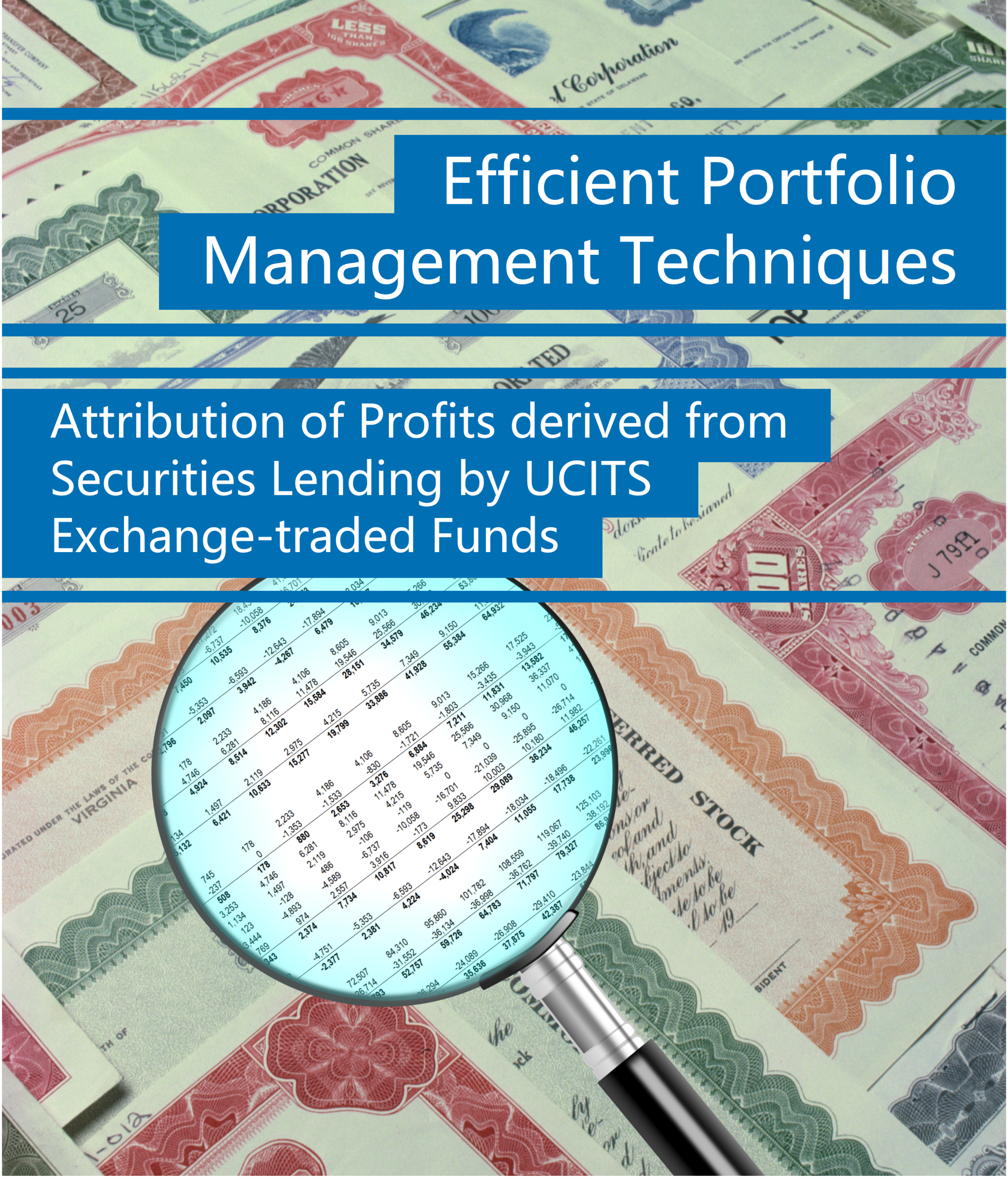
Efficient Portfolio Management Techniques

Attribution of Profits derived from Securities Lending by UCITS Exchange-traded Funds



BETTER FINANCE

The European Federation of Investors and Financial Services Users

Fédération Européenne des Épargnants et Usagers des Services Financiers

BETTER FINANCE

Research Paper on Efficient Portfolio Management Techniques: Attribution of profits derived from Securities Lending by UCITS Exchange-Traded Funds

This research paper is part of **BETTER FINANCE's #FundResearch project**, an umbrella research activity aimed at providing qualitative and quantitative assessments of the EU market for "retail" investment funds, focusing on Undertakings for Collective Investment in Transferable Securities (UCITS) and Alternative Investment Funds (AIFs). This paper looks into the practice of securities lending as an efficient portfolio management technique.

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Authors:

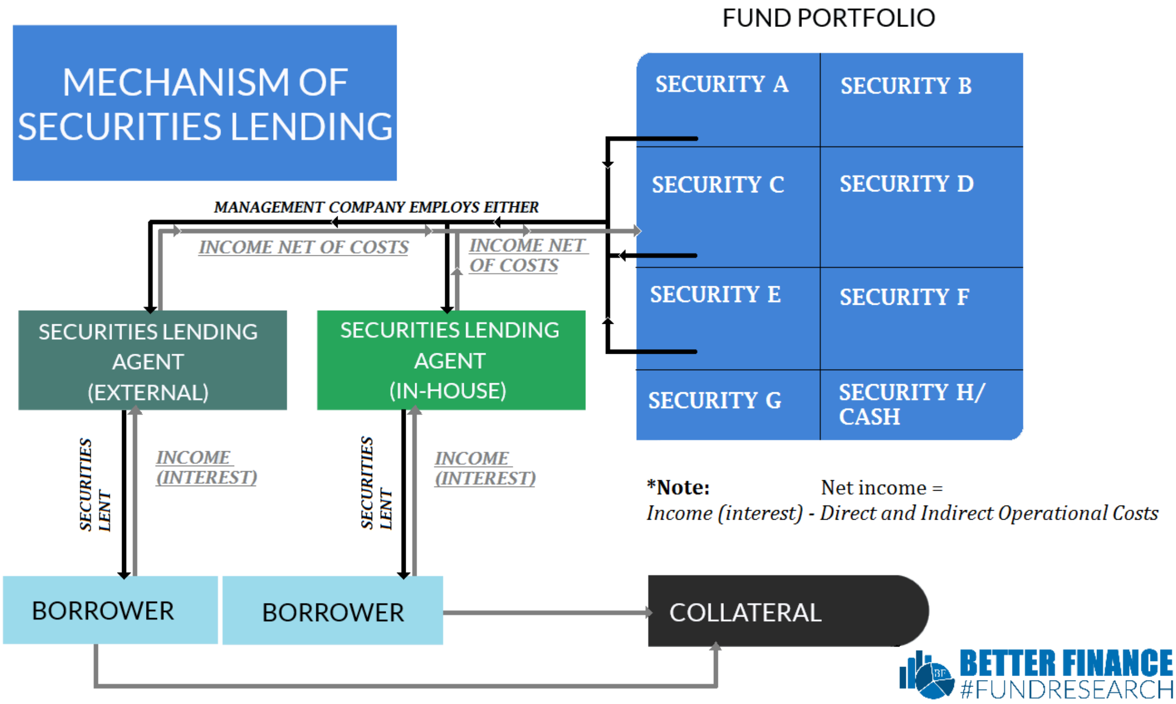
Stefan VOICU, voicu@betterfinance.eu
Guillaume PRACHE, prache@betterfinance.eu

BETTER FINANCE, the European Federation of Investors and Financial Services Users, is the public interest non-governmental organisation advocating and defending the interests of European citizens as financial services users at European level to lawmakers and the public in order to promote research, information and training on investments, savings and personal finances. It is the one and only European-level organisation solely dedicated to the representation of individual investors, savers and other financial services users.

BETTER FINANCE acts as an independent financial expertise and advocacy center to the direct benefit of European financial services users. Since the BETTER FINANCE constituency includes individual and small shareholders, fund and retail investors, savers, pension fund participants, life insurance policy holders, borrowers, and other stakeholders who are independent from the financial industry, it has the best interests of all European citizens at heart. As such its activities are supported by the European Union since 2012.

I. Introduction

BETTER FINANCE conducted research on a part of the efficient portfolio management techniques'[1] employed by UCITS ETF providers. The sample is limited and may not be representative of the total EU market, but it comprises mainstream ETFs of the ten largest providers in the EU. The efficient portfolio management technique under review is that of *securities lending*, by which the securities owner (in this case, the Fund, or its manager on behalf of the fund) temporarily lends its securities to a borrower, for which the borrower provides other assets in exchange as collateral and a payment (interest) for the loan period.



Note: The asset management company is **not** the beneficial owner of the securities or financial assets of the fund. The beneficial owners of the fund and its portfolio are the unit holders (professional or individual investors), whether the fund is a legal entity or not, reason for which securities financing transactions came under close scrutiny at EU level due to the practice of management companies lending the fund's portfolio and deriving additional income from it. In 2012, BETTER FINANCE asked ESMA to ensure that the net income from securities lending transactions is attributed to the funds, i.e. the fund investors, who are the ones who fund these transactions. National regulations (transposing ESMA's 2012 Guidelines) now require asset management companies to return all revenues generated by securities financing transactions to the fund, net of direct and indirect operational costs.

Securities lending or repurchase agreements must be aimed at increasing the return of the fund and **not to generate surplus income** for the management company: ESMA's *Guidelines on ETFs*

[1] "Efficient portfolio management techniques" is the term used by ESMA in its Guidelines on ETFs and other UCITS issues to define what the Securities Financing Transactions Regulation (SFTR) refers to in Article 3(11), among other securities lending and borrowing.

and other UCITS issues of 18 December 2012 (revised on 1 August 2014)[2] with regards to efficient portfolio management techniques require in relation to securities lending revenue:

> *29. All the revenues arising from efficient portfolio management techniques, net of direct and indirect operational costs, should be returned to the UCITS.*

and that, in relation to the revenue net of operational costs,

> *28. The UCITS should disclose in the prospectus the policy regarding direct and indirect operational costs/fees arising from efficient portfolio management techniques that may be deducted from the revenue delivered to the UCITS.* ***These costs and fees should not include hidden revenue****. The UCITS should disclose the identity of the entity(ies) to which the direct and indirect costs and fees are paid and indicate if these are related parties to the UCITS management company or the depositary.*[3]

While the ESMA Guidelines only require management companies to include details related to efficient portfolio management techniques in the Prospectus and Annual Reports (paras 28 and 35). BETTER FINANCE believes it derives from the wording of Article 7(2)d of the KIID Regulation[4] that securities lending transactions, among other asset management techniques, should be disclosed in Section 1 of the fund's KIID. In particular, the provision reads:

> *2. The description referred to in paragraph 1 shall include the following information, so long as it is relevant:* […]
> *(d) where specific asset management techniques are used, which may include hedging, arbitrage or leverage, an explanation in simple terms of the factors that are expected to determine the performance of the UCITS;*

Neither ESMA nor EU law provide a definition for specific asset management techniques or for efficient portfolio management techniques, but instead provide several examples for the latter (repurchase agreements, securities lending). However, we believe that the broad category of Article 7(2)d encompasses EPMT. Therefore, in order to explain "*the factors that are expected to determine the performance of the UCITS*" in the KIID, the UCITS Management Company should clearly mention the technique employed from the outset.

In addition, the ESMA Guidelines require that the relevant *counterparty risk* and, if any, *conflicts of interest* arising from EPM techniques be disclosed in the prospectus:

> *25. A UCITS should inform investors clearly in the prospectus* [...] *a detailed description of the risks involved in these activities, including counterparty risk and potential conflicts of interest* […].

Another important obligation prescribed by ESMA's Guidelines is the requirement to clearly disclose the relevant information on the conflicts of interest and counterpart risk that stem from the efficient portfolio management techniques employed by the management company in the

[2] European Securities and Markets Authority (ESMA) Guidelines for competent authorities and UCITS management companies: Guidelines on ETFs and other UCITS issues, of 18/12/2012 (ESMA/2012/832EN) and 01.08.2014 (ESMA/2014/937EN).
[3] Emphasis added.
[4] Commission Regulation (EU) No 583/2010 of 1 July 2010 implementing Directive 2009/65/EC of the European Parliament and of the Council as regards key investor information and conditions to be met when providing key investor information or the prospectus in a durable medium other than paper or by means of a website, OJ L 176, 10.7.2010, p. 1–15.

Prospectus and in the Annual Report. However, these have not been subject to a full analysis in this report.

II. 2018 ESMA Peer Review

ESMA decided to conduct a "Peer Review" on the precited Guidelines (launched in September 2017) and disclosed its main findings and conclusions on 30 July 2018. This Review demonstrated the challenges ESMA and national supervisors encountered in properly monitoring the market due to the scattered and insufficient data on EPMT employed. Concerning the substance of the Guidelines, in only 35% of jurisdictions national implementing regulations add rules and obligations to those provided by the ESMA Guidelines. Concerning reporting requirements to the supervisory authority, in only 68% of EU jurisdictions UCITS Management Companies are obliged to report on the use of EPMT. What is worse, out of those 68% (21), national supervisory authorities could not provide any aggregated data on EPMT employed by UCITS domiciled therein in a third (7, or 23%, of all 31 in the EEA) of jurisdictions (BE, BG, CZ, HU, MT, NL, NO).[5]

Out of the supervisory authorities that did submit aggregated data to ESMA, the German BaFin only reported on the sum of the value of derivatives positions, although there are several other main components (securities lending, repo and reverse repo agreements) that fall under the scope of EPMT. France is not included in the list of Annex 3,[6] assuming that there is no reporting obligation on EPMT for French-domiciled UCITS. On the other hand, the Luxembourg CSSF provides the most comprehensive data collection in its jurisdiction.

Moreover, according to paras 6-9 of Chapter 4 of the Peer Review, there is no aggregated definition on what constitutes an EPMT, thus leading to potentially divergent applications of the requirements across the EU.

ESMA Review of national implementing acts – the cases of BaFin (Germany) and CSSF (Luxembourg)

1. Luxembourg Financial Supervisory Authority (CSSF – Commission de Surveillance du Secteur Financier)

According to ESMA's 2018 Peer Review, the implementing act of the Luxembourg CSSF only requires "*a minimum percentage of the revenues to be returned to the UCITS, while taking different bases for this, i.e. gross revenues [LU]*", signalling that "*there remains the material risk that hidden revenues are included when setting such thresholds*".[7]

However, the research team could not find the specific CSSF requirement of a minimum threshold of 51% - found by ESMA[8] - that is to be returned to the Fund out of the revenue generated by securities lending transactions, as per ESMA's peer review.

[5] Para 51, Annex 3, European Securities and Markets Authority (ESMA), 'Final Report: Peer Review on the Guidelines on ETFs and Other UCITS Issues', 30 July 2018, ESMA42-111-4479.

[6] In Annex 3 of the ESMA Peer Review the questions of the surveys addressed to the national supervisory authorities and the results are presented, in this case it regards the reporting requirements at local level.

[7] ESMA42-111-4479, p. 41.

[8] Ibid.

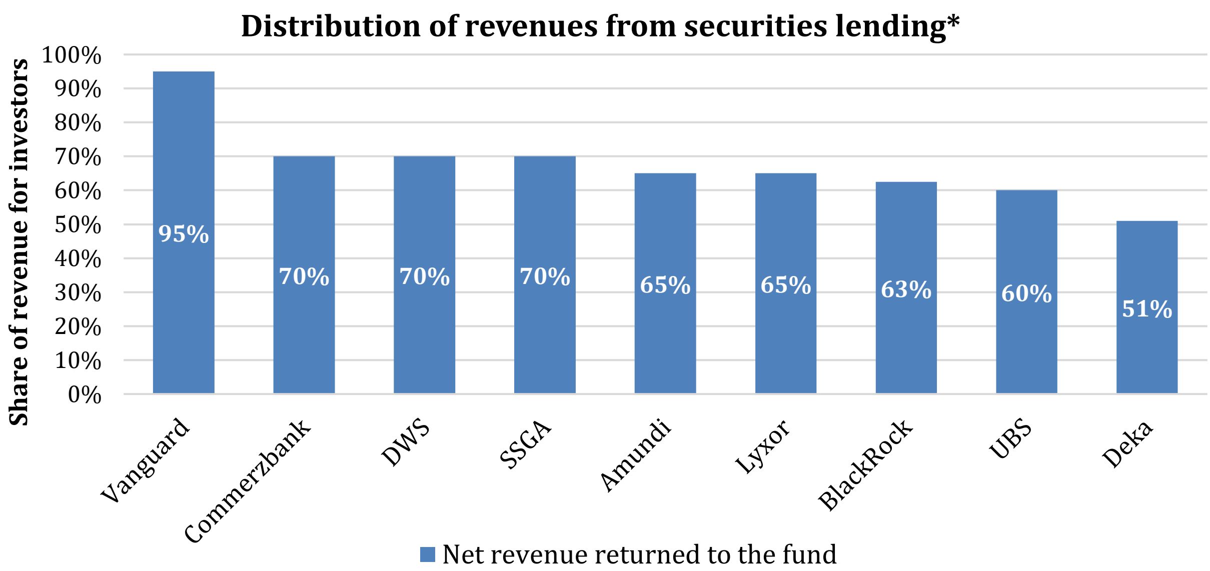
2. German Financial Supervisory Authority (BaFin – *Bundesanstalt für Finanzdienstleistungsaufsicht*)

Prior to the Peer Review, ESMA found in relation to the implementing act of the BaFin "*areas where BaFin's supervisory practices do not ensure compliance with the assessed Guidelines*".

After the ESMA Peer Review, the German Financial Supervisory Authority issued an act on regulatory minimum requirements for asset managers of UCITS in relation to cost clauses, among which there is a rule on the provisions of profit sharing derived from securities financing transactions. According to the BaFin act (shown below), UCITS management companies may collect a share of the profit achieved from securities lending agreements in order to distribute it as direct and indirect operational costs, but the share cannot exceed a third of the total revenue.

III. Summary findings

1) All ten leading providers attribute a single, fixed portion of the gross revenues derived from all securities lending transactions to the funds. To BETTER FINANCE, at first glance, this gross revenue fixed sharing on its own does not seem to ensure that "*all revenues* […] *net of direct and indirect operational costs*" are allocated to the funds as per paragraph 29 of ESMA's Guidelines. Indeed, especially when the securities lending activity is carried out in-house, it probably mostly generates fixed costs (such as personnel and IT), which is therefore not proportional to the revenue or volume of lending securities of the funds' portfolios.
2) The "split" of gross revenues varies widely: **from 51 to 95%** allocated to the funds, and therefore 5% to 49 % to the management company and/or to the SLA according to the Fund documentation. This means that one fund manager returns almost ten times more of the revenues of securities lending to the funds compared to another one. This raises a serious concern with regards to the compliance with the rule that 100% of the net income must be returned to the funds.



© BETTER FINANCE 2019; <u>*Source*</u>: own composition based on fund documentation; *minimum rate according to the publicly available fund documentation;

3) Only two ETF providers currently engaged in securities financing transactions employ an external securities lending service provider (Securities Lending Agent, SLA) These ETF

providers have little possibility to pocket the profit margin of the SLAs. However, when the SLA is part or an affiliate of the fund management company, the fund investors are not informed if the SLA derives any profit, and what becomes of this profit.
4) Two providers clearly disclose in the KIID what percentage of the gross revenue goes to the fund and what share goes to the MC/SLA, as a result of direct or indirect operating costs incurred from this type of Efficient Portfolio Management Technique (EPMT);
5) One ETF provider (using a physical replication method) did not employ securities lending operations for the analysed funds.

Revenue Distribution				
Provider	**Split**			
	Fund	**MC**	**SLA**	**Source**
BlackRock	62.5%	-	37.5%	KIID
SSGA	70%	-	30%	AR
Lyxor	65%	20%	15%	AR
DWS	70%	15%	15%	KIID
Amundi	65%[9]	30%	5%	AR
Vanguard	95%	-	5%	AR
Deka	51%	49%	-	P
UBS	60%	20%	20%	P
ComStage	70%	30%	-	P
Invesco	n/a	n/a	n/a	n/a

© BETTER FINANCE; *Source: public fund documents*; legend: P stands for Prospectus, AR for Annual Report;
n/a means that the documents (Prospectus, Annual Report) have not been further analysed – see below;

BETTER FINANCE has asked the main providers of these UCITS ETFs for further clarifications on how they ensure compliance with the abovementioned ESMA Guidelines. We are waiting for their responses, that we will publish.

IV. Analysis

The EU market for Exchange-Traded Funds (ETFs) has been growing at a fast pace since 2003, but the number of ETFs listed on European exchanges and the size of Assets under Management is not clearly known due to inconsistency of data. Sources analysing the ETF market report inconsistent figures regarding the number – 1,563,[10] 1,706[11] at the end of 2017 – and the AuM – €583 billion,[12] €721 billion[13] and €663 billion[14] at the end of 2017. For these reasons, the research team has chosen one data source[15] for the purpose of this paper.

[9] However, according to the Prospectus the SLA can charge **up to 50%** of the revenue.
[10] European Commission, 'Study on the distribution systems of retail investment products across the European Union', (2018) p. 34.
[11] ETFGI, https://etfgi.com/.
[12] European Commission (n 5), p. 34.
[13] ETFGI (n 6).
[14] Investment Europe, 'Review of the European ETF Market – 2018', https://www.investmenteurope.net/opinion/4000866/review-european-etf-market-2018.
[15] Ibid.

In this paper we focus on ETFs that track mainstream market indices (such as MSCI Europe). The composition of the fund's benchmark does not change often, allowing asset managers that use a physical replication strategy (i.e. holding proportionally the same securities which compose the benchmark) to lend a significant part of their portfolio without affecting their purpose of replicating the returns of the market index.[16]

The UCITS ETF providers were selected based on the size of the Assets under Management (AuM). The first ten largest ETF providers by AuM, summing up €606 billion, represent 93% of the market, with other 39 providers accounting for the rest 7% (€45 bln).[17] These ETF providers are BlackRock (iShares), State Street (SPDR), Lyxor, DWS (Xtrackers), Vanguard, Amundi, UBS, Invesco, Deka, and Commerzbank (ComStage). In total, the research team selected a total of 30 mainstream equity UCITS ETFs from the 10 providers, cumulating €38 billion in Assets under Management (AuM, latest data available).[18]

The analysis starts with the fund's website and its Key Investor Information Document (KIID). We analysed, in particular, whether the securities lending operations are mentioned in Section 1 (*Objectives and Investment Policy*) and, if so, whether the split between gross revenue for the fund and costs are mentioned in Section 3 (*costs*).

The research team also checked who is the designated Securities Lending Agent (SLA) and whether the SLA is in-house (same as the management company, parent, affiliated or subsidiary) or third-party (external) in the Prospectus or Annual Report, case by case.

Note: For ease of reference and intelligibility, the research team refers in this study to securities lending agents that are related to the management company as "in-house" (see below). However, the legal reference to an "in-house" relationship, pursuant to EU law, is that of "close links" and "qualifying holding". According to Article 2(1), pt. i), of the UCITS Directive[19], if one of the management companies, sub-fund managers or securities lending agents, either has participation (20% or more of voting rights) or control (a parent-subsidiary relationship) in the other, these will be defined as having close links to one another. Similarly, if one of the three has "*10 % or more of the capital or of the voting rights or which makes it possible to exercise a significant influence over the management of the management company*", the first will be deemed as having a qualified holding in the other.

[16] Securities lending is possible with any type of fund, not only index-tracker ETFs; however, these are the most prone to employ such techniques given that the portfolio composition is very much likely to stay the same for long periods of time (sometimes, even years), whereas active fund managers may need to buy and sell securities in order to generate excess return to the benchmark; in addition, index-tracking ETFs that use a *synthetic replication* method (i.e. swapping the returns of the fund's holdings with the returns of securities that constitute the benchmark) are less likely to use securities lending operations since the revenue must be ceased to the swap counterparty.

[17] Ridhima Sharma, 'Review of the European ETF Market, April 2018' (2018) InvestEurope, https://www.investmenteurope.net/investmenteurope/opinion/3710324/review-european-etf-market-april-2018.

[18] Data on AuM was mainly collected through the UCITS ETFs' own websites, or through the Morningstar public database; AuMs of UCITS ETFs denominated in other currencies than Euro were converted using the foreign exchange rate of 25/04/2019 published by the European Central Bank's Statistical Data Warehouse: (https://sdw.ecb.europa.eu/curConverter.do).

[19] Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (recast), http://data.europa.eu/eli/dir/2009/65/2014-09-17.

These aspects are only relevant for compliance with conduct of business rules on conflicts of interests, which are not subject to the analysis herein.

Finally, we reported the above information, focusing on the split between what the fund receives and what the Management Company (MC) and/or the SLA receive.

The findings relevant for this research are explained below and presented in the overview table at the end of the document (Annex I).

1. BlackRock ETFs (iShares)

A. The three ETFs analysed from BlackRock (iShares Euro Stoxx 50, MSCI EMU and MSCI Europe), all disclose in the Key Investor Information Document (KIID):
   - in Section 1, that the Fund will employ securities lending to increase income;
   - in Section 2, that the Fund may be exposed to counterparty risk;
   - in Section 3, what the exact revenue split will be between the Fund and the Securities Lending Agent, which is in-house (BlackRock).

Therefore, in these cases, we did not analyse the Prospectuses and Annual Reports any further.

B. The management company uses a single fixed split proportional to the size of the gross revenue whatever the fund (62.5% to the Fund and 37.5% to the SLA). Since all the necessary information (for the purpose of this study) was found in the KIID, the Annual Reports and Prospectuses have not been further analysed with regard to the split of revenues.

2. SSGA (SPDR ETFs)

The two funds' KIIDs do not specify the split of revenue between the Fund and Management Company (MC) or Agent but do indicate that "*the Fund may lend up to 100% of the securities it owns*" (Section 1 – *Objectives and Investment Policy*). The Prospectus states that the costs of securities lending will be borne by the fund revenue out of the revenues achieved from EPMT and will be equal to that provided in the securities lending agreements, but it is not specified in what proportion.

The Annual Report specifies a split of 70% - 30% between the fund and SLA, which is in-house (SSGA).

3. Lyxor (Lyxor ETF)

Out of the three Lyxor UCITS ETFs, the first two (Euro Stoxx 50 and CAC 40 trackers), even though the webpage and KIID indicate that the fund engages in securities lending, do not mention the distribution policy of income/revenue in Section 3 (costs).

The Prospectus provides that all income is distributed to the sub-fund, but it is calculated "net of any direct or indirect operating costs" generated by securities financing transactions, which are disclosed in the annual report.

The annual report (on page 21) shows that, in 2018, the UCITS fund received 65% of revenue generated by securities lending; 20% was attributed to the management company; 15% to the agent.

4. DWS (x-Trackers)

In the same manner as BlackRock, it is apparent from the KIIDs of the three DWS x-Tracker ETFs that the management company uses SL transactions, and the third section of the KIID (Costs) shows who the SLA is and the split of revenues: 70% for the Fund, 15% for SLA (which will be either DWS or a Deutsche Bank entity) and 15% for DWS or another Deutsche Bank entity which oversees the operations. On the webpages of these UCITS ETFs we also found the Securities Lending Policy for Xtrackers, according to which 70% (the net lending revenue) is passed on to the fund, with the exception of two UCITS ETFs (Xtrackers DAX UCITS ETF and Xtrackers DAX Income UCITS ETF), where the funds will receive 90% of the revenue earned from securities lending. None of the UCITS ETFs chosen for this study fall under that exception. In addition, the Securities Lending Policy document specifies that the securities lending agent will be Deutsche Bank AG.

Since the securities lending policy document does not exactly specific the split of revenue between the management company and the SLA, just that "*the remaining 30%* [70% goes to the Fund] *will be split between the Securities Lending Agent and the Management Company*", the research team also analysed the Prospectuses and Annual Reports to determine exactly the split.

According to the Prospectus, the split of revenue appears more difficult to understand: "*To the extent the Sub-Fund undertakes securities lending to reduce costs, the Sub-Fund will be allocated 85 percent of the associated revenue generated of which it will receive 70 percent with the remaining 15 percent being received by the Sub-Portfolio Manager on instruction of the Sub-Fund. The outstanding 15 percent will be allocated to the Securities Lending Agent*".

5. Vanguard

The KIIDs of the three examined UCITS ETFs indicate that the management company uses securities lending transactions, but do not specify the split of revenues: "[t]*he Fund may engage in short term secured lending of its investments to certain eligible third parties*". This information can be found in the Prospectus of each Fund (or sub-Fund) and further details (specifics) can be found in the Annual Report.

Vanguard is one of the only two providers from this sample that employ an external Securities Lending Agent, along with Amundi (below). In addition, the policy of Vanguard is to pay a minimum of fees to the SLA for the purpose of securities lending, and not retaining any part of the revenues for itself, returning to the Fund 95% of all the revenues generated. Vanguard's allocation of revenue as direct and indirect operational costs is six time lower than the second-best fund manager (5% versus 30%).

6. Amundi

The analysis for the Amundi ETFs is divided in two parts, depending on the umbrella fund: one for the DAX tracker (Amundi ETF DAX UCITS) and one for the MSCI Europe and CAC 40 trackers (Amundi Index MSCI Europe UCITS ETF and Amundi CAC 40 UCITS ETF). From the outset, neither of these ETFs' KIIDs mention securities lending nor the split of revenue.

A. The German blue-chip index tracker (DAX) specifies in the Annual Report that the revenues achieved from SL will be divided 65% to the Fund and 35% to the SLA, which seems in-house ("Amundi Intermédiation"). However, the Prospectus states that the SLA can charge **up to 50%** of the revenue from SFTs.

B. For the two other ETFs (tracking MSCI Europe and CAC 40), the Prospectus mentions that maximum 35% of the Fund's revenues from SL shall be paid to the management company, without indicating whether the management company, an affiliate or a third-party act as the SLA. Only from the Annual Report it appears that the SLA belongs to the same Group of companies[20] and receives 5%, the management company receives 30% and the Fund the rest 65%.

7. UBS

UBS AG is one of the two major ETF providers in the EU (and analysed in this paper) that contracts a third-party as SLA, therefore avoiding a risk of conflicts of interests. The KIIDs of the Funds make no mention of securities lending or the corresponding counterparty risk, with the exception of a note in the charges section, where it is mentioned that "*As securities lending revenue sharing does not increase the costs of running the sub-fund, this has been excluded from the ongoing charges*". This gives a clear indication that efficient portfolio management techniques are used.

The Prospectus indicates that the revenue will be split 60% - 40% between the Fund, on one side, and the management company and securities lending agent, on the other side, "*to cover the due diligence and operational costs*". The Annual Reports show the same split of the revenue between the MC and SLA.

8. Invesco

Out of the analysed ETFs (asset class: equities; region: Europe; replication method: physical) from Invesco, the KIID does not mention securities lending. The Prospectuses, however, specify that the corresponding Funds do not employ this type of securities financing transactions. The research team undertook a supplementary effort to find Invesco ETFs that track a mainstream index using a physical (direct) replication technique and that employ securities lending operations but could not find any. However, the research team did not analyse all Invesco ETFs fulfilling the abovementioned criteria.

9. Deka

The Deka Investments GmbH ETFs stand out compared to other European providers due to the very high weight of direct or indirect operational costs incurred through securities lending. Although the KIIDs fail to provide this information, the Prospectus states that up to 49% of the revenue achieved from securities lending will be directed to the Management Company, without any indication on who is the designated Securities Lending Agent. Furthermore, the Annual Reports do not mention a specific split in revenue.

The Prospectus, however, mentions that "*The Company receives for the initiation, preparation and execution of securities lending transactions and securities repurchase agreements a flat rate for the account of the Fund Remuneration of up to 49% of the income from these transactions. The costs*

[20] The SLA is CACEIS, which is owned by Credit Agricole which also has a majority stake in Amundi AM.

incurred in connection with the preparation and execution of such transactions, including the fees payable to third parties, are borne by the Company".[21]

Based on our interpretation of the abovementioned paragraph of the Prospectuses, we believe that the Management Company is responsible for all costs deriving from securities lending operations (payable or not to third-parties or in-house agents and depositaries), for which it charges a flat rate of the revenue earned from these transactions in order to cover them. Therefore, we believe that when the actual split between the Management Company and other entities involved in the securities lending operations (except the borrower) is not further disclosed, the revenue distribution (for the purposes of this paper) is that indicated in the Prospectus: 51% for the Fund and 49% to the Management Company.[22]

10. Commerzbank (ComStage)

For the three Commerzbank's ComStage UCITS ETFs, the analysis has been straightforward. The KIIDs do not contain any mention of securities lending transactions, however the Prospectus specifies a single fixed split of 70% - 30% of revenues between the Funds and the Management Company, which will be liable for all direct and indirect operational costs incurred from SFT – which is in line with the provisions adopted by BaFin in 2018, but still six time more costly than the best in class.

V. Policy recommendations

In light of the findings in this research paper, BETTER FINANCE puts forward three policy recommendations for ESMA and national competent authorities in the field of EPMT, in particular securities lending transactions:

1. For ESMA to investigate why costs of securities lending vary from 5% to 49% (one to ten) of revenues from one fund manager to the other. Pending any further explanations from fund managers, BETTER FINANCE strongly suspects that a part of securities lending profits is not returned to fund investors as it should. One solution could be to cap the cost charged by the MC/SLA at 5% of securities lending revenues (as achieved by one leading player), or to disclose/explain clearly why MC/SLA costs would be higher than this cap.

2. For ESMA, to clarify in the Guidelines the obligation of UCITS Management Companies to disclose in Section 1 of the KIID, as per Article 7(2)d of the KIID Regulation, whether securities lending transactions are employed and to what limit of the portfolio.

3. For ESMA, to clarify in the Guidelines the obligation of UCITS Management Companies to disclose in Section 3 of the KIID, pursuant to Article 12(1), the level of direct and indirect operational costs – either as a percentage or an absolute number – that will be deducted from the revenue generated. In line with one of the initial observations of this paper, since some Management Companies disclose the aforementioned in the KIID and some only in the Prospectus, ESMA should ensure a level playing field and

[21] Our translation, original here: "*Die Gesellschaft erhält für die Anbahnung, Vorbereitung und Durchführung von Wertpapierdarlehensgeschäften und Wertpapierpensionsgeschäften für Rechnung des Fonds eine pauschale Vergütung in Höhe von bis zu 49 % der Erträge aus diesen Geschäften. Die im Zusammenhang mit der Vorbereitung und Durchführung von solchen Geschäften entstandenen Kosten einschließlich der an Dritte zu zahlenden Vergütungen trägt die Gesellschaft*".

[22] Since there was no specific disclosure, we could not ascertain the existence of an SLA per se.

also protect the investor from confusing information stemming from the KIID of two different products, both employing SLT, but only one disclosing it in the KIID.

VI. Next steps

It is the intention of BETTER FINANCE to publish any further clarifications received from fund managers on how they ensure compliance with the abovementioned ESMA Guidelines, and return the entire net income from securities lending to fund investors.

ANNEX I – Overview table of findings

For the purpose of this table:

SLA	means	Securities Lending Agent
MC	means	Management Company
KIID S#	means	Section number of the Key Investor Information Document
in-house	means	the same company or a subsidiary or the parent company of the management company or an affiliate of the management company
ext	means	the Securities Lending Agency is a third-party to the management company
[Annual Report]	means	the source of the information is the Annual Report
[KIID]	means	the source of the information is the KIID
[Prospectus]	means	the source of the information is the Prospectus

BlackRock			
iShares Core Euro Stoxx 50 UCITS ETF			
ISIN:	IE00B53L3W79		
KIID here		KIID date: 25/01/2019	
Fund receives:	62.5%	SLA: in-house (BlackRock) [KIID]	
SLA receives:	37.5%		
KIID S3:	*** To the extent the Fund undertakes securities lending to reduce costs, the Fund will receive 62.5% of the associated revenue generated and the remaining 37.5% will be received by BlackRock as the securities lending agent. As securities lending revenue sharing does not increase the costs of running the Fund, this has been excluded from the ongoing charges.*		
iShares Core MSCI EMU UCITS ETF			
ISIN:	IE00B53QG562		
KIID here		KIID date: 06/03/2019	
Fund receives:	62.5%	SLA: in-house (BlackRock) [KIID]	
SLA receives:	37.5%		
KIID S3:	*** To the extent the Fund undertakes securities lending to reduce costs, the Fund will receive 62.5% of the associated revenue generated and the remaining 37.5% will be received by BlackRock as the securities lending agent. As securities lending revenue sharing does not increase the costs of running the Fund, this has been excluded from the ongoing charges.*		
iShares Core MSCI Europe UCITS ETF			
ISIN:	IE00B1YZSC51		
KIID here		KIID date: 24/01/2019	
Fund receives:	62.5%	SLA: in-house (BlackRock) [KIID]	
SLA receives:	37.5%		
KIID S3:	*** To the extent the Fund undertakes securities lending to reduce costs, the Fund will receive 62.5% of the associated revenue generated and the remaining 37.5% will be received by BlackRock as the securities lending agent. As securities lending revenue sharing does not increase the costs of running the Fund, this has been excluded from the ongoing charges.*		

SSGA	
SPDR® MSCI Europe Small Cap UCITS ETF	

ISIN: IE00BKWQ0M75
KIID here — KIID date: 18/02/2019
Fund receives: 70% — SLA: in-house (SSGA) [Annual Report, p. 529]
SLA receives: 30%

Annual Report: (p. 526) — *State Street Bank GmbH has been appointed to act as Securities Lending Agent for the Funds for the purposes of lending securities to brokers, dealers and other financial institutions. In lending their securities, the Funds will receive income while retaining the securities' potential for capital appreciation and depreciation. The securities lending income was split between the Funds and the Securities Lending Agent in a ratio of 70:30 in favour of the Fund.*

SPDR® MSCI Europe UCITS ETF

ISIN: IE00BKWQ0Q14
KIID here — KIID date: 18/02/2019
Fund receives: 70% — SLA: in-house (SSGA) [Annual Report, p. 529]
SLA receives: 30%

Annual Report: (p. 526) — *State Street Bank GmbH has been appointed to act as Securities Lending Agent for the Funds for the purposes of lending securities to brokers, dealers and other financial institutions. In lending their securities, the Funds will receive income while retaining the securities' potential for capital appreciation and depreciation. The securities lending income was split between the Funds and the Securities Lending Agent in a ratio of 70:30 in favour of the Fund.*

LYXOR	
Lyxor EURO STOXX 50 (DR) UCITS ETF	

ISIN: FR0007054358
KIID here — KIID date 20/01/2019
Fund receives: 65% — SLA: in-house (Société Générale) [Prospectus, p. 689]
MC receives: 20% — Third-party: 15% [Annual Report, p. 21]

These direct or indirect operational costs will be calculated as percentage of gross income of the mutual investment fund (*fonds commun de placement* – FCP) [Annual Report]

Lyxor CAC 40 (DR) UCITS ETF

ISIN: FR0007052782
KIID here — KIID date: 19/02/2019
Fund receives: 65% — SLA: in-house (Société Générale) [Prospectus, p. 8]
MC receives: 20% — Third-party: 15% [Annual report, p. 20]

Lyxor MSCI Europe (DR) UCITS ETF

ISIN: FR0010261198
KIID here — KIID date: 29/03/2019
Fund receives: ? — SLA: ?
SLA receives: ?

"*This fund does not engage in securities financing transactions*" [Prospectus - page 625].

Webpage: indicates that it does (https://www.lyxoretf.fr/fr/retail/produits/etf-actions/lyxor-msci-europe-dr-ucits-etf-dist/fr0010261198/eur) – see Annex III

DWS Xtrackers

Xtrackers MSCI Europe Small Cap UCITS ETF 1C

ISIN: LU0322253906

KIID here | KIID date: 19/02/2019

Fund receives: 70% | SLA: in-house (Deutsche Bank) [SL Policy]

MC receives: 15%

SLA receives: 15%

KIID (S3): "*To the extent the Fund undertakes securities lending to generate revenue, the Fund will ultimately be allocated 70% of the associated revenue, the securities lending agent, which will be a DWS entity or other Deutsche Bank entity, will be allocated 15% and the remaining 15% will be allocated to the DWS entity which monitors such activities, as set out in the prospectus*"

"*the associated revenue generated [...] 15 percent being received by the Sub-Portfolio Manager on instruction of the Sub-Fund*" [Prospectus p. 260]

Xtrackers MSCI Europe Mid Cap UCITS ETF

ISIN: LU0322253732

KIID here | KIID date: 19/02/2019

Fund receives: 70% | SLA: in-house (Deutsche Bank) [SL Policy]

SLA receives: 15%

MC: 15%

"*the associated revenue generated [...] 15 percent being received by the Sub-Portfolio Manager on instruction of the Sub-Fund*" [Prospectus p. 257]

Xtrackers MSCI Europe UCITS ETF 1C

ISIN: LU0274209237

KIID here | KIID date: 19/02/2019

Fund receives 70% | SLA: in-house (Deutsche Bank) [SL Policy]

SLA receives: 15%

MC: 15%

KIID (S3): "*To the extent the Fund undertakes securities lending to generate revenue, the Fund will ultimately be allocated 70% of the associated revenue, the securities lending agent, which will be a DWS entity or other Deutsche Bank entity, will be allocated 15% and the remaining 15% will be allocated to the DWS entity which monitors such activities, as set out in the prospectus*"

"*the associated revenue generated [...] 15 percent being received by the Sub-Portfolio Manager on instruction of the Sub-Fund*" [Prospectus p. 93]

Xtrackers S&P Europe ex UK UCITS ETF 1D

ISIN: IE00BGV5VM45

KIID here | KIID date: 19/02/2019

Fund receives 70% | SLA: in-house (Deutsche Bank) [SL Policy]

SLA receives: 15% | [KIID]

MC receives: 15%

KIID (S3): "*To the extent the Fund undertakes securities lending to generate revenue, the Fund will ultimately be allocated 70% of the associated revenue, the securities lending agent, which* *will be a DWS entity or other Deutsche Bank entity, will be allocated 15% and the remaining 15% will be allocated to the DWS entity which monitors such activities, as set out in the prospectus*"

Vanguard

Vanguard EuroStoxx 50 ETFs

ISIN:	IE00BF4R5F1	
KIID here		KIID date: 18/02/2019
Fund receives	95%	SLA: ext [Annual Report – p. 366]
V receives	5%	

Vanguard DAX UCITS ETF

ISIN:	IE00BG143G9	
KIID here		KIID date: 18/02/2019
Fund receives	95%	SLA: ext [Annual Report – p. 366]
SLA receives	5%	

Vanguard FTSE Developped Europe

ISIN:	IE00B945VV1	
KIID here		KIID date: 18/02/2019
Fund receives	95%	SLA: ext [Annual Report – p. 366]
SLA receives	5%	

Amundi

Amundi ETF DAX UCITS

ISIN:	FR0010655712	
KIID here		
Fund receives	65%	SLA: in-house (Amundi) [Prospectus]
SLA receives	35%	

Charges by Amundi Intermédiation must not exceed 50% of the income generated by these transactions [Prospectus]

Amundi Index MSCI Europe UCITS ETF

ISIN:	LU1437015735	
KIID here		
Fund receives	65%	SLA: CACEIS (in-house) [Annual Report]
SLA receives	5%	MC: 30% [Annual Report]

The direct and indirect operating costs relating to securities lending transactions are deducted from gross income and paid to the management company. This cannot exceed 35% of gross income. [AR]

Amundi CAC 40 UCITS ETF		
ISIN:	LU1681046931	
KIID here		
Fund receives	65%	SLA: CACEIS (in-house) [Annual Report]
SLA receives	5%	MC: 30%
The direct and indirect operating costs relating to securities lending transactions are deducted from gross income and paid to the management company. This cannot exceed 35% of gross income. [SLR]		
UBS		
UBS ETF (LU) EURO STOXX 50 UCITS ETF		
ISIN:	LU0136234068	
KIID here		KIID date: 07/02/2019
Fund receives:	60%	SLA: third-party (SSGA) [Prospectus, p. 11]
SLA receives:	20%	MC receives: 20%
Of the revenue received by the borrower on the market, 60% is credited to the relevant sub-fund while UBS and lending agent receive 40% to cover the due diligence and operational costs resulting from the transactions carried out in relation to the securities lending [website] – same indicated in the Prospectus (p. 240)		
UBS ETF (LU) FTSE 100 UCITS ETF		
ISIN:	LU1107559459	
KIID here		KIID date: 07/02/2019
Fund receives	60%	SLA: third-party (SSGA) [Prospectus, p. 11]
SLA receives	20%	MC receives: 20%
Of the revenue received by the borrower on the market, 60% is credited to the relevant sub-fund while UBS and lending agent receive 40% to cover the due diligence and operational costs resulting from the transactions carried out in relation to the securities lending [website] - same indicated in the Prospectus (p. 240)		
UBS ETF (LU) MSCI Europe UCITS ETF		
ISIN:	LU0446734104	
KIID here		KIID date: 07/02/2019
Fund receives	60%	SLA: third-party (SSGA) [Prospectus, p. 11]
MC receives:	20%	SLA receives: 20%
Of the revenue received by the borrower on the market, 60% is credited to the relevant sub-fund while UBS and lending agent receive 40% to cover the due diligence and operational costs resulting from the transactions carried out in relation to the securities lending [website] - same indicated in the Prospectus (p. 240)		
Invesco		
Invesco EURO STOXX 50 High Div Low Vol ETF		
ISIN:	IE00B60SWX25	
KIID here		
Fund receives	N/A	SLA: N/A
SLA receives	N/A	
In January 2017, the stock lending programme was suspended. [Annual Report]		
Invesco MDAX UCITS ETF		
ISIN:	IE00BHJYDV33	
KIID here		
Fund receives	N/A	SLA: N/A
SLA receives	N/A	

During the financial period ended 30 June 2018 and financial year ended 31 December 2017, none of the Funds entered into any Securities Financing Transactions. [Prospectus]

Invesco FTSE RAFI Europe UCITS ETF

ISIN: IE00B23D8X81

KIID here

Fund receives N/A SLA: N/A

SLA receives N/A

In January 2017, the stock lending programme was suspended. [Annual Report]

Deka

Deka EURO STOXX 50 UCITS ETF

ISIN: DE000A0S3MB1

KIID here KIID date: 01/02/2019

Fund receives 51%

MC receives 49% [Prospectus, p. 18]

The loan transactions described here are made in order to provide the Fund with additional income in the form of lending fees. The Company receives up to 49% of the income from these transactions in accordance with the Special Investment Conditions. [Prospectus]

Deka MSCI Europe UCITS ETF

ISIN: DE000ETFL284

KIID here KIID date: 01/02/2019

Fund receives 51% [Prospectus, p. 18]

MC receives 49%

The loan transactions described here are made in order to provide the Fund with additional income in the form of lending fees. The Company receives up to 49% of the income from these transactions in accordance with the Special Investment Conditions. [Prospectus]

Deka DAX UCITS ETF

ISIN: DE000ETFL011

KIID here KIID date: 01/02/2019

Fund receives 51%

MC receives 49% [Prospectus, p. 17]

The loan transactions described here are made in order to provide the Fund with additional income in the form of lending fees. The Company receives up to 49% of the income from these transactions in accordance with the Special Investment Conditions. [Prospectus]

Commerzbank		
ComStage DAX I D UCITS ETF		
ISIN:	LU0378438732	
KIID here		
Fund receives	70%	
MC receives	30%	[Prospectus]
The Management Company shall receive for the initiation and implementation of special techniques and instruments, such as securities lending transactions, securities repurchase transactions and derivatives, for the account of the relevant Sub-Fund a fee of up to 30% of the income from these transactions. Additional services of the Management Company, such as, for example, the administration of securities (known as Collateral Management) or services pursuant to Regulation (EU) No. 648/2012 (European Market Infrastructure Regulation – the so-called EMIR) shall be paid for. The excess income less any transaction costs of the securities lending or repurchase transactions associated with the transactions or costs in connection with the use of OTC-Swaps are credited to the respective Sub-Fund. The service of a lending agent will not be used. [Prospectus, p. 48]		
ComStage EuroStoxx 50 I D UCITS ETF		
ISIN:	LU0378434079	
KIID here		
Fund receives	70%	[Prospectus] (same for all, p. 48)
MC receives	30%	
ComStage Euro Stoxx Select Dividends 30 UCITS ETF		
ISIN:	LU0378434236	
KIID here		
Fund receives	70%	
MC receives	30%	[Prospectus]

Source: Own composition

Important note: This research paper is not exhaustive and does not determine whether these UCITS management companies comply with the legal provisions applicable by virtue of EU law. The sole purpose of this paper is to provide an analysis, concerns and recommendations "through the eyes of a retail investor" about the disclosure and accessibility of information for a few (30) leading UCITS ETFs traded in the Capital Markets Union.

Annex II – Translation of BaFin normative on cost clauses

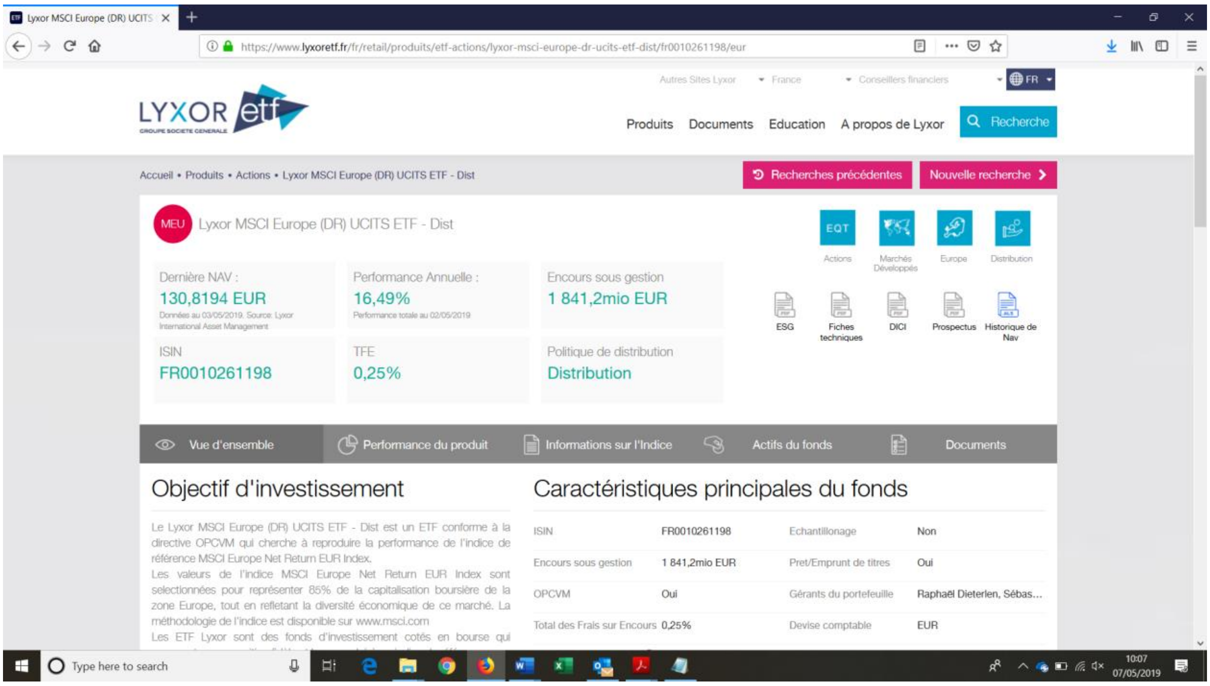
The translation for the excerpt below of the BaFin regulatory minimum requirements is not official.

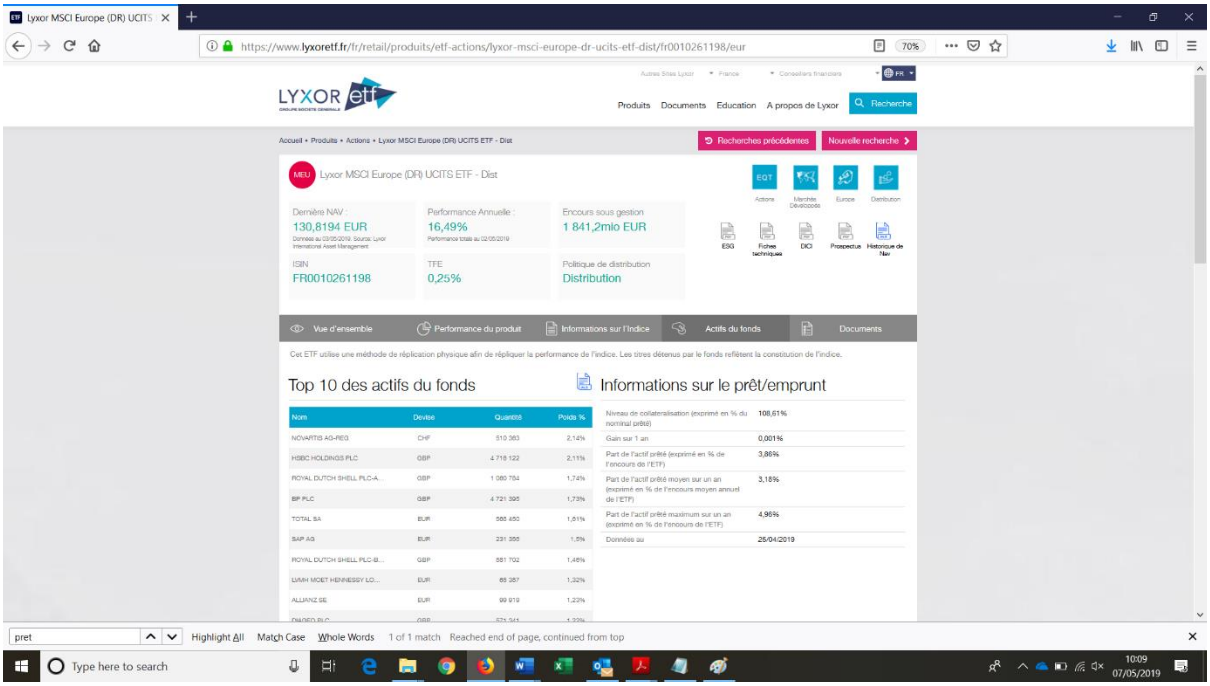
Musterbausteine für Kostenklauseln offener Publikumsinvestmentvermögen	**Templates for cost clauses of open-ended investment funds**
b) Wertpapierdarlehensgeschäfte und Wertpapierpensionsgeschäfte Die Gesellschaft erhält für die Anbahnung, Vorbereitung und Durchführung von Wertpapierdarlehensgeschäften und Wertpapierpensionsgeschäften für Rechnung des Sondervermögens eine marktübliche Vergütung in Höhe von maximal einem Drittel der Bruttoerträge aus diesen Geschäften. Die im Zusammenhang mit der Vorbereitung und Durchführung von solchen Geschäften entstandenen Kosten einschließlich der an Dritte zu zahlenden Vergütungen trägt die Gesellschaft.	b) Securities lending transactions and repurchase agreements For the initiation, preparation and execution of securities lending transactions and securities repurchase transactions for the account of the Fund, the Company ***receives a standard market reimbursement of up to one third of the gross proceeds from these transactions.***[23] The costs incurred in connection with the preparation and execution of such transactions, including the fees payable to third parties, are borne by the Company.
Kapitalanlagegesetzbuch (KAPG)	**German Investment Code**
Allgemeine Verhaltens- und Organisationspflichten §26. Allgemeine Verhaltensregeln; Verordnungsermächtigung (1) Die Kapitalverwaltungsgesellschaft handelt bei der Wahrnehmung ihrer Aufgaben unabhängig von der Verwahrstelle und ausschließlich im Interesse der Anleger. (2) Die Kapitalverwaltungsgesellschaft ist verpflichtet, 1. ihrer Tätigkeit ehrlich, mit der gebotenen Sachkenntnis, Sorgfalt und Gewissenhaftigkeit und redlich nachzugehen, 2. im besten Interesse der von ihr verwalteten Investmentvermögen oder der Anleger dieser Investmentvermögen und der Integrität des Marktes zu handeln, 3. alle angemessenen Maßnahmen zur Vermeidung von Interessenkonflikten und, wo diese nicht vermieden werden können, zur Ermittlung, Beilegung, Beobachtung und gegebenenfalls Offenlegung dieser Interessenkonflikte zu treffen, um a) zu vermeiden, dass sich diese nachteilig auf die Interessen der Investmentvermögen und der Anleger auswirken und	**General conduct and organizational duties** §26. General rules of conduct; statutory authorization (1) In performing its duties, the management company acts independently of the depositary and exclusively in the interests of the investors. (2) The management company is obliged to 1. honestly conduct their business with due skill, care and diligence and honesty, 2. to act in the best interests of the investment funds it manages or the investors of those investment funds and the integrity of the market, 3. Take all reasonable steps to avoid conflicts of interest and, where these cannot be avoided, to identify, resolve, monitor and, where appropriate, disclose such conflicts of interest (a) to prevent them from adversely affecting the interests of the investment property and the investors; and

[23] Emphasis added.

b) sicherzustellen, dass den von ihr verwalteten Investmentvermögen eine faire Behandlung zukommt, 4. über die für eine ordnungsgemäße Geschäftstätigkeit erforderlichen Mittel und Verfahren zu verfügen und diese wirksam einzusetzen, 5. alle auf die Ausübung ihrer Geschäftstätigkeit anwendbaren regulatorischen Anforderungen zu erfüllen, um das beste Interesse der von ihr verwalteten Investmentvermögen oder der Anleger dieser Investmentvermögen und die Integrität des Marktes zu fördern und 6. alle Anleger der Investmentvermögen fair zu behandeln. (5) Die Kapitalverwaltungsgesellschaft muss insbesondere über geeignete Verfahren verfügen, um bei Investmentvermögen unter Berücksichtigung des Wertes des Investmentvermögens und der Anlegerstruktur eine Beeinträchtigung von Anlegerinteressen durch unangemessene Kosten, Gebühren und Praktiken zu vermeiden.	(b) to ensure that the investment funds it manages are treated fairly; 4. dispose of and use the funds and procedures necessary for the proper conduct of business, 5. to comply with all regulatory requirements applicable to the conduct of its business activities in order to promote the best interests of the investment funds or investors of those investment funds and the integrity of the market; and 6. to treat all investors in the investment funds fairly. (5) In particular, the management company must have suitable procedures for avoiding, in the case of investment funds, taking into account the value of the investment fund and the investor structure, the undue burden on investors of undue costs, fees and practices.
Allgemeine Vorschriften für offene Publikumsinvestmentvermögen §162 Anlagebedingungen (2) Die Anlagebedingungen müssen neben der Bezeichnung des Investmentvermögens sowie der Angabe des Namens und des Sitzes der Verwaltungsgesellschaft mindestens folgende Angaben enthalten: 11. nach welcher Methode, in welcher Höhe und auf Grund welcher Berechnung die Vergütungen und Aufwendungserstattungen aus dem Investmentvermögen an die Verwaltungsgesellschaft, die Verwahrstelle und Dritte zu leisten sind;	**General rules for open-ended investments** §162 Investment Conditions (2) In addition to the name of the investment fund and the name and registered office of the management company, the investment conditions must include at least the following information: 11. by what method, in what amount and on what basis the fees and expenses reimbursements from the investment fund have to be paid to the management company, the depositary and third parties;

Annex III – Lyxor MSCI Europe UCITS ETF





BETTER FINANCE
#FUNDRESEARCH

The European Federation of Investors and Financial Services Users
44, Rue d'Arenberg, 1000 Brussels - Belgium
Tel. (+32) 02 514 37 77 - Fax. (+32) 02 514 36 66
E-mail: info@betterfinance.eu - http://www.betterfinance.eu

European Commission

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