ASIC Consultation Paper 356 – ETP naming conventions

FSC Submission

7 March 2022

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1. About the Financial Services Council

The FSC is a peak body which sets mandatory Standards and develops policy for more than 100 member companies in one of Australia's largest industry sectors, financial services.

Our Full Members represent Australia's retail and wholesale funds management businesses, superannuation funds, life insurers and financial advice licensees. Our Supporting Members represent the professional services firms such as ICT, consulting, accounting, legal, recruitment, actuarial and research houses.

The financial services industry is responsible for investing $3 trillion on behalf of more than 15.6 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange, and is the fourth largest pool of managed funds in the world.

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2. Key Recommendations

The FSC welcomes the opportunity to provide a submission to CP 356 on exchange traded product naming conventions.

The FSC is supportive of simple, clear and consistent exchange traded product (ETP) naming conventions that assist consumer understanding. Furthermore, we consider there is merit in identifying and categorising complex structures or particular risks to further help understanding.

We are overall supportive of the simplified and more meaningful naming convention approach set out in the consultation paper however we propose a number of recommended changes to simplify and enhance consumer understanding of the naming conventions by only having a single category of naming conventions (rather than Primary and Secondary) with all labels mandatory and consistently used across the industry. The FSC recommends that there be a single category of naming conventions consisting of ETF; Active ETF and Complex ETF where the name is mandatory and consistently applied across exchanges and the industry. Under this approach where a fund meets the Complex ETF criteria, it will be called a Complex ETF irrespective of whether it is an Active ETF or index tracking ETF.

This submission also makes a number of key recommended changes to the "Complex" label so that it can better distinguish between products which have different risk profiles, unique or complex structures. The purpose of the naming conventions is to simplify the process for investors, many of whom may not read the Product Disclosure Statement, so that they can get a quick and clear understanding of the product they invest in. In this regard the "Complex" label is intended to serve as a signal to the investor that may wish to do some research on the product, if they are not familiar with it.

We also note that the naming conventions are only proposed to apply to ETP's. Given that there are now dual access funds available as ETPs, changes to ETP naming conventions are likely to have broader implications for managed funds. We note that the consultation has implications to the managed investment schemes (MIS) more broadly with the dual listing structure used by some issuers.

Primary labels and Secondary labels

The CP proposes introducing Primary labels which are intended to apply to all ETPs and Secondary labels which will apply in addition to Primary labels, but only for some ETPs and on a discretionary basis by licensed exchanges.

In order to enhance consumer understanding, the FSC considers that discretion in naming conventions should be minimised. There should be consistency in naming conventions across the industry and across exchanges to facilitate a common understanding of terms. In this regard we are supportive of not having any Primary or Secondary labels.

There should just be one clear and enforced naming convention, uniformly applied across the industry, to help identify product risks for investors.

However, we note that our proposal could still be applied in the 2-tier convention proposed by ASIC, with both primary and secondary labels being mandatory and no discretion to add additional secondary labels without a broader industry consultation.

If this recommendation is not adopted all primary and secondary labels should however be mandatory and applied on a consistent basis across the industry.

More specifically we support the following naming conventions being used:

Exchange Traded Funds (ETF)

- We are supportive of a similar approach currently set out in Info 230 which is used for passive investment strategies or tracking an index. Similar to the current definition outlined in Info 230, albeit with some small changes, we support ETF's being defined as a collective investment vehicle (such as registered managed investment schemes and CCIVs) that have a passive investment strategy and seek to replicate or track the performance of an index via a long term disclosed strategic asset allocation, or other widely regarded/available benchmark the value of which is continuously disclosed or can be immediately determined.

Active ETF

- We are supportive of Active ETF being used to help clearly distinguish whether the ETF is actively or passively managed. We support the definition proposed – that it is used for an ETF that does not employ a passive investment strategy (i.e. to buy and sell investments base don an active strategy) or has delayed portfolio holding disclosure under an internal market making or material portfolio information disclosure models.
- We are also supportive of the removal of “managed fund” when referring to active ETFs on the basis that this does not assist consumer understanding.
- Should ASIC however retain Primary and Secondary labels, our recommendation is that Active ETF is elevated to a Primary label (and not as a Secondary label) to help clearly distinguish upfront to retail investors whether the ETF is actively or passively managed.

Deviations from public index

CP paragraph 41 envisages that Active ETF labelling would be used where the investment manager has discretion in their investment allocations and includes a strategy that can deviate from a public index or from a transparent internal quantitative approach (which we consider should have appropriate robust calculation methodology to produce daily NAVs and internal independence when calculated by the issuer).

Feedback however notes that it is not clear what is a public index and whether ASIC is referring to indices maintained by main index providers or any published index where the index is publicly available and reported on a regular/daily basis. The following definition could be used “those considered to be widely regarded by the industry and/or being widely regarded as having robust and transparent eligibility criteria and governance arrangements and robust and transparent methodology for constructing and maintaining the index”.

We note there is no reference to what a public index means in Draft Info Sheet 230 and recommend that one is included so that a consistent understanding and approach is set out by ASIC

Further, Licensed exchanges should verify where necessary that their arrangements with the benchmark/index administrator comply with recognised benchmark selection principles such as the International Organization of Securities Commissions (IOSCO) Principals for financial benchmarks (PDF 388 KB), the EU Benchmarks Regulation or other internationally recognised benchmark selection principles for any index relied on by the ETP. These principles relate to governance, quality of the benchmark and methodology, and accountability.

Complex ETFs

The CP envisages that the label 'complex' will be used to describe products that may have specific features or more complicated investment strategies. Specifically Draft Info Sheet 230 envisages that complex ETF's would be funds that:

- Use debt or leverage to make a financial investment;
- Include inverse exposures;
- use short selling;
- use derivatives (other than for exchange rate hedging purposes); and/or
- otherwise meets the hedge fund criteria in Regulatory Guide 240 Hedge funds: Improving disclosure (RG 240).

The current proposal of what is considered to fall within the "Complex" label is overall a very broad category, capturing commodities such as gold right through to oil ETFs, whilst having a very narrow definition for derivative usage which potentially results in the majority of ETF's, without consideration to the strategy or desired outcome for using these derivatives, being labelled as complex if the current proposed definition is retained. This will not meaningfully help distinguish products which are genuinely more complex or have unique risks/features that warrant being called out as complex.

Complex definition relating to Derivatives is too narrow

Derivatives are used routinely by many types of funds for ordinary, day-to-day activities, but which go beyond hedging foreign exchange risk. One example is that equity derivatives are commonly used for efficient portfolio management, even by simple long-only equities funds. Derivative usage is imperative for cash flow management and is an important part of best practice management.

The CP envisages that ETF's that use derivatives other than for exchange rate hedging purposes are proposed to be called complex products. We agree that where an ETF uses derivatives for currency hedging purposes that it should not be classified as complex.

Whilst we agree with the above, we are concerned that the current drafting relating to derivatives is too narrow and should be broadened.

If the current drafting is adopted, we anticipate that the majority of active and passive ETFs currently on the market will be labelled “Complex”. This will not meaningfully differentiate products for investors. It would also misrepresent simple long-only funds as being more complex than they are. All of this is inconsistent with the objective of funds being “true to label”.

Derivatives

ASIC has already adopted a test in Regulatory Guide 240: Hedge Funds Improving Disclosure (RG 240) relating to derivative use as a measure of complexity. That test includes various carve-outs and is well understood by industry and by investors. Paragraph RG 240.11 in RG 240 recognises that funds can use derivatives without being characterised as a hedge fund for the following three reasons:

> *“(a) derivatives used for the dominant purpose of managing foreign exchange or interest rate risk;*
>
> *(b) derivatives used for the dominant purpose of more efficiently gaining an economic exposure, through the use of exchange-traded derivatives, to the underlying reference assets of those derivatives, but only on a temporary basis (i.e. less than 28 days, which cannot be extended by rolling over or replacing the derivative); or*
>
> *(c) exchange-traded derivatives, provided the notional derivatives exposure of the fund does not exceed 10% of its net asset value (unless the exposure is attributable to circumstances that were not reasonably foreseeable by the responsible entity, such as unforeseen market movements or large redemption requests, and the exposure is for a period of no more than three consecutive business days).”*

The FSC supports a similar approach being taken in INFO Sheet 230. We propose that the derivatives test for the “Complex” label should mirror the existing test under RG 240. This would mean that where a fund meets the criteria in RG 240, wherein it would be deemed to be a hedge fund, then it would also be deemed as “Complex” for the purposes of INFO Sheet 230.

If <u>ASIC does not support using the existing derivatives test in RG 240 for</u> the “Complex” label in revised INFO Sheet 230, we recommend the derivative limit should be 10% consistent with the position set out for synthetic ETF in Info Sheet 230 and RG240. We note that ASIC has not outlined any reason for why the current use of derivative for index and active products is not suitable for future labels. Derivative usage should not be exclusively for exchange rate hedging; derivative usage for other purposes should also be permitted such as fixed income derivatives (e.g swaps) that are used to hedge out duration risk.

Types of Complex ETFs

Commodity ETFs

Not all commodities are created equal. Synthetic ETFs that are implemented via derivative strategies are considered to be riskier ETFs and have a very different risk profile to say a

Gold ETF. We consider that synthetic commodity ETF's should be identified as complex ETFs whereas ETFs which have a physical structure such as Gold should not be called complex.

Unregulated Assets

We support ETPs tracking unregulated and decentralised asset classes, e.g. cryptocurrency being labelled as Complex.

Consistent labelling of Complex ETFs

For the reasons we have outlined above, we consider that the "Complex" label should also form part of the single and consistent naming convention – it should not be used as a secondary label which is applied on a discretionary basis. We do not consider that it would assist consumer understanding to have Active ETF (complex) or ETF (complex) – with reference to the word complex in brackets which is used on a discretionary basis. It would be simpler and more meaningful to investors to identify upfront if an ETF is deemed to be complex.

We envisage that this would mean that where a fund meets the Complex ETF definition – it is called a Complex ETF (irrespective of whether it is an actively managed ETF or index ETF). Under this approach any ETP that is not a Complex ETF will either be identified as an ETF or Active ETF as appropriate.

Structured Products

Draft Info Sheet 230 proposes to define Structured Products as an ETP that is a security or derivative that gives financial exposure to the performance of underlying investments. The CP describes this as products which are open ended and structured as derivatives, redeemable preference shared or debt securities.

We are supportive of these products being labelled as Structured Products.

3. ASIC Consultation Questions

3.1. ASIC consultation paper proposal to revise the existing naming conventions by dividing them into two levels of labelling:

(a) primary labels—to distinguish between types of financial products that are ETPs; and
(b) secondary labels—signifying the risks and strategies of the products. Note: We have set out our draft guidance on the naming conventions in the attachment to this consultation paper.

Feedback

B1Q1 What have been your experiences with the ETP naming conventions to date?

Feedback:

- They have not been applied consistently
- They are not meaningful to investors, who currently view all listed products as ETFs
- The managed fund label does not add anything meaningful.
- There is overlap between the current categories which can be confusing

B1Q2 Do you agree that naming conventions for ETPs are useful in alerting investors to important features and risks of ETPs? If not, why not? Please provide any evidence or research to support your views.

Feedback:

- We agree that simple, clear and consistently applied naming conventions for ETPs will be useful for retail investor understanding. There is a risk that consumers will not always read a Product Disclosure Statement (PDS) prior to purchasing an ETP on the exchange. In this regard the name can be an important signal as to the nature of the product and whether further research is warranted.
- A clear delineation of product risks is needed and the ETF Name is a sensible place to call this out to retail investors.

B1Q3 Do you agree that ASIC should continue to outline ETP naming conventions for licensed exchanges and product issuers? If not, why not?

Feedback:

- Yes, we think ASIC should set the standard for all ETP naming conventions which can then be enforced by the exchanges.
- Our recommendation is to only use Primary labels which are utilised by all exchanges consistently.
- If ASIC retains the Secondary label, Active ETF should become a Primary label and the use of Secondary labels should also be mandatory such that they are applied consistently across the industry.

- Further, exchanges should not be discretion to create other naming conventions which would could create more confusion and inconsistency across the industry, new labels should be only after industry consultation.

B1Q4 Do you agree with ASIC's assessment that the current naming conventions require updating? Please provide examples and assessment to support your response.

Feedback:

- Yes we are very supportive of removing the managed fund label, and elevating 'Active' and 'Complex', together with ETF, into a single naming convention proposal to provide meaningful information to retail investors.
- We have a number of concerns however with the 'Complex' definition and make a number of recommendations to amend this label.

B1Q5 Do you agree with the proposed two-level naming convention approach? If not, why not?

Feedback:

- No, we think ETF, Active and Complex should all be primary labels and all enforced in a uniform way. There is no need for a Primary and Secondary label, there should be just one clear enforced naming convention to help identify the product risks for investors.
- However, as noted our proposal could still be applied in the 2-tier convention proposed by ASIC, with both primary and secondary labels being mandatory and no discretion to add additional secondary labels without a broader industry consultation.

B1Q6 Are there any gaps or areas of inconsistency between ASIC's guidance on ETP naming conventions and the application of design and distribution obligations to ETPs that would benefit from additional clarification?

Feedback:

- If secondary labels are retained, but not applied consistently, then this naming convention misses an opportunity to assist with the DDO, as clear product labels could form part of the initial investment decision.

B1Q7 Do you foresee any difficulties or unintended consequences resulting from the introduction of the design and distribution obligations and ASIC revising its guidance on ETP naming conventions?

Feedback:

- No.

3.2. Primary labels—ETP naming conventions by product type

B2Q1 Do you agree with the proposed distinction between these product types? If not, why not?

Feedback:

- Yes but as above, we think ETF, Active ETF and Complex ETF should all be primary labels and all applied concurrently.
- We also believe changes are required to the Complex ETF definition to ensure it is meaningful and aligns with existing ASIC guidance/criteria set out for derivatives.

B2Q2 Do you agree that issuers of listed investment products (LICs and LITs) should be unable to use the term 'Exchange Traded Fund' or 'ETF'? If not, why not?

Feedback:

- Yes we agree that LICs and LITs are not ETFs and shouldn't use the label as it would not help consumers distinguish between these kinds of products and could potentially be misleading.
- The closed ended structure of these products means that they have different pricing mechanisms and may trade at a premium or discount to NTA, which could create investors confusion on pricing.

B2Q3 Should the updated guidance include a standard abbreviation for Structured Products (similar to 'ETF' for Exchange Traded Funds)? If yes, please indicate your preferred abbreviation for Structured Products and provide reasons for your response.

Feedback:

- No comment, other than to ensure that it is not labelled ETF.

3.3. Secondary labels—Naming conventions related to risks and strategy Proposal

ASIC proposes to have Active ETFs and Complex ETFs as a secondary label which is good practice guidance for exchanges (not mandatory). Where a product applies the Complex label, it would not have to apply the Active label. The retention of these two secondary labels is intended to support the retirement of the 'Managed Fund' label; and (b) explicitly recognising that, over time, licensed exchanges may choose to develop and apply additional secondary labels to address other risk or strategy considerations as the market develops. The application of any secondary labels will be at the discretion of the licensed exchange.

B3Q1 Do you agree with ASIC continuing to provide good practice guidance on specific risk-based or strategy-based labels for ETPs to alert investors to the presence of additional risks where this is appropriate? If not, why not?

Feedback:

- Yes we agree.

B3Q2 Do you support the two secondary labels that we have proposed for ETPs? Please provide reasons for your response.

Feedback:

- We support the names, but consider that the three labels (ETF, Active ETF and Complex ETF) should all be primary and consistently used across the industry.
- We do not support exchanges having discretion around the use of secondary labels which may not be used consistently. This could lead to a proliferation of secondary labels down the track, as products to continue to evolve and differentiated products are launched.

B3Q3 Do you support the updated definition for the 'Active' label? If not, why not, and what alternative definition would you suggest?

Feedback:

- We support the label but recommend a definition for public index is specified in Info Sheet 230.

B3Q4 In relation to the proposed 'Complex' label:

(a) do you agree that a single label can effectively alert investors to the presence of a range of important risks? If not, why not?

Feedback:

- Yes if the label is meaningfully defined. The current meaning potentially risks the unintended outcome of most and possibly all ETF's being labelled as complex which will not assist consumer understanding.

(b) if the 'Complex' label is adopted, do you agree that only derivatives used for exchange rate hedging purposes are able to be excluded? If not, do you have any suggestions for how to revise the consideration of derivatives in the 'Complex' label?

Feedback:

- We do not agree that only derivatives used for exchange rate hedging are able to be excluded. Most index funds would be labelled complex if this was the case as derivative usage is imperative for cash flow management and is an important part of best practice management.
- It is recommended that the derivative criteria for RG 240 also be used for the "Complex" label. Failing that, we note that the derivative limit should remain at 10%

and not be exclusively for exchange rate hedging as outlined in our submission above.

(c) do you have any suggested amendments to the proposed definition, or examples of specific product strategies or risks that should be captured by the 'Complex' label but are not currently included in the definition?

Feedback:

- It would be useful to list commodity ETFs that gain their exposure via derivative and unregulated decentralised assets such as Crypto ETFs under the complex label example definition proposed in the table in draft Information Sheet 230.

(d) we are open to alternatives to the word 'Complex' to describe this category of ETPs. Please let us know if you have any one-word or two-word suggestions.

Feedback:

- We do not have any proposed alternatives to the word 'Complex'.

B3Q5 As an alternative to the 'Complex' label, would you prefer that the current distinction between 'Synthetic' funds, 'Hedge funds' and other 'higher risk' ETFs be preserved but updated to address overlap and confusion? If so, do you have any suggestions for how those definitions could be revised?

Feedback:

- No, complex is a simple label that alerts the investor to potential risks in the product. Adding additional labels may create confusion.

B3Q7 Do you agree that for products that apply the Structured Product label there is no need to outline secondary labels? If not, why not?

Feedback:

- Structured products should be considered separately. Clarity for investors is always beneficial, using similar labels for structured products may confuse retail investors and then link them with ETFs.

B3Q8 Are there likely to be any unforeseen consequences related to ASIC's proposed updates to the INFO 230 naming conventions? If yes, please elaborate.

Feedback:

- If the derivative limit is maintained under complex ETF, the consequence would likely be that <u>most ETFs would fall under the complex label</u>
- This would not assist consumer understanding or help to distinguish ETFs with more complex investment strategies. We therefore support the refinements to derivatives as we have outlined above.

B3Q9 Do you have any other ideas for future development or improvement of ETP naming conventions to promote confident and informed investment in Australian ETPs?

Feedback:

- To support consistent in naming conventions, there should be a suitable transition period of 12 months for implementation of the labels across all products, with media coverage and investor education promoted across all product issuers to create a clear message to investors. This would mean 12 months after finalization of Info Sheet 230, all new and existing products would utilise the naming conventions set out in updated Info Sheet 230.

3.4. Conventions concerning the appearance of any labels applied Proposal

ASIC proposes to update INFO 230 to include general conventions that: (a) labels should appear at the end of the product name; (b) any relevant secondary labels should appear in brackets—for example, 'Name of Fund (Active) ETF' or 'Name of Fund ETF (Active)'; and (c) issuers or licensed exchanges should take steps to ensure that relevant naming conventions appear in all instances where a product name is used.

C1Q1 Do you agree with our proposed conventions concerning the appearance of any naming convention labels applied? If not, please provide reasons.

Feedback:

- We are supportive of the labels appearing at the end of the product name – such as XYZ ETF.
- We do not however think that Active or Complex should be secondary labels which are discretionary and should be used before 'ETF' without brackets – e.g. XYZ ETF, XYZ Active ETF, XYZ Complex ETF.

C1Q2 Are there alternative conventions for the display or appearance of labels that you would recommend in addition to or as an alternative to this proposal? If yes, please explain what & why

Feedback

- As we have outlined above.

3.5. The role of licensed exchanges

ASIC proposes to work with licensed exchanges authorised to admit ETPs to quotation to increase certainty (for both licensed exchanges and product issuers) through the implementation of a more consistent, market-wide approach to ETP naming conventions at the time of admission and on an ongoing basis.

Feedback

C2Q1 Do you agree with our proposal for licensed exchanges to implement consistent rules concerning ETP naming at the time of admission? If not, why not?

Specifically, we propose that relevant licensed exchanges should have rules to the effect that:

- the name of any ETP admitted to quotation must, in the opinion of the licensed exchange: (i) not be capable of misleading retail investors as to the nature, features or risks of the product; and (ii) be consistent with ASIC guidance on naming convention requirements;
- if a product issuer proposes to change the name of the product, the product issuer must first seek the approval of the licensed exchange for the new name; and
- a licensed exchange may require a product issuer to change the name of their product if the licensed exchange forms the view that the name of a quoted product is, for any reason: (i) capable of misleading retail investors as to the nature, features or risks of the product; or (ii) not consistent with ASIC guidance on naming conventions.

C3Q1 Do you agree that ETP name changes at any time after admission should also require the approval of the licensed exchange? If not, why not?

Feedback:

- Yes.

C3Q2 Do you agree with licensed exchanges having an explicit power to require product issuers to change the name of a product? If not, why not?

Feedback:

- Yes, within a set framework.

C3Q3 Are there any other rules or initiatives of licensed exchanges that would help to give effect to the aim or purpose of ASIC's guidance on ETP naming conventions?

Feedback:

- Allow the exchanges to make the determination of the name of each product, within the defined rules.

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3.6. Transitional arrangements

ASIC is interested in feedback on transitional arrangements that balances the aims of: (a) reducing confusion for investors through the use of consistently applied labels across both existing and new ETPs (particularly in relation to primary labels); and (b) minimising costs and administrative burden on industry and licensed exchanges in respect of any transition. At a minimum, we propose to work with licensed exchanges to ensure that any existing product that updates its primary label also considers the application of any relevant secondary labels. We propose that compliance will be enforced by licensed exchanges, if necessary.

C4Q1 Do you support a transition to updated primary labels being made mandatory (for all ETPs or classes or subsets of ETPs) to promote consistency across the industry and reduce investor confusion? Please provide reasons for your response.

Feedback:

- Yes but as above, we support ETF, Active ETF and Complex ETF all being primary labels. If they are not all made primary labels, we think the secondary labels should also be made mandatory.
- We are supportive of a suitable transition period of 12 months, after which all products will (whether existing or new) will meet the new naming conventions. This will ensure maximum clarity for investors as all products will change at the same time, rather than having a period where some have changed but others have not which would confuse investors.

C4Q2 Please outline your understanding of what would be required from you to implement the new naming conventions, including: (a) an estimate of costs; (b) what you would consider a reasonable timeframe if adoption was to be mandated for all or any class of products; and (c) any relief or other assistance from ASIC that you consider may be needed to facilitate a transition for existing products.

Feedback:

- There would be considerable changes for the industry to meet the proposed naming convention updated including changes to PDS updates, research house updates, website updates, collateral updates (factsheet, DDO, marketing material) and changes to presentations.
- For consistency sake it would be useful to have a fixed transition date, 12 months after Info Sheet 230 is finalised, after which all products (new and existing) would satisfy the naming convention requirements.
- We note that there may be character limits on platforms, data providers such as Morningstar, ASX, and google/facebook advertising which can have practical limitations on the ability to include the full name in its correct form in the naming convention.

C4Q3 For product issuers, it would greatly assist our consideration of these issues if you were able to provide a preliminary indication of your appetite to adopt updated naming conventions of the type described at proposals B2 and B3 for any or all of your existing ETPs.

Feedback:

- Yes we can see that it would be beneficial for ETF investors if the names were adopted and we are supportive of updating the naming conventions of all the ETPs.

C4Q4 Are there any other matters related to transition that ASIC should consider in connection with making revisions to INFO 230 guidance on ETP naming conventions?

Feedback:

- As mentioned, implementing the change with a hard date for updating will ensure clarity for investors whilst also likely for it to gain the maximum level of coverage, which will assist in it adoption.