



Press Release

Nice, London, Singapore, January 16, 2012

New EDHEC-Risk Institute research assesses the true risks of Exchange-Traded Funds (ETFs)

New research at EDHEC-Risk Institute has addressed the question of the true risks of Exchange-Traded Funds (ETFs) in Europe in the light of issues raised by financial regulators and international organisations. According to EDHEC-Risk Institute, any discussion of the risks inherent in ETFs should go beyond merely hypothesising about potential risks, and should also take into account the empirical evidence provided by the existing academic research on ETFs, which has documented various benefits in terms of liquidity and price efficiency.

Among the conclusions of the EDHEC-Risk Institute study:

- ❖ The vast majority of European ETFs are managed within the UCITS framework and as such have the same levels of security and the same risks as any UCITS fund. Highlighting the supposed risks of ETFs therefore makes little sense, and even less so in matters of retail investor protection in that ETFs represent but a fraction of the products sold to the general public in Europe and competing investment vehicles typically do not benefit from the same level of protection as that provided by the UCITS framework.
- ❖ The massive marketing and media relations campaigns implemented by some ETF providers in an effort to promote counterparty-risk-based distinctions between physical and synthetic replication ETFs are misleading.
- ❖ As far as counterparty risk is concerned, it makes little sense to oppose physical replication and synthetic replication products on the one hand, or draw a fine line between unfunded and funded swaps on the other. Both distinctions are largely irrelevant in practice and convey a false sense of "comparative" safety. In fact, whatever the replication techniques employed, ETFs are exposed to counterparty risk. As a matter of fact, securities lending is widely practiced by physical replication ETFs and leads to counterparty risk, just as surely as the reliance on over-the-counter derivatives by synthetic replication ETFs. Investors should pay more attention to first order issues that determine the effective mitigation of counterparty risk: the level of collateralisation, the quality of the assets performing the economic role of collateral and the ability of the fund to enforce its rights against collateral in the case of default by the counterparty.
- ❖ The issue of counterparty risk should be addressed through clear guidelines on counterparty risk mitigation up to the quality, marketability and diversification of assets performing the economic role of collateral and these should apply irrespective of the manner in which counterparty risk is assumed or mitigated, and to all UCITS and competing investment vehicles.
- ❖ Transparency should not be restricted to the problems posed by counterparty risk and its mitigation, but should include disclosure of the revenues and costs from ancillary activities such as securities lending. Last but not least, it is curious that while most ETFs are passive investment vehicles tracking indices, there is no standardisation or mandatory information on tracking error risk today in the European regulations. In the same way, regulators should give a legal definition of what constitutes an index and decide on the transparency and auditability requirements of indexes, which remain the main drivers of the financial risks assumed by ETFs.

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A copy of the study can be found here:

[EDHEC Position Paper What are the Risks of European ETFs?](#)

An ETFs roundtable entitled “Perceived Risks and Benefits of ETF Investments and Regulators’ Considerations: Towards More Regulation for ETFs?” will be held as part of the EDHEC-Risk Days Europe 2012 conference at The Brewery conference centre in London on March 27, 2012, enabling this subject to be discussed with numerous industry representatives and regulators.

Contact:



For further information, or to receive a press pass to the EDHEC-Risk Days Europe 2012 conference in London on March 27, please contact Séverine Anjubault:

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About EDHEC-Risk Institute

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

EDHEC-Risk Institute is located at campuses in Singapore, which was established at the invitation of the Monetary Authority of Singapore (MAS), the City of London in the United Kingdom, and Nice, France. In addition, it has a research team located in the United States. The research projects managed at EDHEC-Risk Institute receive the support of several financial companies representing some thirty different sponsors (including AXA Investment Managers, BNP Paribas Investment Partners, CME Group, Deutsche Bank, Eurex, iShares, NYSE Euronext, HSBC, Pictet, Robeco, Rothschild & Cie, Russell Investments, Newedge, SocGen, State Street, UBS, and many others).

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 48,000 regular visitors, is aimed at professionals who wish to benefit from EDHEC-Risk’s analysis and expertise in the area of applied portfolio management research. Its monthly newsletter is distributed to more than 1,000,000 readers.

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

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