IRELAND – EUROPE’S CENTRE OF EXCELLENCE FOR EXCHANGE TRADED FUNDS
Executive Summary

Ireland - the European Centre for Exchange Traded Funds (ETFs)

Growth of Irish ETFs and Current / Future Influences

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EXECUTIVE SUMMARY

In 2017 the global exchange traded fund industry grew at a phenomenal rate with both institutional and retail investors choosing this investment vehicle. Inflows in 2017 exceeded the previous record set in 2016 by more than 60%. According to data from independent research and consultancy firm ETFGI, there is more than US$4.4tn in ETFs globally. Ireland continues to lead the way in this fast-growing sector as the domicile of choice and the centre of excellence for supporting ETFs in Europe. This paper outlines the reasons for this success and explores both recent and future developments.

1 ETFGI December 2017 Industry Insights Report
IRELAND - THE EUROPEAN CENTRE FOR EXCHANGE TRADED FUNDS (ETFs)

Ireland has established itself as the European centre of excellence for the ETF industry and is the domicile of choice for ETF Sponsors with a current market share of 54%. Following the launch of the first ETF in 1990, another significant milestone was reached in March 2017 where the 27 year old ETF industry at $3.55tn in assets overtook the 69 year old hedge fund industry at $3.01trn. As the popularity of ETFs continues, exceptional growth has been witnessed over the last number of years and this is expected to continue going forward.

Ireland is a hugely important centre for both domestic and offshore investment funds. Irish domiciled funds are sold in 70 countries across Europe, the Americas, Asia and the Pacific, the Middle East and Africa. Over 900 fund promoters from in excess of 50 countries have assets administered in Ireland. The full suite of fund types - mutual, alternative, money market and ETFs - are serviced in Ireland. There are 38,000 people employed in the financial services industry and in excess of 16,000 servicing investment funds.

Growth of Irish domiciled funds has consistently increased, from €1,055bn in 2011 to €2,396bn in December 2017.

There are a number of reasons which contribute to Ireland’s success as a domicile of choice.

Wealth of Experience
For more than 25 years, Ireland has been a leading domicile for internationally distributed investment funds. Ireland has a wealth of experience in areas of fund

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Ireland - The European Centre for Exchange Traded Funds (ETFs)

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<thead>
<tr>
<th>Year</th>
<th>Irish Domiciled Funds (€ billion)</th>
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<tbody>
<tr>
<td>2011</td>
<td>600</td>
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<tr>
<td>2012</td>
<td>1,200</td>
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<td>2013</td>
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<td>2014</td>
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<td>2015</td>
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<td>2016</td>
<td>3,600</td>
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<td>2017</td>
<td>4,200</td>
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Source: Central Bank of Ireland (using data as at 31st December 2017)
establishment and servicing such as legal, fund accounting, transfer agency, AML/KYC, depositary, transaction processing and financial reporting. Other “front of house” activities are also completed in Ireland such as broker/dealer, securities trading, FX, quantitative research, market making and wealth management.

As part of Ireland’s membership of the EU, regulated funds can benefit from passporting opportunities, which provide access to the EU single market and beyond. Post-Brexit Ireland will be the only English speaking country in the EU.

Technology Ecosystem
Many financial institutions leverage off the well-established technology ecosystem which has existed in Ireland for many years. Hence, these institutions have established technology and innovation capabilities as well as IT/technology support services to complement their activities already in Ireland. This has assisted in driving the total automation rate in Ireland to 90.6% which means that Ireland is leading the drive for greater efficiencies in fund servicing.

Regulatory Environment
Ireland has a strong and stable regulatory environment. The Central Bank of Ireland (CBI) is responsible for the regulation of funds and the authorisation and approval of all fund service providers in Ireland. The CBI is wholly independent of the Irish Government or any financial institution and is committed to being independent and transparent. ETF issuers can rely on a clear and practical authorisation process which provides certainty on approval timeframes.

The CBI have taken a lead role in discussions of interest in the ETF industry. In early 2017 the CBI released a discussion paper regarding ETFs which was widely welcomed by the industry. The paper covered three primary themes, including investor expectations, liquidity and the requirement for additional regulation. The release of the paper indicates the CBI’s view of how important the ETF sector has become and outlines some of the key areas they are interested in. The paper invited responses from the industry, all of which are available on the CBI’s website (centralbank.ie). Following receipt of responses the CBI held a conference on the stability and growth of Exchange Traded Funds which was well attended by members of the ETF industry globally. A number of panel discussions were held covering the primary topics of interest to the CBI. They are now considering responses received to the discussion paper and points raised during the conference.
GROWTH OF IRISH ETFs AND CURRENT / FUTURE INFLUENCES

Growth in assets of funds domiciled in Ireland incorporates the strong growth in ETF assets. Since 2011 there was a 400% increase in the ETF assets domiciled in Ireland, from €67bn in 2011 to €362bn in December 2017. Outside of the US, Ireland is the leading domicile for ETFs globally and it is interesting to note that the first ever ETF launched in Europe is domiciled in Ireland.

In recent years ETFs have been launched in Ireland by both international and European issuers. The increase in assets is a result of existing ETF issuers growing their platform, but also new entrants to the European ETF market by leading asset managers such as JP Morgan, Fidelity and Franklin Templeton all of whom opted to domicile their products in Ireland. Global issuers who already have ETFs domiciled in Ireland and are actively launching new products include Vanguard, First Trust, BlackRock ETFs, SPDR, BMO and UBS.

The compound average year-on-year growth rate of Irish domiciled ETFs since 2011 is in excess of 30%, where 2014 represented the largest year-on-year growth rate of 50%. In December 2017, Irish domiciled ETF assets represented over 15% of the overall assets, an increase from 6% in 2011. In the US this figure is 11.8%. Looking forward, continued growth is expected where some industry experts predict that in 5 years ETF assets domiciled in Ireland may reach $700bn.

Source: Morningstar, Irish Funds

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2. "Reshaping Around the investor" Global ETF Survey, ET.
A larger percentage of the new ETF launches in Ireland, by both existing and new market entrants, are from US issuers. There are a number of reasons why US issuers opt for Ireland as the domicile of choice, such as its similar legal system, cultural similarities and that English is the primary working language in both counties.

The ease of listing and the existing ETF ecosystem in Ireland is also a positive feature. In addition, Ireland has an efficient tax regime for funds and has tax treaties with more than 70 other countries, (including the US). A listing on the Irish Stock Exchange (ISE) can be used to gain admittance to trading for the ETF on the Main Market of the London Stock Exchange (LSE) and there are significant benefits in choosing this route. In Ireland there is a substantial established ETF ecosystem which services and provides expertise to ETF issuers. These factors attract new ETF issuers to launch ETFs in Ireland when compared to other jurisdictions which have a smaller ETF ecosystem. Some of the largest US ETF issuers, including iShares and Vanguard, have ETFs domiciled in Ireland.

Traditionally, Ireland has been the domicile of choice for physical ETFs. Over the last number of years there has been a general trend in the ETF marketplace to move away from synthetic products in favour of physical products. As such, ETF assets in Ireland increased as synthetic products were converted to physical and in some instances redomiciled to Ireland. In addition, more physical products are being launched in place of synthetic products. These changes have had a materially positive impact on the growth of ETF assets domiciled in Ireland. 54% of the total ETF assets in Europe are domiciled in Ireland².

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Source: Morningstar (using data as at 31st December 2017)
GROWTH OF IRISH ETFs AND CURRENT / FUTURE INFLUENCES

New Strategies - Active ETFs

Recent launch activity has shown some new products which shift from traditional index based ETFs to a wide spectrum of new types of ETFs from factor based products to more active strategies. Some industry surveys have indicated that this will remain the case as newer entrants try to differentiate themselves in the marketplace.

A key attribute of active ETFs is, unlike passive ETFs, investment in a portfolio of securities that is subjectively chosen by a fund manager rather than following a rules-based index. The idea is to perform better than a benchmark index through active management.

As such, the approach to portfolio management of active ETFs may be quite similar to actively managed mutual funds.

One of the characteristics of active ETFs which interests investors is that active ETFs aim to outperform the benchmark index. This out-performance, combined with the transparency and liquidity inherent in ETFs, provides investors with clear advantages when compared to investing in actively managed mutual funds. ETFGI reported assets invested in active ETFs and ETPs listed globally have increased by 57.3% during 2017 to reach $75 billion at the end of December. Whilst a small number in relative terms, it is indicative of the trend towards packaging certain active products in ETF wrappers.

As a result, many traditional managers are looking at how to package successful strategies into an active ETF format. A key reason for a manager launching an active ETF is to gain access to a broader distribution reach. Implementing an active strategy into an ETF wrapper brings additional choices to investors. It can help to deliver more efficient investment solutions and can also bring additional levels of transparency to investors when compared to other vehicles providing access to this strategy.

A key consideration for managers of active ETFs is transparency and the requirement to publish the portfolio holdings on a daily basis. As such, the manager is providing details in near real time of their portfolio. Some managers have raised concerns stating that the provision of these details may enable others to “front-run” securities in the portfolio and also reveals key intellectual property. This is an area of considerable interest for regulators and there are ongoing discussions between regulators and the industry on this topic.
To date, a total of 504 fund promoters from over 40 countries have chosen Ireland as a domicile for their investment funds. Irish UCITS have 23,000 registrations for distribution across Europe, the Americas, Asia and the Pacific, the Middle East and Africa.

Irish UCITS are currently registered for sale in all leading UCITS distribution countries around the world including the UK, US, Spain, Australia, Chile and South Africa. Of the Irish UCITS fund registrations globally, Irish ETFs currently make up 6,308 (over a quarter) of these registrations, which is more than double Ireland’s nearest competitor domicile.

**Taxation of ETFs in Ireland**

Irish regulated funds, including ETFs, are exempt from Irish tax on income and capital gains derived from their investments and are not subject to any Irish tax on their net asset value. There are additionally no net asset, transfer or capital taxes on the issue, transfer or redemption of units owned by non-Irish resident investors.

An attractive feature of Ireland for ETFs is Ireland’s tax neutral regime for cross border globally distributed funds which has been in place for over 25 years. The ability to pool global investors savings in a tax efficient fund vehicle has led to Ireland becoming renowned globally as a major centre of excellence for both UCITS and AIFs. In many other fund domiciles, distributions from funds (including ETFs) to investors may be subject to withholding taxes on payments to investors. This can have a significant impact on the tax efficiency of the return to investors, particularly where the ETF is distributed cross border. While investors may be able to obtain a credit or refund from the source country, the reclaim process can be complex and time consuming. However, distributions by Irish ETFs should not be subject to withholding tax, which is an important feature from both a tax efficiency perspective and also helps keep the administrative burden and costs to a minimum.

Ireland has a continuously expanding tax treaty network, including over 70 countries. Access to tax treaties is an important component in fund performance. For example, Ireland’s tax treaty with the US provides for a reduced rate of tax on portfolio dividends for ETFs.

**Benefits of Listing on the Irish Stock Exchange**

Issuers with UCITS compliant ETFs that have a primary listing on the ISE are allowed direct admission to other European markets such as the LSE to make their ETFs available for trading without having to go through the process of obtaining local official listing through the UKLA.

This ISE listing provides an alternative route to market for ETF issuers with requirements that are tailored for investment funds and recognise existing regulation. There are significant benefits in using this route which include enhanced speed to market, reduced costs and straightforward documentation. ETFs are typically listed on multiple stock exchanges. 46% of European ETFs are currently listed on two to three different stock exchanges.

**Looking Forward**

Looking ahead, the pace of innovation will increase as managers develop different themes and strategies to compete within a changing political and regulatory environment. There are likely to be areas within the ETF ecosystem which will be looked at closely by regulators following the recent CBI paper and as IOSCO review its principles for the regulation of exchange traded funds in 2018. In the area of exchange consolidation there was welcome news that the ISE will become the global centre of excellence for all Euronext’s group-wide activities in the listing of ETFs following its acquisition of the ISE.

MIFID II came into effect on 3 January 2018 and is generally considered to be positive in terms of flows into ETFs, as transparency around volumes of trading is increased due to the need to have

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9Monterey Insight Ireland Report 2017
10PwC Market Research Center based on Lipper LIM data, end June 2017.
11PwC Market Research Center based on EU Stock Exchanges data, end June 2017.
trades recorded and the heightened focus on fund cost and charges.

This increased transparency into the depth of liquidity in EU domiciled ETFs may result in a redirection of European investor flows which are currently directed to US products.

Improvements are already in train in the operating model (e.g. ETF settlement across European exchanges). Fungibility at the trading level - the ability to buy/sell across a number of exchanges - has improved with the introduction of the ICSD settlement model which eight issuers now use.

In a European context, more than 99% of ETF products are domiciled outside of the UK and as such, distribution should be minimally impacted by Brexit in that it is widely expected that UK investors will maintain access to UCITS post-Brexit given the UK Government’s announcement to allow the ongoing marketing of EEA funds into the UK during the post-Brexit implementation period.

Key to the continued success and growth of the ETF market in Europe, particularly among retail investors, is the enhancement of technologies that facilitate increased distribution and market penetration. The investment in Fintech by most asset managers is likely to play a crucial role in the expansion of this distribution channel for ETFs to investors. When developing their distribution strategy, ETF issuers, particularly if they want to encourage use by retail investors, need to give some thought to the increased use of technologies such as online platforms and robo-advisors and also tools that would allow marketing and investing via social media channels.

The new automated advice platforms which provide online investment advice using algorithms with varying degrees of human interaction are increasingly important influencers driving ETF assets growth.

The Irish Government’s recently published IFS2020 strategy highlighted the Government’s focus on ensuring ongoing support for the collaboration between Fintech and financial services. With Ireland’s relatively mature Fintech market due to the long-standing presence of many of the world’s leading tech firms, Ireland is well-positioned to supply the talent pool of individuals with the necessary skill sets to facilitate innovation in this space.
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