MAPLES GROUP

ETFs

A Guide to Exchange Traded Funds in Ireland

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WHAT IS AN EXCHANGE TRADED FUND?

An exchange traded fund (**"ETF"**) is a form of collective investment scheme. The key factor which differentiates an ETF from other investment fund structures is that it is traded on stock exchanges. Therefore, ETFs are an investment product which combine the features of an investment fund with those of an exchange-traded security.

In Europe, ETFs are normally structured as investment companies established as undertakings for collective investment in transferable securities (**"UCITS"**).

ETFs can be traded intra-day on the majority of global stock exchanges in the same way as other public traded securities.

The aim of an ETF is to track or replicate a particular index, a portfolio of assets or a strategy through a single liquid instrument that can be purchased or sold on a stock exchange.

ETFS BACKGROUND AND GROWTH

ETFs emerged in the early 1990s and symbolised a revolutionary shift in the mutual funds industry. They appeal to a diverse array of investors.

Ireland is the largest European centre for ETFs and ETFs are the fastest growing type of investment fund globally.

US $5.32 trillion

[1]assets invested in global ETFs and exchange traded products

US $882 billion

[2]assets invested in European ETF and ETP industry

[1] ETFGI press release, 13 June 2019.
[2] ETFGI press release, 29 May 2019.

ETF TRADING

Primary Market

ETFs do not typically sell individual shares directly to, or redeem their individual shares directly from investors. Instead, transactions go through third party intermediaries, called Authorised Participants.

The Authorised Participant subscribes for and redeems ETF shares directly with the ETF in creation units, which are large blocks of tens of thousands of ETF shares. This is known as the primary market. The Authorised Participant will subscribe for shares directly with the ETF either in cash or in specie/in-kind (i.e. by providing a creation basket referencing the underlying securities of the reference index or strategy) in exchange for creation units.

Authorised Participants are commonly referred to as the "market makers" as they create a secondary market for the ETF shares.

Secondary Market

ETF shares that are acquired by the Authorised Participant on the primary market will be listed on an exchange and are available for purchase by investors from the Authorised Participants on these exchanges. These markets are referred to as the secondary market in the ETF context.

The settlement of the ETF shares is facilitated through recognised clearing and settlement systems (i.e. Clearstream and Euroclear). This settlement system permits ETF shares to be bought on an intra-day basis without incurring subscription or redemption charges.

The Authorised Participant/market makers will be the only direct participating shareholders in the ETF with all other investors holding an interest in those shares via the secondary market.

Secondary market investors must have a right to sell shares directly back to the UCITS ETF in circumstances where the stock exchange value of the shares significantly varies from its net asset value (**"NAV"**) (e.g. in cases of market disruption such as the absence of a market maker). The process and potential costs involved in such a redemption must be disclosed by the UCITS ETF in its prospectus.

TYPES OF ETFS

Physical ETFs	A physical ETF invests directly in the underlying assets that comprise the index in the same weightings and concentrations as the financial index/underlying portfolio (subject to compliance with the diversification limits applicable to UCITS). The main advantage to the physical ETF model is that there is no counterparty risk in respect of direct investment.
Synthetic ETFs	A synthetic ETF gains exposure to an index through a derivative (usually a swap) with a counterparty. A synthetic ETF invests in financial derivatives where a counterparty pays the exact return of the relevant underlying asset. Such products may be more cost effective compared to a physical ETF but they do entail counterparty risk and are subject to the UCITS limits on counterparty exposures.
Passive ETFs	Originally, ETFs were structured as passive ETFs. Passive ETFs seek to provide their investors with a return closely aligned to the return of the relevant index and their purpose is to match the performance of the index. Passive managers try to track/replicate the performance of a given market or index and do not necessarily try to outperform their corresponding financial index/ portfolio.
Active ETFs	An actively managed ETF is where the investment manager frequently trades assets in an effort to outperform the index/market and retains discretion over the portfolio composition rather than tracking an index. Actively managed ETFs seek to implement their own investment strategy and have discretion over the composition of its portfolio subject to the investment objective and policy of the fund in an effort to outperform the relevant index/ market.

They have great strength in handling country registrations and all aspects of maintaining all regulatory filings...

Commercially minded, aware of new developments and very proactive...

They are outstanding on international aspects...

Chambers Europe

Highly knowledgeable, proactive and, above all, pragmatic...

...regarded by some as being 'the best in Dublin'...

Exceptional technical knowledge...

Legal 500

Partners and associates are technically excellent and can be relied on for practical and sound business advice...

The team at Maples is outstanding...

Maples is one of the key law firms in Ireland. They're very commercial, responsive and solutions-orientated...

IFLR

The Maples Group is independently ranked first amongst Irish law firms in Ireland in terms of total number of funds advised (based on the latest Monterey Ireland Fund Report, as at 30 June 2018).

ADVANTAGES OF ETFS

Flexibility and Timing	ETFs can be traded in real time throughout the day rather than at one fixed point as with mutual funds. This gives investors flexibility and discretion to move in and out of their chosen index or sector on an ad-hoc basis and avail of market developments.
Diversification	Traded like shares, ETFs are quoted on the stock exchange and offer broad diversification. The range of assets covered by ETFs provide an easy way for managers to give their clients exposure to different markets/sector.
Liquidity	ETFs typically have higher daily liquidity than mutual fund shares, making them an attractive alternative for investors.
Transparency and Disclosure	In contrast to mutual funds, ETFs are required to reveal their holdings on a daily basis meaning that although indices rarely change, when they do, the information is readily available to investors.
Cost Efficiency	ETFs are an easy and cost effective way for investors to achieve returns from indices without having to purchase the stocks and offer a convenient and cost efficient alternative to purchasing all of the underlying securities of a particular index. ETFs generally have lower expense ratio when compared with mutual funds.

WHY IRELAND FOR ETFS?

Ireland is the number one European domicile for ETF issuers and is home to almost 50% of all European ETF assets. Six of the top 10 European ETF issuers in Europe are based in Ireland, a further indication that Ireland is to the forefront of the European ETF market.

1. Ireland has emerged as one of the primary locations for ETFs in Europe, due to a large pool of expertise and experience available, an appealing regulatory framework and supporting infrastructure.

2. Establishing an ETF as a UCITS means that it benefits from a brand that is recognised and understood throughout the world and the availability of the UCITS passport enables the ETF to be registered for public distribution throughout the EU. Irish ETFs can benefit from a well-established and flexible Central Bank of Ireland (**"Central Bank"**) approval process, which enables sponsors to bring innovative and complex index-tracking products to market quickly.

3. In Q3 of 2018, the Central Bank announced that ETFs can establish both listed and unlisted shares classes within a single fund structure (subject to disclosure requirements) and that it will permit different dealing times for hedged and unhedged share classes within the same ETF. These are welcome developments from the Central Bank.

TAX HEADLINE POINTS FOR ETFS

Tax Efficient	No Irish taxation arises on income or gains at the level of the Irish ETF.
No Withholding Tax	No withholding tax on dividend or redemption applies on payments to non-Irish investors.
Tax Treaty Access	Irish ETFs may be entitled to benefit from the provisions of Ireland's double tax treaties, including the US / Ireland treaty, subject to the provisions of each treaty and the rules in the relevant treaty partner country in each case.
VAT Exemptions	The provision of certain standard services to Irish ETFs (e.g. investment management, administration, transfer agency, depositary, etc.) are treated as VAT exempt in Ireland. To the extent that the Irish ETF incurs Irish VAT on certain services it receives (e.g. audit and legal fees), it may recover a portion of this VAT based on its recovery rate.
Stamp Duty and Subscription Taxes	No stamp duty is payable in Ireland on the issue, transfer, repurchase or redemption of shares in an Irish ETF. No subscription taxes are levied by the Irish tax authorities on the assets of an Irish ETF.
Exchange of Information	Ireland is fully compliant with the OECD Global Forum on Transparency and Exchange of Information for Tax Purposes. Ireland has implemented both the US FATCA regime and the OECD common reporting standard (**"CRS"**). Irish ETFs are thus capable of complying with international FATCA and CRS requirements. Provided the Irish ETF complies with its FATCA obligations, no FATCA withholding should apply on payments from US sources.

DISCLOSURE REQUIREMENTS FOR ETFS

Naming	A UCITS ETF is required to use the identifier "UCITS ETF" to identify it as an exchange-traded fund in its name, its constitutional document, the prospectus, the key investor information document (the **"KIID"**) and marketing communications.
Transparency	A UCITS ETF shall, in (a) the prospectus; (b) the KIIDs; and (c) the marketing communications of the UCITS ETF disclose the policy of the UCITS ETF regarding portfolio transparency and where information on the portfolio may be obtained, including where the indicative NAV (**"iNAV"**), if applicable, is published.
Use of Indices	A UCITS that uses a financial index for investment purposes shall, in the prospectus of the UCITS, provide sufficient disclosure to allow a prospective investor to understand the market that the index is representing, why the index is being used as part of the investment strategy of the UCITS, whether the investment will be made directly, through investment in the constituents of the index, or indirectly, through an FDI; and where additional information on the index may be obtained.
Prospectus Disclosure	The prospectus of the relevant UCITS must disclose the rebalancing frequency of the financial index in which it invests and its effects on the costs within the index. A UCITS shall not invest assets of the UCITS in a financial index that rebalances on an intraday or daily basis, or the rebalancing frequency of which prevents investors from being able to replicate the financial index. There are also additional disclosure requirements for index-tracking UCITS, index-tracking leveraged UCITS and actively managed UCITS ETFs.

DISTRIBUTION OF ETFS

Our Global Registration Services (**"GRS"**) team provides a range of services, including supporting UCITS (domiciled in Ireland and Luxembourg) by providing an integrated global network of experts coordinated by a dedicated central team who manage and support all legal and regulatory aspects governing the cross border marketing of these products on both a private placement and public offer basis.

Combining expert local knowledge with full project management functionality through a seamless service creates a powerful and efficient multi-jurisdictional solution. In doing so, the GRS team delivers tailored solutions through a single point of contact, which frees valuable internal resources and generates significant added value for our clients.

Our aim is to offer a service that provides efficiency, value and peace of mind so that our services become solutions, tailored to the needs of our clients.

We offer our clients a range of services addressing regulatory aspects to help optimise fund distribution activities globally. We believe that by having a dedicated team solely focused on registration business, coupled with our experience in dealing with a broad range of local services, we provide the best service to our clients and can proactively identify areas where economies of scale can be achieved.

Our core GRS service offering includes:

- Market Intelligence;
- Market Entry through the EEA Passport or Restricted Offerings; and
- Maintenance.

For further details please refer to our GRS brochure Marketing UCITS and AIF through the European Passport.

THE MAPLES GROUP ETF EXPERIENCE

We have a significant ETF practice within the Maples Group, currently advising (inclusive of sub-funds) approximately 118 ETFs which include a substantial portion of the large institutional banks. As a result, we are at the forefront of the approval of ETFs with the Central Bank and leading the industry development on matters such as look-through provisions both at diversification level and asset eligibility level for complex financial indices.

We advise on a significant portion of ETFs in the Irish market including synthetically replicating ETFs, physical replicating ETFs, hybrids of both synthetic and physical ETFs and numerous innovative ETF products.

We were the first listing sponsor to list an ETF on the ISE and admit the ETF to trade on the London Stock Exchange and have listed over 100 ETFs since 2010.

In addition we advised on the first non-UCITS ETF retail product.

As such we are exceptionally well placed to advise on the implications of the current changes to ETFs and on the trends and areas of interest in the broader ETF market generally.

CONTACTS

Dublin

Peter Stapleton
Head of Funds & Investment Management
+353 1 619 2024
peter.stapleton@maples.com

Stephen Carty
Partner
+353 1 619 2023
stephen.carty@maples.com

Ian Conlon
Partner
+353 1 619 2714
ian.conlon@maples.com

John Gallagher
Partner
+353 1 619 2073
john.gallagher@maples.com

Philip Keegan
Partner
+353 1 619 2122
philip.keegan@maples.com

Deirdre McIlvenna
Partner
+353 1 619 2064
deirdre.mcilvenna@maples.com

Aaron Mulcahy
Partner
+353 1 619 2104
aaron.mulcahy@maples.com

Eimear O'Dwyer
Partner
+353 1 619 2065
eimear.o'dwyer@maples.com

Emma Conaty
Head of Global Registration Services
+353 1 619 2708
emma.conaty@maples.com

Catherine Lane
Senior Vice President, MPMF
+353 1 697 3215
catherine.lane@mpmfmanagement.com

London

Adam Donoghue
Partner
+44 20 7466 1711
adam.donoghue@maples.com

Cayman

Pádraig Brosnan
Partner
+1 345 814 5441
padraig.brosnan@maples.com

Hong Kong

Michelle Lloyd
Partner
+852 3690 7504
michelle.lloyd@maples.com


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GROUP
maples.com