DILLON EUSTACE

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December, 2017

ETFs - Stability and Growth Conference

Dillon Eustace attended the “Exchange Traded Funds – Stability and Growth” conference hosted by the Central Bank of Ireland (“CBI”) on 29th November 2017. The conference follows the publication in May of the CBI’s comprehensive discussion paper on the Exchange Traded Fund (“ETF”) industry.

The speakers were an excellent mix of both ETF industry representatives and regulators and the tone of the event was very much one of open discussion and collaboration. Participants included a range of regulators including the CBI, the SEC, the ECB, the FCA, the AMF, ESMA and IOSCO, ETF providers such as Vanguard, Deutsche Asset Management and WisdomTree and service providers Susquehanna, JP Morgan and PWC.

US v Europe

We heard the US perspective on the evolution of the European ETF market, which always gives a welcome insight into the direction and future of the European market. The fragmentation of the European ETF market was discussed in the context of local distribution and taxation complications, although there was a noticeable absence of any mention of the international clearing and settlement system.

In addition, on the same day that we saw further European stock exchange consolidation with the announcement of the Euronext acquisition of the Irish Stock Exchange, one panellist mooted an idealistic but arguably unrealistic concept of the creation of a single European ETF exchange.

Regulatory developments

Dillon Eustace Listing Team contacts:

Tara O‘Callaghan
DD: +353 (0)1 673 1831
tara.ocallaghan@dilloneustace.ie

Fionnán Gannon
DD: +353 (0)1 673 1867
fionnan.gannon@dilloneustace.ie

Helen Daly
DD: +353 (0)1 673 1830
helen.daly@dilloneustace.ie

The general sentiment amongst speakers was that the transparency in ETF trading under MIFID II will be a good thing for the ETF industry with more visibility on OTC trades and liquidity levels in the market.

Market participants will have been relieved to hear the regulators repeatedly clarify that there is no immediate intention to impose a new set of regulatory standards on ETFs although the role of the Authorised Participant ("AP") was highlighted as an area of focus that is likely to come under closer regulatory scrutiny, with discussion on the introduction of codes of conduct and best practice models for APs.

Impact of ETFs on Securities Markets

There was plenty of discussion on the real and potential impact of ETFs on the liquidity of the underlying index constituents and markets in general, particularly in the context of the intraday trading of ETFs and ETFs being used as part of hedging and alternative strategies. The ETF sector was described as a "teenager", and its impact on other markets is being closely considered prior to it potentially having systemic influence. Scenarios such as the ETF sector's ability to trade through market events, such as market "trading pauses" of the August 2015 flash crash, the observation of price corrections in ETFs following market events as well as the potential for market manipulation were discussed by a number of panels.

Active v Passive ETFs

We heard a number of calls to simply do away with the term "passive" and there were – unsurprisingly – different views on what constituted an active ETF. There was a call for "not more but better" information in relation to the portfolio held by actively managed ETFs. It was generally accepted that APs can arbitrage efficiently with indicative portfolio information, but the question was posed as to whether investors could accurately understand active products and their constituents.

Investor expectations

It was acknowledged that ETFs are sometimes complex investment products, perhaps too complex for retail investors to ever fully understand. Investor education was repeatedly mentioned as something that was essential for the ETF market to continue to grow. The low level of retail holding of ETFs in Europe was cited and there were differing opinions as to whether the classification of an ETF's risk profile should be simplified so as to be accessible to retail investors or whether the industry was likely to remain predominantly institutional.

If you have any questions on the matters discussed above please contact your usual Dillon Eustace financial services contact.

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DILLON EUSTACE

Dublin
33 Sir John Rogerson's Quay, Dublin 2, Ireland. Tel: +353 1 667 0022 Fax: +353 1 667 0042.

Cayman Islands
Landmark Square, West Bay Road, PO Box 775, Grand Cayman KY1-9006, Cayman Islands. Tel: +1 345 949 0022 Fax: +1 345 945 0042.

New York
245 Park Avenue, 39th Floor, New York, NY 10167, U.S.A. Tel: +1 212 792 4166 Fax: +1 212 792 4167.

Tokyo
12th Floor, Yurakucho Itocia Building, 2-7-1 Yurakucho, Chiyoda-ku, Tokyo 100-0006, Japan. Tel: +813 6860 4885 Fax: +813 6860 4501.

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