



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 29<sup>th</sup> 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

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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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