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Irish regulator eyes more flexible stance in potential boost for active ETFs

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The Central Bank of Ireland (CBI) is understood to be considering a more accommodative stance for governing exchange-traded funds (ETFs) in certain areas, in efforts that could see Ireland consolidate its position as the dominant European domicile in this rapidly-growing market and boost the popularity of active ETFs in particular.

In 2017, the regulator issued a discussion paper on the ETF market, which it expects to grow from €287bn in 2017 to as large as €720bn in Ireland by 2021, and consulted with the industry on potential new regulations concerning primary and secondary trading arrangements, risks inherent in the vehicles' structure and leverage.

However, *Investment Week* understands the CBI will now allow the International Organisation of Securities Commissions (IOSCO) to take the lead in developing a more global approach to regulating market risks associated with the ETF market, which currently lacks any uniformity at regulatory level across the world. IOSCO is set to embark on its own industry consultation on the subject of ETF regulation this year.

Investment Week believes the CBI is also in discussions to overturn the current requirement for daily portfolio disclosures in its jurisdiction for the emerging active ETF market. These products have moved away from the traditional passive approach in favour of a manager making decisions on the underlying portfolio allocation, and have become increasingly popular.

Partner at Dublin law firm Dillon Eustace, Brian Higgins, said the CBI is considering altering its position, with the potential for either "a delay in disclosure" or "changes around the level of disclosure required".

He added: "It is not yet clear precisely what the CBI will propose.

"However, if its final position is sufficiently flexible, it could open the market to a far greater number of active ETF funds and thereby provide greater choice to investors."

Hector McNeil, co-CEO of HANetf, said the change would be significant as it would reduce concerns that providers have about front running.

He said: "The firms running active ETFs feel they have something of significant value and lots of intellectual property and therefore they want to disclose that to as few people as possible. ETFs are UCITS, so what is allowable under UCITS should be allowable for ETFs, and that should include the rules around transparency and restricted disclosures.

"The transparency of an ETF was never designed for the end client. It is not a market disclosure tool, it is for the market makers to price it."

At present, there are no uniform European regulations for the disclosure of active ETF portfolios and some exchanges, such as the London Stock Exchange, do not require portfolio holdings to be disclosed. Ireland currently represents over 54% of the ETF market share in Europe, according to trade body Irish Funds, but its closest rival Luxembourg has softer disclosure requirements with respect to active ETFs.

McNeil explained there is a degree of "arbitrage between Luxembourg and Dublin", with the former offering a "more accommodating" environment for active ETFs currently, despite Dublin retaining the vast majority of business.

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Global ETF regulation

In November 2017, the CBI followed its discussion paper with an industry conference in Dublin where it outlined the key areas that will form part of its new regulatory framework for ETFs.

Investor protection, liquidity concerns and the role of "authorised participants" (APs), as well as the ways existing European regulation relates to ETF-specific issues, were set to be at the forefront of new rules put in place by the CBI.

Work is still being done with the potential to develop a new Irish regulatory framework over the coming months. However, *Investment Week* understands the CBI is now likely to allow its research and consultation with the industry to be used by IOSCO in its efforts to create a more uniform, global form of ETF regulation.

A senior legal figure at a major European ETF provider told *Investment Week* the CBI's discussion paper should be seen as more about data gathering, rather than regulating.

They said: "If you speak to the CEO of any major asset manager and ask them what their priorities are over the next five years, they will probably say technology and developing some kind of ETF offering.

"In that context, the CBI is looking at the assets it regulates and probably got slightly spooked about the size of that market and the associated flows, and realised it did not really understand the mechanics behind it.

"They are now trying to position themselves as a thought leader in the market in Europe."

ETF share classes

It is also understood the CBI is considering allowing an ETF share class of mutual funds, as is allowed in other global jurisdictions such as Luxembourg.

Dillon Eustace's Higgins said this change could "enable promoters to offer ETF shares classes within an existing fund and thereby gain access to the market without having to establish a new mirror fund", which have larger additional operating costs and reduce economies of scale.

A CBI spokesperson confirmed the regulator was looking into portfolio transparency and ETF share class arrangements, but said "there are still some challenging issues the Central Bank will need to consider before proceeding".