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Dear Sir/Madam

Response to Discussion Paper on Exchange Traded Funds ("ETFs")
(the "Discussion Paper")

Maples and Calder clients very much welcome the opportunity to comment on the Discussion Paper. Based upon the feedback we have received to date, the publication of the Discussion Paper and the request for feedback has been warmly welcomed by the Industry.

Using the numbering detailed with the Discussion Paper we have set out our thoughts and comments in relation to each of the queries within the Discussion Paper.

SECTION I – ETF DEALING

QUESTIONS

A. Is public disclosure of the identity of APs and OLPs of an ETF of benefit and should regulators have a clearer view of the interconnectedness of the AP / OLP ecosystem? Therefore should remuneration models of OLPs (and if relevant APs) be disclosed?

In many cases, information on APs and OLPs is already publically available. The majority of ETF providers disclose their APs and OLPs on their websites. In addition, many exchanges require information on OLPs to be listed on their websites. As such, investors in such ETFs are aware of which entities are providing these roles.

Investors trading ETFs do so on the specific exchanges and tend to look for information on OLPs from exchange websites as opposed to directly from an ETF provider. As much of this information is already freely available, the view of our client base is that there is no real benefit to creating additional disclosure requirements for ETFs.

We acknowledge that regulators should be made aware of the interconnectedness of APs and OLPs and in our experience industry is happy to assist regulators in obtaining this information.

Remuneration models are commercial arrangements as between ETFs and APs/OLP and as such it would not seem appropriate to require their general publication. Additionally, the publication of commercial terms may ultimately have a negative impact as certain providers may decide to limit offerings (and thus reduce liquidity within the market) should their

commercial arrangements be made public. There is also the argument that the disclosure of the commercial arrangements would not portray the complete picture, as certain providers will bring a value-added to a commercial arrangement (such a large number of investors) which will not be easily identifiable from such a disclosure.

B. Transparency is described as the feature which enables a tight secondary market price (by comparison to net asset value) to be maintained. It also provides certainty to investors in terms of exposure achieved through the ETF. It might be the case that there are other mechanisms which achieve the same goal as transparency? If ETFs are not transparent does this have unintended consequences?

Transparency is a key feature investors expect when buying an ETF and it is important for efficient trading. While transparency has contributed to the lowering of fees, it is difficult to see what further benefits could be derived from providing transparency to investors in regard to all operational aspects of an ETF.

C. Is the idea of secondary market investors dealing directly with an ETF when the AP arrangements breakdown unworkable in practice or unnecessary? Is there a better way of enabling secondary market investors to dispose of their ETF shares at a price close to the next calculated net asset value when secondary market liquidity is impaired?

Operationally it would be somewhat cumbersome for ETFs to have to deal directly with secondary market investors. However, there are a number of other avenues open to secondary market investors should a specific AP cease to trade on a given day.

In general, ETFs utilise the services of several APs and liquidity providers which increases overall liquidity for ETFs and allows investors various forms of access to ETF should a specific AP close to dealing on a given day.

Furthermore as ETFs are generally listed on several exchanges, if trading on one exchange is hindered investors can trade the ETF shares on the other exchanges the ETF trades on which provides investors with a further source of liquidity.

One participant noted that given the size, importance and growth projections of the ETF market the likelihood of such APs not providing a service during unusual market conditions is reduced on the basis that such APs will not want to put these arrangements in jeopardy in the long-term.

D. Should ETFs warn investors that the ETF may temporarily become a closed-ended fund in certain market conditions? Would requiring an ETF to remain open-ended in a stressed market be disadvantageous to existing investors or have other unintended consequences?

We would be of the view that it would be inaccurate to suggest that ETFs may temporarily become 'close-ended', rather in times of market stress, an ETF (as with UCITS or all other collective investment scheme products) may temporarily suspend trading in line with the terms of its offering documents. The ability to temporarily suspend trading is fully disclosed in a fund's offering document and investors are on notice of this fact.

Given that other UCITS are not required to remain open to trading in periods of market stress it would not seem appropriate to force ETFs to do so.

E. Is it correct to permit share classes to be structured having regard to the operational concerns of APs and the impact this may have on secondary market pricing? Are

there factors (other than those noted above) that could be relevant to ETF structuring?

Once there is no prejudice to shareholders and the proposed share classes satisfy the ESMA Opinion on Share Classes, we would be of the view that operational concerns should be permitted to be reflected in share class terms. In certain instances it may be advantageous to ETF providers to structure share classes with different dealing cut off times such as for hedged and non-hedged share classes. Given that tailoring share classes to specific needs is likely to result in an increase in AP activity this should ultimately be of benefit to the investors.

F. What are the benefits or disadvantages of permitting listed and unlisted share classes within the same investment fund? Do listed and unlisted share classes create unfairness as between investors in the same investment fund and if so, can these be mitigated or addressed?

The advantages to having listed and unlisted share classes within one fund relate to reduced cost (by virtue of the pooling of assets) and the promotion of investor choice.

We would suggest that having listed and unlisted share classes does not create unfairness between investors. Investors have different requirements/criteria for investing. Specific investors who wish to avail of intraday liquidity are likely to buy ETF shares class while other investors who do not require that level of liquidity but still wish to avail of the other features of an ETF are happy to invest in an unlisted share class. Investors are free to choose which share classes they wish to invest in and as such offering both forms of shares within a fund does not contravene shareholder rights.

The ability to have two types of share classes within the same fund reduces the need to create additional funds purely for the purpose of having unlisted/listed share classes which will result in economics of sale for investors and thereby reduce costs.

We would also note that the ESMA paper entitled "The ESMA Guidelines on ETFs and other UCITS issues" acknowledge that some classes may trade and others not:

“A UCITS ETF is a UCITS at least one unit or share class of which is traded throughout the day on at least one regulated market or Multilateral Trading Facility with at least one market maker which takes action to ensure that the stock exchange value of its units or shares does not significantly vary from its net asset value and where applicable its Indicative Net Asset Value".

This would seem to support the view that funds should be permitted to have both listed and unlisted share classes within the same fund.

SECTION II – DISTINCTIVE ETF RISK FACTORS

QUESTIONS

G. Are conflicts of interest rules effective for dealing with concentrations of activities within an ETF provider’s financial group (e.g. group entities could act as promoter, investment manager, AP and swap counterparty or SFT counterparty)? Are other approaches worthy of consideration?

As a starting point it is important to note that in many cases ETFs are set up with a similar concentration of activities as a standard mutual fund, with the AP activity being the main difference.

The majority of ETFs are structured as UCITS funds and as such are required to comply with the UCITS Regulations and the Central Bank's rules in respect of UCITS, including the UCITS conflict of interest rules. As such, the relevant ETF providers are well versed in managing such conflicts and have put in place detailed and robust policies and procedures in respect of disclosure and required management of such conflicts. In particular, it is noted that disclosures are made through the ETF documentation, including the prospectus and the financial statements and the directors are required, at all times, to ensure any connected party transactions are conducted at arms' length and in the best interests of the shareholders of the relevant ETF.

Accordingly, we would be of the view that the UCITS regulations already provide sufficient rules in relation to the managing of conflicts of interests and that no additional requirements or obligations are required in the context of ETF products.

H. Could multiple counterparties expose ETFs to unintended risks and consequences?

This would seem unlikely as generally diversification of counterparties/trading parties dilutes rather than increases risk.

The majority of ETF providers we work with have multiple counterparties and utilising multiple counterparties is their stated preference.

I. Some academic research suggests that if a synthetic ETF experiences counterparty default, the synthetic ETF is more likely to be able to deliver the performance of its underlying index if the collateral received is correlated to that index. Should collateral received (where a funded model is used) or securities purchased (where an unfunded model is used) be correlated to the index being tracked? Is this practical, particularly for example where the index tracked by an ETF is comprised of securities which may be relatively expensive to access? Is collateral quality sufficiently regulated and disclosed?

Our view is that asset managers are best placed to determine what type of collateral is most appropriate to the relevant asset class. As such, we would be of the view that prescribed or mandated collateral is not appropriate.

The UCITS regulations already provide detailed requirements in respect of the form, type and use of collateral and ETFs should not be subject to additional form of collateral requirements. The purpose of collateral for synthetic ETFs (and indeed most products) is to ensure that the investor does not lose their capital in the event of default of the counterparty; using collateral for continuation of the investment requirements of the fund will not always be possible and should not be viewed as the intended use of collateral.

A number of industry participants were of the view that requiring collateral to be correlated to an index could be viewed as forcing synthetic ETFs to in effect convert to physically replicating ETFs, leading to lack of choice in the market. The priority of such industry participants was more focused on liquidity, as against correlation to the index, of such assets with the appropriate stress testing and risk assessment being undertaken in accordance with the UCITS requirements.

Industry participants also noted that as a practical matter, while it may be possible for ETFs tracking equity or fixed income indices to receive collateral which is correlated to the index these ETFs track, this may not be the case for other types of ETFs, such as those tracking commodity indices. In particular it may not be possible to achieve correlation to these securities and such

collateral may not be liquid enough. As such it may not be appropriate, or be in investor interests, to focus on correlation maximisation in certain cases.

SECTION III – PARTICULAR TYPES AND FEATURES OF ETFS

QUESTIONS

J. Are active strategies appropriate for "housing" in an ETF structure and if so, is there a limit to the type of strategy that would be appropriate? If the ETF structure provides opportunities for managers to achieve scale is there a downside to this where the strategy is active (or, if scale is achieved, its potential impact is not otherwise capable of being ascertained)?

Once appropriate levels of transparency and disclosure are set out in offering documentation, feedback we have received is that industry participants are of the view that 'Active' strategies are appropriate for ETFs.

In terms of appropriate strategies, once any proposed strategy meets the requirements and obligations of the UCITS regulations the view provided to us is that there should be no further limitations placed on the type and form of strategies which "Active" ETFs may engage in.

K. Similar to the question posed in Section I, is portfolio transparency fundamental to the nature of an ETF or are there are other mechanisms which achieve the same goal as transparency? In the context of an active ETF, is transparency essential in order to achieve a liquid market and to facilitate efficiency in pricing?

Portfolio and pricing transparency are key tenets of the ETF brand and have been instrumental in attracting investors to ETFs. Portfolio transparency is also key to Market Markers and Authorised Participants.

If Market Markers and Authorised Participants do not have sufficient access to information on underlying fund positions this may affect their ability to negate risk and as a result the spreads which may be offered may need to widen to deal with risk pricing.

While this is not a significant issue for passive ETFs, lack of portfolio transparency may cause concern for "Active" ETF. Due to the importance of Market Makers, it is important to balance the needs of portfolio transparency without resulting in "Active" ETF managers being required to disclose their proprietary trading strategies.

In this regard, certain participants suggest that Market Markers and "Active" ETF managers may enter into separate arrangements or disclosure agreements to provide Market Makers with sufficient information for the purposes of being able to create the required market, without jeopardising such proprietary information. It is also noted that the rules of certain exchanges on which ETFs are traded require that the portfolio composition be displayed on the 'Active' ETF Managers' website on a delayed basis.

SECTION IV – ETFs AND MARKET LIQUIDITY

QUESTIONS

L. Some commentators are concerned that ETFs are tracking indices of underlying stocks which are not sufficiently liquid to match the intra-day liquidity on the secondary market which the ETF offers. This statement is quite simplistic and does not, for example, reflect that there may be much secondary market activity but very little primary market activity. UCITS, including UCITS ETFs, are subject to general liquidity management rules which should ensure that ETFs track indices of underlying stocks that are sufficiently liquid to allow the ETF to meet creation and redemption requests. Is this sufficient? What liquidity practices do ETFs follow? Are there other practices that might be appropriate for ETFs?

The liquidity of an ETF is linked to the liquidity of its underlying assets.

ETF managers utilise various liquidity controls and continually monitor the liquidity of underlying asset and the ability for fund assets to be sold in stress market situations. ETF Managers may employ value adjustments, gates, anti-dilution levies and other liquidity tools to ensure the overall liquidity of their product.

As stated above, ETFs are by and large structured as UCITS. Under the UCITS regulations managers have an obligation to ensure that a UCITS product does not invest in an instrument which comprises the UCITS' own liquidity. This also applies to ETFs. We are of the view that the general liquidity obligations of the UCITS regulations are sufficient for liquidity management purposes of an ETF.

M. One of the potential impacts from greater investment in index-tracking ETFs is decreased informational efficiency of underlying securities as well as increased non-fundamental volatility of underlying securities. However, these may not be risks per se or, at any rate, may not be risks that ETF providers or regulators can mitigate, manage or eliminate. Is this assessment correct or could measures be taken to address this impact?

Feedback we have received does not suggest that this has caused a significant impact within the markets and that market forces should be allowed to manage this situation. ETF trading is still quite small relative to overall equity trading and as such it is difficult to envisage ETF having a significant negative effect in this manner.

SECTION V – OTHER CONSIDERATIONS

QUESTIONS

N. One of the key issues in the context of support by ETF providers is investor expectation. Investors' views about purchasing ETFs and their ability to sell may be informed by whether or not the ETF provider will support the ETF in the face of stress events. There are, however, divergent views amongst ETF providers as to whether they would support their ETFs. Is provider support a desirable objective?

This is a risk all funds are subject to and as such we do not believe this should be discussed separately in the context of ETFs.

O. The Central Bank is primarily interested in risks associated with Irish authorised ETFs and European ETFs more generally yet much of the available academic literature, analysis and data relates to US ETFs. The concern is that any analysis of Irish authorised and European ETFs may be adversely affected by reliance on US-centric materials. Is this valid? Are Stakeholders aware of EU ETF specific information that might lead to different conclusions? Will MIFID II resolve these data issues?

The US market is far larger; less fragmented and has a higher number of retail investors. Therefore US centric materials are unlikely to be consistently and reliably reflective of the European market.

We expect additional trading information will be available to the Central Bank following the implementation of MiFID II and based on current understanding of MiFID II obligations the Central Bank is likely to also obtain further information on trading, as well as target markets of distributors and brokers.

P. Does the nature of an ETF have peculiarities (and therefore risks) that neither the UCITS nor MiFID regulatory frameworks, either in isolation or in conjunction, address and which we have not examined here?

Not in our view.

Many thanks for requesting industry participation in regard to this topic and if we can be of any further assistance please do not hesitate to contact us.

Yours faithfully

Maples and Calder