Central Bank of Ireland – Discussion Paper – Exchange Traded Fund

Section I Questions – ETF Dealing

Ref	CBI Question	Computershare Response/Comment
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? Should remuneration models of OLPs (and if relevant APs) be disclosed?	No comment
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?	No comment
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?	Secondary market investors could deal directly with an ETF if there was an avenue to place instructions with the Administrator directly (online, fax, phone etc). Settlement would take place on the CSD delivery versus payment. This mirrors the AP creation/redemption process whereby APs interact directly with the Administrator to receive/deliver shares. We understand that this may create difficulty for the Administrator and fund accounting so all parties would need to be in agreement but the infrastructure to process the transactions is in use today. We are not aware of any other mechanism of disposal in stress conditions.
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?	No comment
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?	No comment
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 benefit of having listed and unlisted share classes within the same investment fund gives a greater choice to Issuers and Investors. If both share classes were open to all investors and the differences in share classes clearly communicated the perceived unfairness issue could be resolved. The investor could make the choice on which class to invest in.

	Additional question Page 39: 80. Is there an "unfairness" here that could be addressed by arranging for unlisted shares to be issued into and settled in a settlement system? Views are requested as to whether this is proportionate and whether there could be undesirable consequences arising from such a proposal?	Yes, If unlisted shares were issued into a settlement system they could take advantage of the efficiencies and automation of that settlement system removing the perceived unfairness related to settlement. For the unlisted share class investors would be able to take advantage of automated settlement (intraday), greater liquidity and it would harmonise the holding structure with other investment products (ETFs, Ordinary shares etc). Issuers would benefit from access to greater pools of liquidity, centralised settlement and further cost benefits in having the AML/KYC completed at CSD level. This would open the products up to a wider market and encourage further investment. This is a key evolutionary step for unlisted shares and comes with numerous benefits both commercially and operationally for all stakeholders. A further enhancement would be to allow direct redemptions facilitated through the fund Administrator. If logistically this is possible it could mitigate concerns over liquidity during times of market stress. As noted above, this would need to be agreed with the Administrators as we understand it could pose some difficulties.

Section II Questions – Distinctive ETF risk factors

Ref	CBI Question	Computershare Response/Comment
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?	No comment
H.	Are multiple counterparties necessary, or appropriate for ETFs? Could they expose ETFs to unintended risks and consequences?	No comment
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?	No comment

Section III Questions - Particular types and features of ETFs

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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)?	No comment
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?	No comment

Section IV Questions – ETFs and market liquidity

Ref	CBI Question	Computershare Response/Comment
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?	No comment
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?	No comment
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?	Dependency on ETF providers and APs to provide services in stressed market conditions may not be necessary if ETF Issuers or Administrators were agreeable to the facilitation of direct redemptions from market participants. This could be achieved if participants dealt directly with the fund (through the Administrator) within the CSD and redeeming shares could be performed on a delivery versus payment basis similar to the standard redemption process with APs. Investor views regarding ETF provider support in the face of stress events may influence their investment decisions but is only one of a number of factors. The structure of the fund with regard to the Issuer's choice of primary settlement venue can impact on costs borne by shareholders and arrangements regarding exercise of rights. Non-domestic primary settlement arrangements can require share-blocking during the voting period for general meetings, which discourages participation/engagement and also contributes to liquidity concerns. We believe there should be greater transparency in this area combined with development of best practice. Any factor regarding the structure of the fund that impacts the investor financially or otherwise should be clearly communicated, and should be done at both an institutional and retail level to cater for different investor types.

Section V Questions – Other considerations

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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 our 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?	No comment
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 has not been examined here?	Something that should be noted is the balance of the requirements of the APs versus the average Investor. Both parties (APs & Investors) try to make a return from an ETF in different ways and have different interests in the post-trade settlement process. The APs make a return due to differences in pricing and efficiency in trading. They do not generally hold shares beyond the Creation/Redemption cycle whereas investors generally buy shares to hold them for longer periods. Both parties are essential to the ETF Ecosystem but conflicts can arise when fund structures prioritise the interests of one party over the other. This could create risk (or unfairness) that would need to be addressed.