

# Irish UCITS and Exchange Traded Funds

## What is an ETF?

An Exchange Traded Fund (ETF) is an investment vehicle that is structured to enable investors to track a particular index through a single liquid instrument that can be purchased or sold on a stock exchange. An ETF offers characteristics of an investment fund, such as low costs and broad diversification but also characteristics more commonly associated with equities, such as access to real time pricing and trading. ETFs generally function as index tracking funds, i.e. they provide their investors with an exposure to the securities in an index, while the listing on an exchange means the ETF shares can be bought and sold by investors on an intra-day basis and using real-time pricing, much like an equity security.

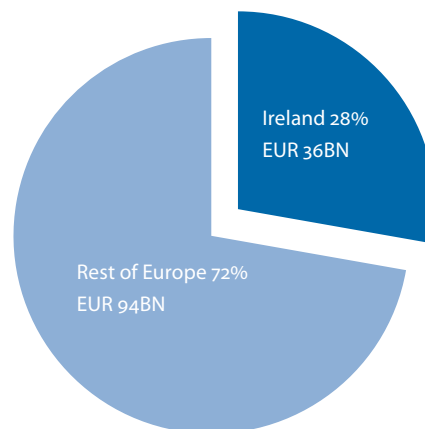
## Product Features

- » Investment product representing a basket of securities that track a specified index.
- » An ETF acts like a fund and trades like a share. Shares in the ETF are traded throughout the day on exchanges and are continuously re-priced.
- » ETFs are available to both retail and institutional investors.
- » An ETF can be structured as a unit trust or a variable capital company (VCC), with VCC being the most frequently used structure.
- » An ETF can be set up as a UCITS or non-UCITS fund – most ETFs are structured as UCITS to avail of the UCITS retail ‘passport’.
- » ETFs can be listed on the Irish and other stock exchanges.

## Advantages

- » **Low Costs.** The decreased level of portfolio transactions means that the ETF is subject to lower transaction costs than a traditional index tracking fund.
- » **Diversification and choice.** Investment in an index tracking product will automatically provide investors with diversification as available ETFs cover indices on most major equity markets.
- » **Transparency.** The components of the basket for the purchase or sale of creation units are published on each dealing day.
- » **Liquidity.** Intra-day trading at real-time pricing enables investors to buy and sell their shares at any time throughout the day.
- » **Shorting and margin.** As an ETF share is an exchange traded security, it can be treated by investors similar to an equity security and so can be sold short or purchased on margin, subject to regulatory restrictions that may apply.
- » **Flexibility.** ETFs attract both active traders and long-term investors. Investment managers may utilise ETFs where they find it difficult to out-perform a certain market / market sector.
- » **Treaty Access.** Ireland has an extensive and growing network of tax treaties with key jurisdictions, e.g. Irish domiciled ETFs have access to the US double taxation treaty where the fund is demonstrated to be trading.

## Ireland as a domicile for European ETFs



Total Assets of European ETFs = EUR 130 billion

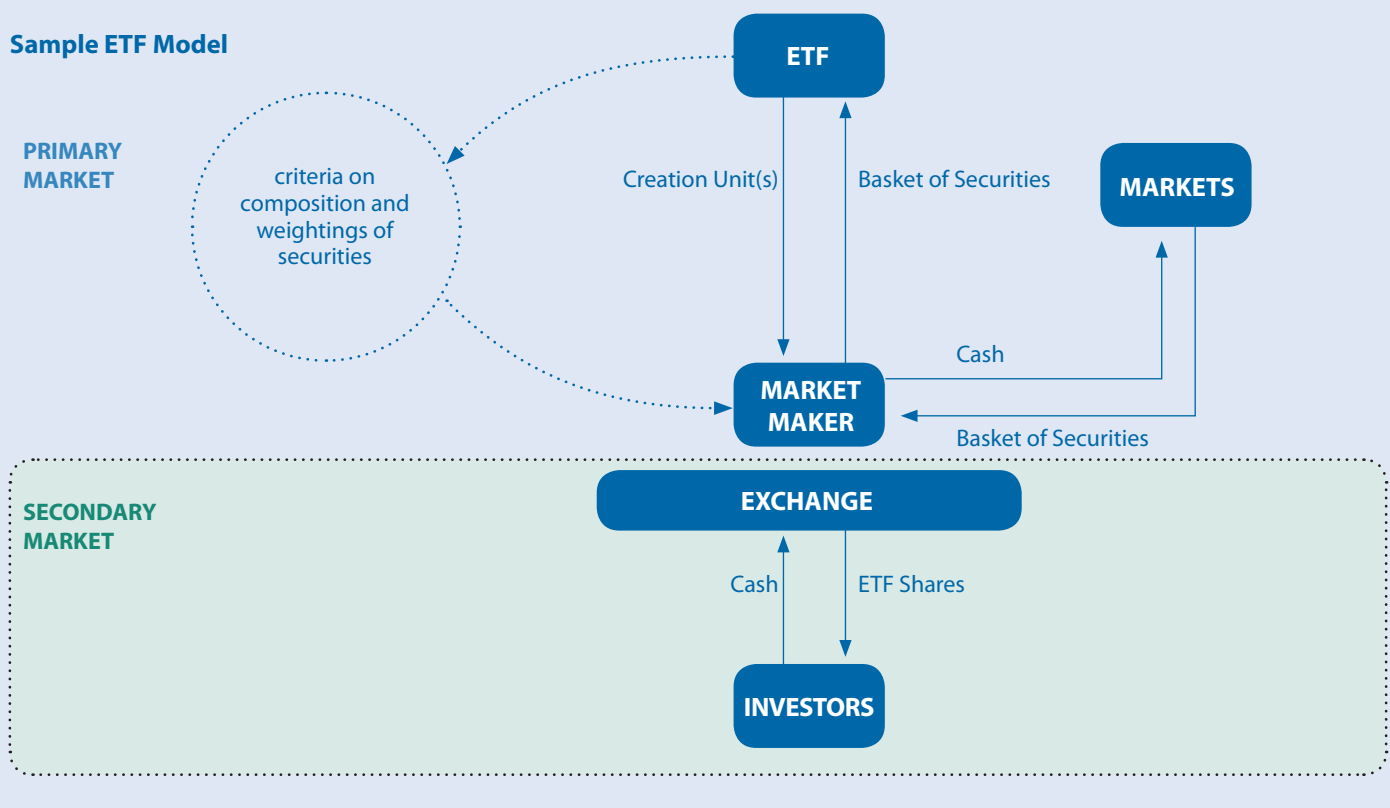
Source: Barclays Global Investors & IFIA, July 2009

## Why set up an Irish ETF?

- » Leading European fund domicile for internationally distributed ETFs.
- » Irish fund administrators have strong expertise/customised systems for servicing ETFs.
- » Fastest growing international fund domicile for UCITS over the past five years.\*
- » 80% of Irish domiciled investment vehicles are UCITS.
- » Ireland has over 20 years of experience as a fund administration centre.
- » The Irish legal framework provides for the role of the Trustee – an extra level of investor protection.
- » Availability of wide ranging legal/product/tax/audit expertise.

\* The net assets of Irish domiciled UCITS funds grew by 51% between 2004-2008; The European average for the same period was 10%. Source: Central Bank of Ireland & EFAMA

## Sample ETF Model



### Setting up an Irish UCITS ETF

Many ETFs in Ireland have been set up under the UCITS regime, thereby benefitting from the principle of mutual recognition within the EU and a high level of acceptance by regulators worldwide. As with any other UCITS product, an ETF set up as a UCITS would have to comply with the various UCITS investment rules, including those relating to index replication. In brief the UCITS investment restrictions would cover:

- (i) 5/10/40 exposure concentration rule
- (ii) 20% and 35% Rule
- (iii) Index replication
- (iv) Sufficient diversification
- (v) Adequate benchmark
- (vi) Publication
- (vii) Eligibility of assets comprising the index

### TA and Clearing/Settlement/Depository Systems

Trading and settlement of ETF shares in the secondary market is facilitated through one or more clearing and settlement systems, e.g. CREST/Euroclear/Clearstream.

- » Some of these systems provide for the trading and settlement of shares in dematerialised form, i.e. shares which are transferred without requiring the transfer to be evidenced by written transfer of ownership.
- » If the shares are to settle on an electronic clearing system, the ETF must appoint a registrar and transfer agent or depository which is a member of the electronic clearing system.

### Why UCITS and ETFs

- » UCITS - global brand distributed in over 50 countries
- » Transparent, tried and tested regulation
- » Attractive for institutional and retail investors
- » Focus on risk management & investor protection
- » Flexibility to accommodate alternative investment strategies (leverage and short exposure)
- » Continuous evolution – UCITS I/UCITS III and UCITS IV (2011)

### Listing & trading on the Irish Stock Exchange

- » The Irish Stock Exchange (ISE) is the leading exchange globally for listing investment funds and has an active market in listing and trading Irish UCITS ETFs.
- » The ISE's efficient, low cost listing process minimises the time and resources required for an EU Regulated Market listing.
- » The ISE's traded markets provide opportunities to widen distribution channels at a low marginal cost in terms of listing fees.
- » World class trading and post-trade infrastructure and leading specialist ETF market making firms in place.
- » Can work with issuers and expert Irish advisers to facilitate time to market for new product launches.
- » European ETFs listed on the ISE can apply directly to the London Stock Exchange for admission to trading on its Main Market without needing to obtain a separate LSE listing. This cost efficient admission process is available only to ETFs already listed on an EEA stock exchange.