



U.S. Fund Managers Launching ETFs in *Europe and the UK*

What Do You Need To Know?



Exchange-Traded Funds (ETFs) continue to be incredibly popular investments for both active and passive investors alike. Year after year, assets invested in ETFs have climbed to increasingly loftier heights.

With ETF and exchange-traded product (ETP) assets in Europe topping \$1.5 trillion in 2021¹, according to data released by ETFGI, it is a natural next step for U.S. fund managers to look across the pond for opportunity. However, the journey to Europe is not without pitfalls and key differences between the two locations could, if not skillfully navigated, obstruct and challenge managers.

EMEA ETF / ETP Market¹



1,927

ETFs as of YE 2021



689

ETPs as of YE 2021



\$1.5 trillion

in ETF Assets



\$94 Billion

in ETP Assets



24.7%

increase in assets from 2020 to 2021



\$3 trillion by 2026²

ETF Assets are expected to reach

¹ www.etfgi.com

² Based on 60% of survey respondents, PwC's ETF 2026: The next big leap, <https://www.pwc.com/gx/en/industries/financial-services/publications/etf-2026-the-next-big-leap.html>

The Three Major Differences Between U.S. and European/UK³ ETF Markets

Many U.S. fund managers are unaware of what it takes to launch a successful ETF in Europe and the UK. Duplicating and listing an existing U.S. ETF in one or more jurisdictions is not enough to raise assets. There are critical differences in both the structure of the market and the process for launching a product that must be taken into consideration.

1 *Institutions Drive Demand*

Unlike in the U.S., investors in the UK and Europe aren't self-directed, meaning institutions are almost the sole source of demand. This institutional bias requires a key shift in a fund's marketing and distribution strategy, especially for U.S. funds that are driven by retail popularity.

2 *Multiple Exchanges and Settlement Systems*

Throughout Europe and the UK, 27 exchanges trade across 22 countries. That can create pockets of liquidity that present headwinds to the growth of a fund. As a result, there are now two methods for settlement:

2

- **Local clearing** – In this approach the issuer settles in the local settlement structure where the ETF is listed.
- **International Central Securities Depository (ICSD)** – This model allows for the use of a single clearing house for ETF settlement across multiple markets. The model removes many of the challenges experienced by liquidity providers in the past. This method is used by the vast majority of ETF issuers.

Europe's complex web of exchanges and settlement systems can pose another potential challenge to U.S. fund managers who are accustomed to a simpler settlement process.

3 *Different Structure*

3

In Europe, ETFs are structured as Undertakings for Collective Investment in Transferable Securities (UCITS) versus the familiar U.S. trust structure. While this change in structure must be considered, it also provides a unique benefit. The UCITS structure allows funds to be sold on a retail basis to any investor within the European Union, under a unified regulatory framework. In addition, the UCITS brand is a globally recognized product.

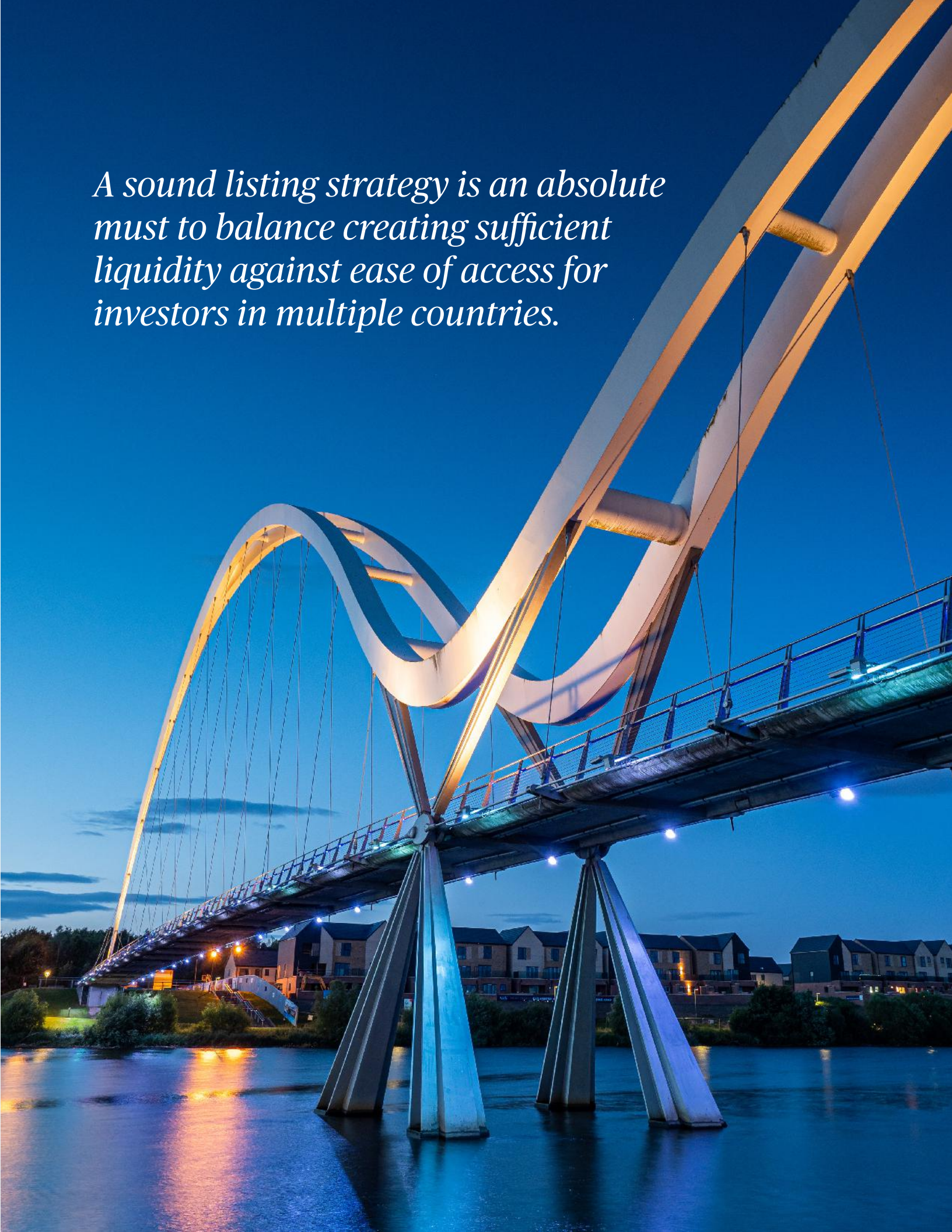
Due to European watchdog regulations, funds in the UK and Europe are required to use a depository. Usually domiciled in Ireland or Luxembourg, the depository acts as a fiduciary to make sure the assets are accurate per the fund mandate, and where they should be – with a custody bank. They also provide due diligence to ensure that a fund's net asset value (NAV) is tracking properly.

³ European Market referenced in this paper is defined as European Economic Area (EEA) and Switzerland.

Notable Differences for U.S. Fund Managers

	U.S. ETF	EUROPEAN/U.K. ETF
Structure	U.S. '40 Act	UCITS/ICAV
OTC vs. Exchange	30:70	80:20
Market Making	No direct incentives. Possible to fund indirect exchange incentives	Dedicated market makers usually directly compensated
Market Dealing	In-specie where possible (due to U.S. tax treatment) with cash dealing limited to restricted markets	NAV Plus cash dealing with very limited in-specie. Directed trading program essential. switches between share classes allowed
Order Taking	Centralized order taking available	Multiple order platforms based on service providers and issuers
Settlement	NSCC/CNS Settlement	ICSD or Local Clearing house

A sound listing strategy is an absolute must to balance creating sufficient liquidity against ease of access for investors in multiple countries.



Seven Key Steps to Launch an ETF in the UK and Europe

1. Establish Domicile

- Where will the ETF be domiciled to maximize distribution?
- What are the tax implications?



3. Select a Settlement System

- Is local or international settlement needed?



5. Select Service Providers

- What service providers are required and approved based on domicile?



7. Obtain Fund Approval



2. Determine Listing Strategy

- In what jurisdiction will you list your ETF to balance access and liquidity?



4. Establish Fund Structure

- What is the best fund structure to maximize your strategy?



6. Documentation

- What documents need to be in place?
- What needs to be drafted or filed?



LAUNCH

1. Establish Domicile

Over 66% of all UK/European ETFs are domiciled in Ireland due to its recognition for cross-border distribution and its beneficial tax treaty access for U.S. equities. Ireland is home to six of the top ten ETF issuers in Europe, and has been at the forefront of product, operational and infrastructure development.⁴ As the second largest European domicile for ETFs and a significant home for the cross-border SICAV/SICAF market, Luxembourg can also provide a strong base for international distribution of SICAV/SICAF funds.

2. Determine Listing Strategy

Perhaps the most important consideration when setting up a European ETF is to determine the listing strategy. Most funds choose to initially list on the London Stock Exchange and the German Börse—if they don't choose both, it is more difficult to attract investors in the unlisted region. Other popular listing jurisdictions include France, Switzerland, Italy and the Netherlands. However, using a UCITS structure provides the ability to market a fund in additional global markets (without having to list locally) – for example the Middle East, South Africa, Singapore and Taiwan. It is key to strike the correct balance between enabling local access for investors versus splitting your product liquidity across multiple exchange listings.

⁴ https://irishfunds-secure.s3.amazonaws.com/1551880566-5648-Irish-Funds-Why-Ireland-Brochure_EU_WEB.pdf

3. Select a Settlement System

Local clearing houses allow for settlement in that local market where the ETF is listed. However, the majority of new issuers are now using the International Central Securities Depository (ICSD). The ICSD centralizes the settlement of all ETF shares across multiple markets.

4. Establish Fund Structure

There are two main fund regimes in UK/Europe: UCITS and the newer AIF (Alternative Investment Funds), governed by the Alternative Investment Fund Managers Directive (AIFMD). The vast majority of ETFs in UK/Europe are structured as UCITS funds. This provides ease of registration and distribution across multiple countries around the globe.

The AIF structure has yet to be used to list an ETF. However, structuring a fund as an AIF could enable a fund to employ strategies that are not allowable under UCITS.

In Ireland, all new ETFs are structured as an ICAV. The ICAV is a new corporate vehicle that sits alongside the public limited company (PLC) and provides a tailor-made corporate fund vehicle for both UCITS and AIFs. The ICAV helps minimize the administrative complexity and cost of establishing and maintaining collective investment schemes in Ireland.

5. Select Service Providers

All funds require a number of service providers to be approved in advance of the launch. In Ireland, for example, these providers are approved by the Central Bank of Ireland (CBI). These are the essential providers:

- An Irish-based depository
- An Irish-regulated external auditor
- An Irish-based administrator (central administration)
- A management company
- Two Irish resident directors

Luxembourg requires a similar list of service providers, subject to approval by the Commission de Surveillance du Secteur Financier (CSSF).

In the case of UCITS, if the fund promoter and the investment manager are different, they must also be approved by the CBI. For AIFs, the investment manager must obtain approval as an AIFM from the CBI.

6. Documentation

There are several documents that must be established when launching a European ETF. Several of these should be managed and drafted by the fund's legal council and filed with local regulators as needed. Documentation includes:

- **Prospectus and fund supplements** contain the fund's investment objectives, risks, charges and expenses, performance, distribution policy, management and service provider information.
- **Business plan** is a document setting out the ETF's future objectives and strategies for achieving them.
- **Key Investor Information Document (KIID)** is a two-page pre-sale document mandated by the European Commission for all UCITS investment funds which are marketed and offered within all European Union countries. This document provides retail investors with standardized, easy to understand investment information and allows an investor to directly compare UCITS funds by clearly displaying the essential characteristics necessary to understand the nature and risks associated with investing.
- **Authorized Participant Agreement** is a written agreement between the ETF issuer and financial institutions under which such institution is appointed to act as an "Authorized Participant (AP)," distribution agent or in a substantially similar function, allowing them to purchase and redeem shares directly with the ETF in large blocks of shares.
- **Custody/Depository Agreement, Administration Agreement** is a contract between the ETF and a third party, where the third party provides custody, depository, accounting and/or administration services to the fund.
- **Global Share Certificate** is a written document signed on behalf of a corporation that serves as legal proof of ownership of the number of shares indicated.

7. Obtain Fund Approval

Upon receiving approval for the service providers, the promoter or investment manager can then seek approval from the CBI for the fund documentation.

The Right Custodian Bank Can Be a Differentiator

European markets present an excellent opportunity for growth to U.S. fund managers who can successfully navigate the differences between the two markets. However, having a custodian bank that can act as a partner and advisor can provide invaluable assistance during the process. These are the key points of distinction fund managers should look for when selecting a custodian bank:

- How robust are their services across the ETF lifecycle? Can they manage collateral? Help with securities lending?
- Do they have strong relationships with all Authorized Participants in each jurisdiction?
- Do they provide structuring services for secondary markets and listing agency services?
- Are they supportive of innovative product strategies and driving technology advancement of the industry?
- Are they able to provide the best on-exchange experience for investors?
- Do they have the experience and infrastructure to set up your listing in global jurisdictions?

BNY Mellon ETF Services

BNY Mellon has helped launch more than 175 ETFs in the UK and Europe over the past 20 years, including the very first European ETFs. Our ETF Services team works closely with clients at every stage of the ETF lifecycle, offering deep industry perspectives and hands-on support to address their most complex needs. Our understanding of the infrastructure and regulations across exchanges and our deep experience and knowledge of the processes underpinning the product allow us to consult and guide our clients as they enter new markets and leverage the opportunities available to them.



**Contact us to learn how we can help you enter
the UK and Europe ETF Market.**

U.S.

Jeremy Kross
Business Development
+1 212 815 7198
jeremy.kross@bnymellon.com

EMEA

Stephen O'Brien
ETF Product Management
+ 353 1 900 2341
stephen.obrien@bnymellon.com

www.bnymellon.com

BNY Mellon is the corporate brand of The Bank of New York Mellon Corporation and may be used to reference the corporation as a whole and/or its various subsidiaries generally. This material does not constitute a recommendation by BNY Mellon of any kind. The information herein is not intended to provide tax, legal, investment, accounting, financial or other professional advice on any matter, and should not be used or relied upon as such. The views expressed within this material are those of the contributors and not necessarily those of BNY Mellon. BNY Mellon has not independently verified the information contained in this material and makes no representation as to the accuracy, completeness, timeliness, merchantability or fitness for a specific purpose of the information provided in this material. BNY Mellon assumes no direct or consequential liability for any errors in or reliance upon this material.

BNY Mellon will not be responsible for updating any information contained within this material and opinions and information contained herein are subject to change without notice.

BNY Mellon assumes no direct or consequential liability for any errors in or reliance upon this material. This material may not be reproduced or disseminated in any form without the prior written permission of BNY Mellon. Trademarks, logos and other intellectual property marks belong to their respective owners.

© 2022 The Bank of New York Mellon Corporation. All rights reserved.