



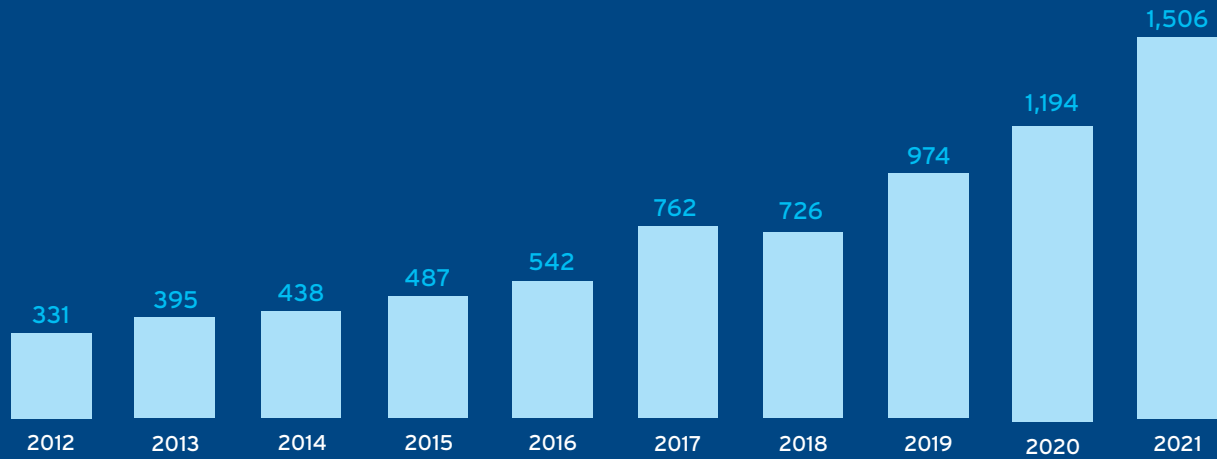
# How to Launch a European ETF

Securities Services

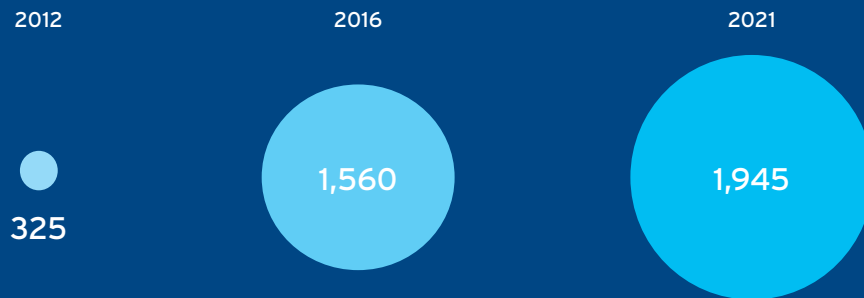


## European ETFs at a Glance

Assets Under Management  
Billions USD



Number of ETFs



# So You Want to Launch a European ETF?

With over \$1 trillion in assets, Europe is the world's second largest Exchange-Traded Fund (ETF) market. However, ETFs represent only 6% of the total European fund market, compared to 20% in the US. The relatively untapped potential of the European ETF market makes it attractive to existing ETF providers looking to expand their global footprint and new entrants trying to avoid the stiff competition in the US market.

Launching an ETF in Europe comes with unique nuances that can be challenging for even the most seasoned ETF manager. With over 20 exchanges and clearinghouses the market is extremely fragmented, compared to the straightforward nature of the US market. Further complicating things is the fact that approximately 70% of European ETF trading is done over-the-counter. All of this means that ETF managers have additional liquidity and settlement timing considerations to factor into their European models.

This playbook will help you understand the dynamics of the European ETF market and the important considerations you should consider when establishing a European ETF.

# Key Regulators

The regulation of ETFs is driven at the European and local market level.

## Europe

The European Securities and Markets Authority seeks to improve the functioning of financial markets, strengthen investor protection, increase cooperation amongst national regulators, and ensure harmonization of rules across the EU.

## Local Regulators

Local regulators are responsible for implementing and enforcing European regulations along with overseeing the local fund markets, including authorizing new fund launches. Key local regulators include:



The Central Bank of Ireland



Commission de Surveillance du Secteur Financier




# Key Regulations

European ETFs are not regulated under a specific framework. Instead ETFs are governed by the Markets in Financial Instruments Directive (MiFID) and the Undertakings for Collective Investment in Transferable Securities (UCITS).

- **MiFID** is the regulatory framework for investment intermediaries and the trading of financial instruments. Under MiFID, firms are required to report ETF transaction details such as trade volume and price.
- **UCITS** is the regulatory framework for European investment funds. The use of the ETF label is restricted to UCITS funds.

# Key UCITS Rules

UCITS funds have a number of investment restrictions designed to mitigate risk and ensure that funds invest in liquid securities. There are also specific manager remuneration rules that are designed to align a portfolio manager's risk appetite with that of the fund. These rules often differ from the rules of other domiciles, so it's important that managers understand the differences.

	<p><b>Cash/Deposit</b></p> <p>No more than 20% of the Net Asset Value (NAV) can be invested in cash/deposits with the same credit institution.</p>
	<p><b>Remuneration</b></p> <p>At least 50% of the manager's variable remuneration must be paid in non-cash and at least 40% of it must be deferred for at least 3 years.</p>
	<p><b>5/10/40</b></p> <p>A maximum of 10% of UCITS net assets may be invested in listed securities and money market instruments issued by the same body. Exposures greater than 5% to single issuers may not exceed 40% of NAV.</p>



### **Asset Eligibility**

Direct investment in illiquid investments are prohibited including:

- real assets
- commodities
- private equity

Investments in non-UCITS funds is tightly restricted and investments in US ETFs is prohibited.

There can be no more than 5% exposure to a single over-the-counter derivative counterparty, with a 10% limit for certain credit institutions.



### **Short Selling**

Physical short selling is not permitted.



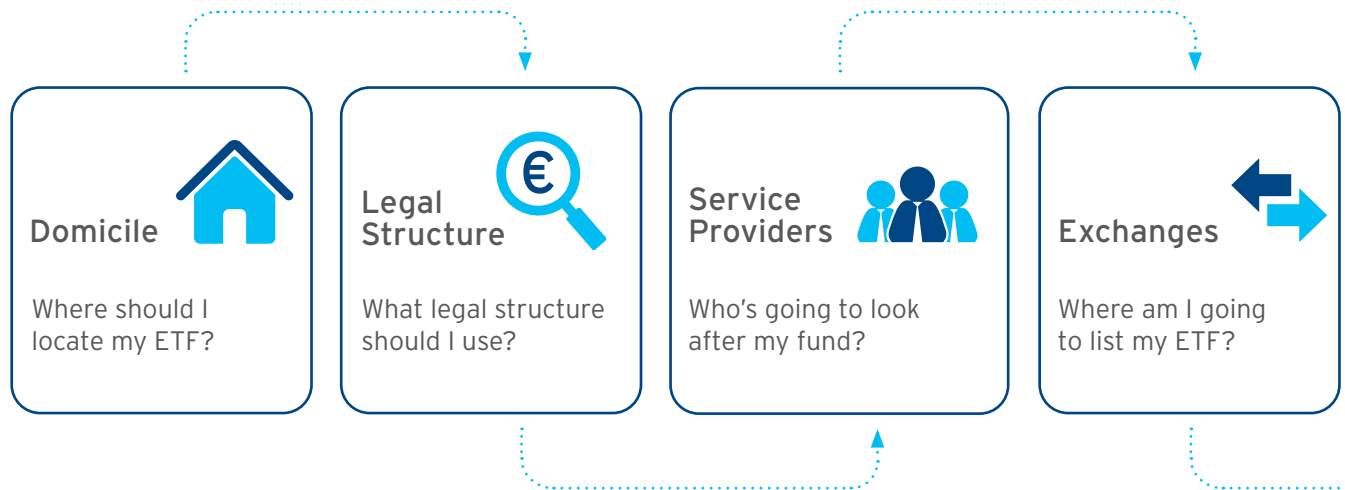
### **Control Rule**

A UCITS fund may not acquire more than the following limits:

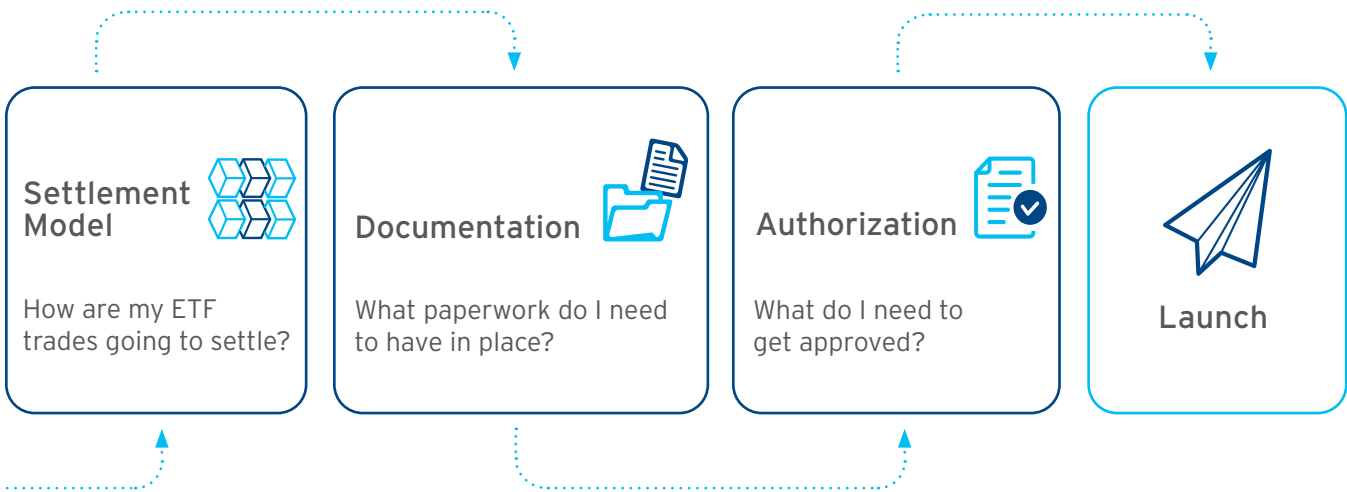
- 10% of the non-voting shares of the same issuer
- 10% of the debt securities of the same issuer
- 25% of the units of the same UCITS funds and/or other funds
- 10% of the money market instruments issued by the same issuer

# How to Launch a European ETF

When launching an ETF, there are a few initial decisions you'll need to make. Selecting your domicile, fund structure, and service providers needs to be done in order to receive the authorization.







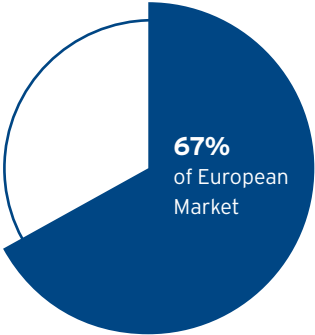
# Domicile

For firms pursuing a cross-border distribution strategy, there are two main domiciles: Luxembourg and Ireland. Between them, they account for 90% of the European ETF market. Both have developed strong reputations as global fund hubs and have local ecosystems to support cross-border ETFs.

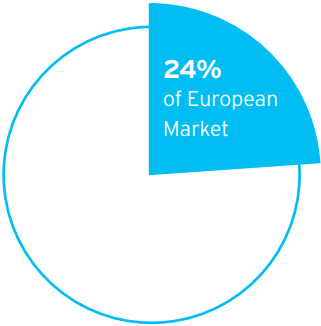
**When selecting which domicile to use, there are some key considerations:**

- Distribution strategy and location of investors
- Native language(s) spoken in domicile and cultural alignment
- Ability to leverage relationships with current service providers
- Location of asset manager
- Legal system, e.g. Common vs. Civil Law

Ireland



Luxembourg



Source: ICI (as of 31 December 2021)

# Legal Structure

The legal structure of the ETF drives a number of factors such as the governance and contractual arrangements. Ultimately, the decision on legal structure comes down to a combination of distribution strategy, investor preference, and specific product requirements. Both Ireland and Luxembourg offer a variety of legal structures.

## Ireland

### Corporate

- **Variable Capital Company** is an open-ended investment company structured as a public-limited company and subject to Irish company law requirements.
- **Irish Collective Asset-Management Vehicle (ICAV)** is a vehicle designed specifically for investment funds and has its own legislative regime, avoiding compliance with certain requirements in European and Irish company law. The ICAV can elect to “check the box” for US tax purposes.

### Trust

- **Unit Trust** is an investment fund established under a trust deed between the management company and the trustee. The trustee acts as the legal owner of the fund’s assets on behalf of the investors.

 Luxembourg

### Corporate

- **Société d'Investissement à Capital Variable** is an open-ended investment company with variable capital and is generally organized as a public-limited company (S.A.) or a European Company (S.E.).
- **Société d'Investissement à Capital Fixe** is an investment company with fixed-share capital.

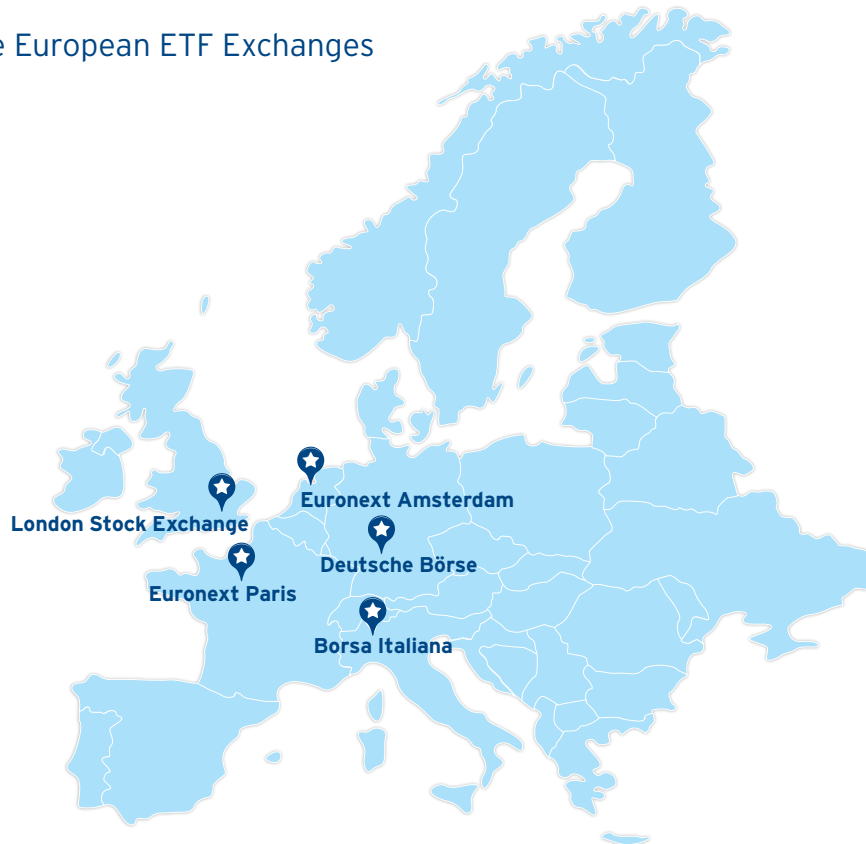
### Contractual

- **Fonds Commun de Placement** is a contractual arrangement with no legal identity that is managed by a management company.

# Exchanges

When establishing a European ETF you will need to develop a listing strategy to determine on which exchanges you want your ETF to trade. Your listing strategy is typically driven by your target market and client type. Most managers usually start with 2-3 exchanges to attract investors.

## Top Five European ETF Exchanges



## Settlement Model

After a listing strategy is selected, managers need to pick a settlement model for their ETF. There are two options:

- **Local Clearinghouses** use the local settlement infrastructure for each exchange where the ETF is listed.
- **International Central Securities Depository (ICSD)** uses a single clearinghouse to settle ETF trades across multiple markets.

The ICSD model eliminates many liquidity and settlement challenges associated with using multiple clearinghouses and the majority of new ETFs are launching with this model.

# Service Providers

In order to launch an ETF, a number of service providers need to be appointed. Most are the same that are required for traditional UCITS funds, but a few ETF-specific providers are needed.

## UCITS Service Providers

### **Administrator**

Responsible for day-to-day operational support to the fund and provides NAV calculation, maintenance of books and records, and financial reporting services

### **Depository**

Provides asset safekeeping, income collection, corporate action processing, and fiduciary and oversight services

### **Transfer Agency**

Provides shareholder services to the fund; such as processing subscriptions and redemptions, shareholder account opening, and correspondence

### **Management Company**

Responsible for general investment management, administration, and distribution of the UCITS fund

May retain all administration and portfolio management or can delegate these functions but must retain the oversight functions

### **Others**

Include legal advisors, auditors, tax advisors, corporate secretary, and listing agent



## ETF Service Providers

### **Authorized Participant(s)**

Liquidity provider(s) to the ETF that have exclusive rights to create or redeem ETF shares

### **iNAV Calculation Agent**

Responsible for calculating the intraday NAV of the ETF based on the underlying portfolio

### **Listing Agent**

Local market agent responsible for filing the application for the ETF to be listed on an exchange and responsible for all communications with the exchange

### **Market Maker**

Broker-dealer that buys and sells prices for the ETF during the trading day

### **Paying Agent**

Responsible for transferring funds from the various local markets to the ICSD

# Documentation

When establishing an ETF, there are a number of documents that must be put in place. The ETF's legal advisors should manage drafting and filing the documents with local regulators, along with any subsequent updates or changes.

- ✓ **Prospectus** contains the details to the fund's investment objectives and policies, risks, distribution policy, dealing procedures, expenses, valuation, and fund service providers.
- ✓ **Risk Management Process** articulates the policies for managing the fund's main risks, with a particular focus on derivative risk monitoring and calculation methodologies.
- ✓ **Business Plan** outlines how the fund will be governed and designates the individuals who will take on each of the specified management functions.
- ✓ **Custodian, Administration, and Investment Management Agreements** establish legal relationships and appoint key service providers to the fund.
- ✓ **KIID** is a two-page document using a set template that provides investors with key information, including: investment objective, key risks, a risk/reward rating, and fees. The KIID is required to be translated into the official languages of all EU jurisdictions where the UCITS fund is sold.



## Authorization

In order to receive authorization firms must apply to the local regulator. The authorization submission must include all relevant application forms, the draft versions of the ETF documentation, along with the proposed service providers. All directors of the ETF must also be approved by the local regulator.

The application and all supporting documentation will be reviewed by the regulator and feedback on the application will be provided. This process will be repeated until the regulator is satisfied with the application. Firms should expect to go through several rounds of feedback before receiving final approval. Depending on the complexity of the ETF, the process can take between 6-16 weeks.

## How can we help?

Whether you're looking to establish an ETF or grow an existing platform, Citi can help. Across 13 domiciles, we offer a holistic enterprise-wide solution that can help coordinate through the entire ETF ecosystem, from issuance to fund servicing. Our consultative approach to ETF servicing, combined with ACES, our advanced workflow tool, provides a scalable platform with local expertise to support your ambitions.

Citi Securities Services supports the world's leading asset managers, institutional investors, and financial institutions. We provide a full suite of solutions in over 100 custody markets, including 64 proprietary branches, and 25 fund domiciles, including: custody, clearing, asset servicing, fund administration, ETF services, middle office, agency securities lending, collateral management, transfer agency, and fiduciary services. The combination of our global end-to-end service capabilities and Citi Velocity<sup>SM</sup> Clarity, our industry-leading data platform, enables our clients to futureproof and grow their business, while mitigating risks and reducing their infrastructure costs.

# Let's Talk

To find out more about how our ETF Services can help you, contact your Citi Representative or email us at [SecuritiesServices@citi.com](mailto:SecuritiesServices@citi.com).



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