



Innovation can help shrug off inflation worries

The roundtable panel in this Summer edition of the Finance Dublin Funds Monitor assess the year to date, as volatile conditions return to the markets, reflecting the inevitable knock-on effects of the global upturn in inflation. This adds to the longer term concerns for investment funds brought about by the Russian invasion of Ukraine, with ESG matters also gaining increased attention with one contributor suggesting that asset managers may give a greater focus to human rights violations before they decide to invest in a country.

Global ETF net flows have had one of their strongest starts to year on record with sovereign bond ETFs enjoying record net flows in May 2022. Innovation in the ETF space has helped to drive the huge growth in global ETF assets and in this issue fertile areas for further innovation are examined including the potential for asset managers to create an ETF structure with listed and unlisted share classes and an increased push into areas such as crypto assets, which, as one contributor says, should not be confused with the narrower class of cryptocurrencies, where 'buyer beware' is very much the order of the day. The emerging area of custody in tokenised assets is also explored as are changing structures in the ManCo market and the drivers behind Ireland's record NAV levels.

The Roundtable Contributors are, listed in order of their appearance in this edition: Mark Seavers, Chief Investment Officer in Dublin, IQ-EQ; Meliosa O'Caomh, Country Head, Ireland, Northern Trust; Ian Sinclair, Managing Director & Head, Digital/Crypto Assets RBC Investor & Treasury Services; Barry O'Brien, Head of Funds, Ireland at Apex Group company FundRock.

Ukraine, sanctions, and the fallout for investment funds

What longer term lessons are likely to be drawn by asset managers in relation to the war? Would you like to comment on this or any other aspects that have become apparent to you and your team?

Mark Seavers, Chief Investment Officer in Dublin, IQ-EQ: Russia's invasion of Ukraine is impacting how asset managers integrate ESG within their investment decisions.

The invasion has underlined Europe's dependence on Russian gas. According to GlobalData's executive briefing, the

energy crisis caused by the war might prompt increased investment in the renewable economy. The EU's search for alternatives to Russian gas could positively impact the transition from fossil fuels to renewables. This would represent an investment opportunity for asset managers.

As for social and governance considerations, the sanctions on Russia have forced managers to re-assess their



Mark Seavers

portfolios and take a more stringent approach to where they invest and how ESG is integrated, not only at the funds level but also within their portfolio companies. According to Bloomberg, there were at least \$8.3bn of ESG-funds held in Russian assets prior to the invasion. In future, asset managers may give a greater focus to human rights violations before they decide to invest in a country.

Irish fund NAVs

Aggregate NAVs of Irish domiciled funds breached the €4 trillion mark at the end of 2021 for the first time (€4.067 bn) (+ 22% on December 2021's total of €3.324bn), before falling slightly back in early 2022 (€3,909 bn in February), while the number of Irish-domiciled funds reached 8,372 in February 2022 (February 2021: 8,043).

EFAMA data for the same period are showing that the slight reductions in the first 2 months are concentrated in the UCITS funds area rather than AIFs, indicating the decline in overall equity market values in the early part of the year.

What comments would you make on the stellar year for the Irish funds industry last year, given these figures and what are your hopes for the rest of 2022?

Meliosa O'Caomh, Country Head, Ireland, Northern Trust: Last year's growth in assets reflects the success of the Irish funds industry in developing a funds framework and bedrock of professional expertise that continues to be attractive to the global investment community, through both steady and more challenging backdrops.



Meliosa O'Caomh

Asset managers from around the world continue to work with us to manufacture fund products, package them into Irish fund vehicles and distribute them around the world. From our perspective as asset servicer to investment funds, we have seen significant growth in the past year across both traditional and alternative asset classes, but also quite specifically in private capital.

Our experience is that a number of asset managers, that have historically been more active in the traditional rather than alternatives space, are now looking at launching private capital products at scale and at adding access to these funds for their clients to diversify their offerings. This aligns with the figures cited covering our industry's recent stellar period of growth up to the period of market turbulence we are currently experiencing.

Mark Seavers, Chief Investment Officer in Dublin, IQ-EQ: The Irish Funds industry had a strong year in 2021 with net assets exceeding €4 trillion (according to Irish Funds Industry Association) for the first time, representing year on year growth of 22%, and with the number of funds (including sub-funds) increasing by 410 to 8,732, representing year on year growth of 5%. In total the number of AIFs increased by a net 182 and the number of UCITS funds increased by a net 228.

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In terms of net sales, the Irish Funds Industry Association reported QIAIFs saw over €70 billion of net inflows in 2021 which was an increase of 150% compared with the €28 billion of inflows in 2020. UCITS funds by comparison had inflows of €237 billion in 2021 which was an increase of 12% compared with the €212 billion of inflows in 2020.

While overall net asset growth partly reflects rising equity markets in 2021, the results also show solid fund inflows and fund formation activity. Ireland continues to consolidate its position as one of the key fund domiciles in Europe and a particularly attractive fund location for non-European managers raising capital in Europe.

Ireland is also increasingly attractive to alternative investment fund managers, and regulatory developments over the past few years such as the Investment Limited Partnership will no doubt continue to attract global alternative investment fund managers to Ireland.

We can probably expect growth in 2022 to be more muted due to global concerns such as the war in Ukraine, the

energy supply crisis, and inflation. These concerns may impact fund formation directly and may also impact net assets through flows as well as from the pull back in global markets seen in early 2022.

Data from EFAMA (the European Fund and Asset Management Association) suggests that in early 2022 the UCITS outflows were concentrated in money market and bond funds which may reflect concerns about inflation and rising yields. While AIFs are often closed ended or otherwise have redemption restrictions, the same themes will likely influence AIF fund inflows in the early part of 2022.

Tokenised assets and custody

The total market capitalisation of digital token has been forecast to reach over EUR 918 billion in 2026 (about half of the forecast EUR 1,820 billion of digital assets - fuelling the surge in demand for custodial services for tokenised assets. What are the major considerations for a custodian and an asset manager in relation to custody of tokenised assets?

Ian Sinclair, Managing Director & Head, Digital/Crypto Assets RBC Investor & Treasury Services: Over the past few years, we have seen an uptick in the demand for custodial services in tokenised assets, which can include but are not limited to cryptocurrencies, stable coins and non-fungible tokens (NFTs). As the safekeeping of assets is a custodian's priority, this also applies to tokenised assets.

However with a new asset class comes the requirement to deploy appropriate infrastructure in order to be able to service those assets in-line with client demand and seamlessly combining TradFi with the new world of Web 3.0. A critical component of this infrastructure and a pre-requisite to any blockchain interaction is private key management. Ensuring safety and security of the private key(s) to keep client assets as safe and secure as possible is of paramount



Ian Sinclair

importance but this security needs to be carefully balanced with timely execution so it is likely that we see an array of capabilities that combine cold, warm, hot storage in some combination.

Tokenised assets are a relatively novel concept to individuals, institutions and regulators and therefore we have witnessed a fragmented approach to the regulation of these assets. From one perspective, the Ontario Securities Commission (OSC) have been forward looking with the approval of 20+ ETFs backed by “physical” cryptocurrencies whereas the Securities and Exchange Commission (SEC) has only approved futures backed ETFs. It is vital to keep in close contact with regulators globally as they evolve their perspectives and align with one another.

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Finally, ESG is also a key consideration for tokenised assets, where proof-of-work consensus mechanisms utilise a vast amount of energy to “mine”. This means the focus could shift towards a protocol that is less energy intensive such as proof-of-stake.

ManCos developments

What are the major trends you see in the ManCo sector and how do you expect this segment of the market to evolve in the coming years?

Barry O'Brien, Head of Funds, Ireland at Apex Group company FundRock: There has been significant consolidation across the ManCo space in Ireland leaving only a small number of leading providers. FundRock as well as being the number one independent ManCo in Luxembourg also enjoys a top 5 position in Ireland through organic growth. The number of Self-Managed Investment Companies or SMICs in Ireland has reduced by over 50% in the last year as shown by PwC research. This has been to the benefit of independent Management Companies and as a direct result of the Central Bank CP 86 process. We predict continued and more widespread use of independent providers

by asset managers leaving them to focus on core investment activities, freeing up resources and capital from non-core tasks.

Active distribution is now a key component of any ManCo offering for in demand strategies and a differentiator in the market where non-EU managers have no experience or substance on the ground in Europe. A ManCo who as well as being global distributor can also provide an experienced active sales team throughout Europe and beyond can be of huge benefit.



Barry O'Brien

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Platform options offer a quicker route to market and are more and more popular albeit that the bigger firms still like to see their “name over the door” with standalone solutions. It used to be the case that asset managers of scale (multiple billions) would also tend to have an inhouse ManCo solution but this is not the case anymore with a divergence occurring even at the bigger end of the scale and not only for new market entrants or those using a hosted solution on a temporary basis as they set-up their own operations.

ETF Innovations

Innovation remains strong in ETFs sphere as can be seen in areas such as personalised direct indexing or the increasing numbers of thematic ETFs based on everything from an executive’s ‘character’ to the ‘Metaverse’. What significant ETF product innovations, or areas of product innovation, could you see in 2022-23?

Meliosa O’Caoimh, Country Head, Ireland, Northern Trust: Globally

there will likely be increasing adoption of physical crypto-assets in ETFs, and not just via the unregulated exchange traded vehicles such as certificates and notes that have largely been the focus of managers to date. As competition grows, regulators are under pressure to be more open to digital assets and to consider how these can be incorporated into regulated fund structures.

From our perspective as an asset servicer to funds, the relatively new characteristics of digital assets have to be incorporated not just into our administration processes, but also our broader thinking to anticipate our clients’ evolving requirements. Crypto staking is emerging as an investment strategy in its own right, not just a passive revenue stream.

Administering these kinds of investments may require real-time data handling and interaction with a more unstructured universe of external parties compared to more traditional asset classes. Continuing to expand our data capabilities to support these evolving assets is among our key areas of focus for the future.

Additionally, the transparency of ETF portfolios continues to be an important topic for actively managed funds. Irish Funds’ response to IOSCO’s Consultation on Good Practices for ETFs was supportive of alternative approaches to full transparency, with options suggested around frequency of publication, and substitution methods. We expect to support innovation in this area as the transparency requirements are adapted.

Crypto Assets, and Crypto currencies

The Central Bank of Ireland has given its first approvals to Irish-domiciled investment funds to invest, albeit indirectly, in crypto assets. The approvals followed warnings from the CBI, in concert with the ECB and other euro system central banks, about the risks of investing in crypto assets, notably crypto currencies. What do you see as main potential risks and opportunities crypto assets pose in the regulated funds space, and do you think there is a need for a clear delineation between cryptocurrencies and a wider universe of ‘digital assets’?

Ian Sinclair, Managing Director & Head, Digital/Crypto Assets RBC Investor & Treasury Services: Investing in any asset class brings about some

degree of risk and digital assets are no different. Notably the volatility that we have seen, specifically crypto assets is not akin to that of traditional asset classes however as institutional adoption ramps

up we will likely see the volatility in this asset class fall, thereby reducing that risk. The asset class does also provide an avenue to further diversify portfolios where an



Ian Sinclair

allocation can be made to crypto assets. Today, there are ETFs traded on the TSX that are fully backed by direct cryptocurrency holdings (and some with indirect holdings) with an AUM of ~3.9bn USD1 and we have seen from those that there is demand for this asset class, which has only grown over the last few years and will likely continue to do so as adoption broadens.

“A critical component of this infrastructure and a pre-requisite to any blockchain interaction is private key management. Ensuring safety and security of the private key(s) to keep client assets as safe and secure as possible is of paramount importance but this security needs to be carefully balanced with timely execution.”

Our view is that there isn’t necessarily a need for a clear delineation between cryptocurrencies and a wider universe of ‘digital assets’ but rather cryptocurrencies need to be considered as one facet of the ecosystem. As such the delineation needs to be between each facet of the ‘digital assets universe’. Therefore cryptocurrencies need to be considered separately to Central Bank Digital Currencies (CBDCs), which need to be differentiated to stable coins and so forth. Each part of this ecosystem does bring slightly different risks and opportunities and so understanding them separately but how they can potentially work cohesively in today’s financial infrastructure could bring about opportunities that we have not seen before including efficiency gains in

transaction settlements, seamless (and possibly instant) cross-border payments where the number of intermediaries are reduced and more.

The Irish Investment Limited Partnership

With Ireland's updated Investment Limited Partnership regime now in situ for over a year what is your assessment on its progress to date and market sentiment towards it so far?

Barry O'Brien, Head of Funds, Ireland at Apex Group company FundRock: Slowly but surely we are seeing more and more reputable clients of scale considering and in a number cases actively in the authorisation process and or indeed having launched an Irish Investment Limited Partnership. Just as the migration initially occurred from the Channel Islands to Luxembourg there is a definite pivot towards Ireland in terms of the establishment of LP/GP structures especially for U.S. and UK managers considering parallel or flagship structures. Providers who offer single source solutions will benefit greatly from this trend - especially those who are already leaders in servicing Private Equity/Debt/Credit structures.

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Challenges with available resources in continental Europe and the servicing culture does provide Ireland with an edge in terms of a cultural fit. Ireland is - as the saying goes - “more Boston than Berlin”. Luxembourg has grown hugely in the private fund space but may well be a victim of its own success in terms of resourcing issues now leaving the door open for Ireland where we now have an LP/GP structure that is finally fit for purpose and is as up to date as any other option available globally such as Cayman, Delaware or Luxembourg.

The ecosystem is adapting and the mindset has changed for all key

protagonists. No longer is Ireland purely a hedge and ETF focused jurisdiction but instead is embracing private funds in a big way. Testament to this is the number of additional providers who have been authorised in the jurisdiction over the past 12 months especially specialised depositaries.

Share classes in ETFs

The potential for asset managers to create an ETF structure with listed and unlisted share classes could appeal to multiple investor types and allow leveraging of scale of an existing pool of assets. Do you see an appetite from asset managers for this type of structure? From an Irish/EU perspective what obstacles would need to be overcome to enable this type of structure to be established?

Meliosa O’Caoimh, Country Head, Ireland, Northern Trust: For asset managers, we see the appeal of operating portfolios that can be distributed through both listed and unlisted structures. Among the key considerations for this hybrid fund structure is the question of how fees can be fairly applied for all investors. Unlisted classes may apply an aggregated dealing spread or dilution levy, whereas listed trades typically apply the actual deal cost per investor deal. Regulatory clarity around the application of dilution levies and fees could smooth the introduction of hybrid funds in Ireland.

Interest has been strongest from established mutual funds, looking to find new distribution markets, using list classes to access exchange trading. Herein lies the challenge for Irish funds, and the CBI’s interpretation of the ESMA rules regarding naming convention. While ESMA have made clear listed sub funds must include ETF in the name, the guidance around share classes is open to interpretation.

In Luxembourg ETF share classes have been launched within existing SICAVs without changing the share class name, preserving the performance history of the fund. The CBI has taken a different stance, requiring a listed class to be named

as an ETF. For an established fund, this may pose a barrier to adoption. Therefore, there may be merit for the Irish market considering the naming convention requirements for listed classes.

ETFs growth

The Global ETF market continues to grow strongly despite difficult markets, with net inflows for the first five months of 2022 the second highest ever at \$417.87 billion (source: ETFGI). From a service provider perspective how do you see this market developing in the coming year?

Barry O’Brien, Head of Funds, Ireland at Apex Group company FundRock: Ireland continues to be the domicile of choice for EU ETFs. In the US there has been a migration from active to passive where the mutual fund is in decline and this is also true in Europe where the ETF market is growing at an enormous pace. Service providers who offer platform solutions on a single source basis will be viewed as a great fit in the ETF ecosystem especially if it is on a global basis. The wider ETP space continues to grow also with greater exposure possible now than ever before to a wide range of alternative investments including commodities and digital assets. Automation and experience in this area is key to cost reduction and time to market.

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Apex Group serves a diverse range of ETF/ETN/ETC/ETPs and crypto funds. Providers who can handle complexity across multiple jurisdictions and investment strategies and who are not afraid of change and innovation will thrive as new product sets emerge and blockchain driven platforms become the norm. This is not to be confused with crypto currencies as an asset class which is still very much “buyer beware” for many Initial Coin Offerings – ICOs.



Meliosa O’Caoimh