



# **ETF Share Class Toolkit**

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# FOREWORD

Nicsa is proud to serve as a catalyst for collaboration across the asset and wealth management industry. We remain committed to supporting our member firms as they navigate an increasingly transformative and rapidly evolving environment. This ETF Share Class Toolkit is the latest example of our collaborative community and industry we serve.

The newly proposed ETF share class structure represents a noteworthy development in the asset and wealth management industry, offering both opportunities and challenges for firms navigating today's changing investment landscape. While potentially allowing mutual funds to issue ETF share classes within the same portfolio is exciting, navigating the changes required within the industry ecosystem is complex.

Operational alignment between mutual fund and ETF share classes, regulatory uncertainty, and compliance risks all pose meaningful challenges that warrant careful consideration. The ETF Share class structure may also require significant updates to technology infrastructure, governance frameworks, and other internal processes.

Despite these challenges, the ETF share class model offers transformative potential. As the industry continues to evaluate this structure, firms must approach it with a clear understanding of the strategic opportunities, economic trade-offs, and the operational and technological demands it presents. To support firms as they assess this evolving structure, we are pleased to share our ETF Share Class Toolkit. This resource is designed to help guide your internal discussions, offering a high-level overview of key factors to consider when evaluating the feasibility and implications of adopting an ETF share class model.

Looking ahead, Nicsa is partnering with Cerulli Associates to further explore these complex dynamics. Jointly, we expect to publish a more comprehensive white paper in May.

In the meantime, we invite you to join us in fostering a collaborative community, sharing insights, and shaping the future of the industry we all serve!

A handwritten signature in black ink, reading "Jim Fitzpatrick". The signature is fluid and cursive, with the first name "Jim" and last name "Fitzpatrick" clearly legible.

**Jim Fitzpatrick**  
President & CEO Nicsa

# ETF SHARE CLASS CONSIDERATIONS

Topic	Description	Impacted Firm(s)
<b>Reg BI Considerations</b>	What impact(s) will an ETF share class have to the Intermediary need to align with the requirements of Reg BI?	Asset Manager Wealth Manager
<b>Tax Efficiency</b>	<p>The process for in-kind purchases and redemptions provides opportunities for ETFs to have greater tax efficiency.</p> <p>In order to drive tax efficiency benefits to the entire strategy, the ETF share class must be at scale.</p> <p>If the mutual fund is no longer available on a major platform due to being designated as a clone, will this create a negative tax experience for the entire portfolio, including ETF shareholders?</p>	Asset Manager Wealth Manager
<b>Share Class Conversions</b>	<p>There is no functionality to systematically support the conversion or ad-hoc exchange of mutual funds to ETF share classes or ETFs to mutual fund share classes. Complexity magnifies based upon the number of in-scope share classes and rules associated with each (e.g. Class A, Class C, etc).</p> <p>Conversions and ad-hoc exchanges from mutual funds to ETFs also introduce challenges for transfer agents as well. The process for moving clients from one transfer agent system to another is also manual, and can be a multi-day process. This process may result in clients being out of the market and/or having account balances reflect zero assets until the transaction is complete.</p>	Asset Manager Wealth Manager Transfer Agent
<b>Trading, Settlement and Custody</b>	<p>Many Intermediaries utilize an omnibus processing environment to trade, settle and custody mutual fund transactions via the NSCC. The services associated with these efforts are compensated by the Fund. ETF positions are held within an omnibus position as well via the DTCC. All client transactions are traded and settled using the DTCC.</p> <p>Late mutual fund trades can make it hard to keep ETF trading smooth. If market makers don't get updates in time, the ETF might trade with wider spreads and less efficiency.</p> <p>What impact(s) will the change in business mix have to existing transfer agent and subaccounting service(s)?</p>	Asset Manager Wealth Manager Transfer Agent

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Topic	Description	Impacted Firm(s)
<b>Pricing Discounts - Brokerage</b>	<p>Intermediaries have invested in infrastructure in order to support many pricing discounts available to shareholders for mutual funds. There is no functionality available today to support tracking these privileges across mutual fund and ETF share classes.</p> <p>Because of the complexity and lack of system integration, there's a high risk of errors. This could lead to offering the ETF share class in a limited way or creating internal rules to decide which discounts apply to the mutual fund.</p>	<p>Asset Manager Wealth Manager Transfer Agent</p>
<b>Total Expenses</b>	<p>As an ETF share class would be part of the same portfolio as a mutual fund share class, it would be considered a clone. It is anticipated that the total expense ratio (TER) of the ETF share class will be consistent with the total expenses of the lowest price mutual fund share class.</p> <p>Assumed management fee of the strategy would be the same across all share classes but the total expense ratios would be different. Anticipated TER would most likely be in line with the cheapest mutual fund share class offered (e.g. R6 or comparable share class).</p>	<p>Asset Manager Wealth Manager</p>
<b>Capacity Management</b>	<p>Mutual fund functionality supports the ability to restrict availability based upon strategy capacity (e.g. soft close/hard close). The industry has not created any acceptable means for controlling capacity with ETFs.</p>	<p>Asset Manager Wealth Manager</p>
<b>Transparency</b>	<p>Mutual fund holdings are disclosed on a delayed basis. This delay can assist active managers in capacity-constrained asset classes, which can assist with generating alpha.</p> <p>ETFs generally provide daily transparency into the underlying holdings of the strategy. Certain technology is available for concealing daily transparency for a fee. This is limited to certain asset classes.</p>	<p>Asset Manager</p>

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Topic	Description	Impacted Firm(s)
<b>Due Diligence</b>	<p>ETFs are currently held to a variety of minimum requirements for platform consideration. If the ETF share class is offered as part of an existing mutual fund offered on the platform, how will the ETF be assessed for due diligence purposes?</p> <p>What will happen if the ETF ever fails due diligence once it's on the platform?</p>	Asset Manager Wealth Manager
<b>Marginability</b>	<p>Mutual funds are generally not able to provide margin value for the first 30 days the position is held within a client account. ETFs are generally immediately available to provide margin value within client accounts.</p>	Wealth Manager
<b>Options and Short Selling</b>	<p>Mutual funds support long-only transactions; however ETFs support buying and writing of options, and short selling.</p> <p>While the options will need to be registered on the exchange prior to being made available, it may be possible to short the ETF share class.</p> <p>An assessment will need to be conducted to determine the impacts of these transactions and determine possible procedural and platform enhancements.</p>	Asset Manager Wealth Manager
<b>Fund Governance &amp; Policy Adherence</b>	<p>Will there be a different treatment of the ETF share class versus mutual fund share classes, as it relates to policies of the Fund?</p> <p>Examples: round-trip trading restrictions, redemption fees, market timing controls.</p> <p>If the mutual fund uses fair value pricing for international equities, the ETF share class would likely need to follow the same pricing method.</p>	Asset Manager

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<b>Trade Timing</b>	<p>Mutual fund transactions will be processed using the published price at the next close of the market, while ETFs support intra-day trading.</p> <p>What implications, if any, would this have on the management of the portfolio?</p> <p>Education may be needed for PMs.</p> <p>Mutual funds offer investors a level of price protection not available with ETFs. How will system outages, etc. be handled when there is a mutual fund and ETF share class of the same portfolio?</p>	Asset Manager
<b>Dividend Reinvestment</b>	<p>ETFs do not offer reinvestment of distributions at NAV. Distributions are paid in cash and must be manually purchased by shareholders during market hours. This lost functionality may be of interest to Fund Boards.</p>	Asset Manager
<b>Trading Denominations</b>	<p>ETFs are traded in the secondary market, and they are traded in full share increments, unless their Intermediary has the ability to trade fractional shares. When shareholders would like to purchase or redeem ETF shares they must enter the number of shares for the transaction, or they must enter a desired dollar amount and note whether they would like the transaction to be “over” or “under” their requested amount. This allows the shareholder to transact in a dollar amount; however it may result in the shareholder purchasing or redeeming too many or too few shares versus the desired amount. This lost functionality may be of interest to Fund Boards.</p>	Asset Manager
<b>Systematic Programs</b>	<p>Systematic investment and withdrawal programs are not available for ETFs. This lost functionality may be of interest to Fund Boards.</p>	Asset Manager Transfer Agent

## ABOUT NICSA

**Nicsa** is a not-for-profit trade association striving to connect all facets of the global asset and wealth management industry in order to develop, share, and advance leading practices. For over sixty years, Nicsa has promoted a collaborative environment where members come together to help strategically address the industry's most vital issues.

To learn more about membership at Nicsa, please reach out to:

**Allie Walsh, Head of Membership** at [awalsh@nicsa.org](mailto:awalsh@nicsa.org).

## ABOUT CERULLI

**Cerulli Associates** is a leading strategic research and consulting firm serving the global asset and wealth management industries. For more than 30 years, the company has provided the world's leading asset and wealth managers with the strategic advice they need to grow their businesses. Cerulli provides custom research and consulting services to its clients and publishes more than 40 comprehensive reports on an annual basis. Its product development practice publishes an annual ETF report that includes insights from industry executives and data from a survey of firms that account for more than 90% of U.S. ETF assets.

## COMING SOON

Stay tuned for an upcoming paper, produced in partnership with Cerulli Associates, addressing the operational and economic hurdles associated with the dual share class structure of mutual funds and ETFs.

If you or someone from your firm is interested in having their voice heard on this critical topic, please contact **Chris Swansey** ([cswansey@cerulli.com](mailto:cswansey@cerulli.com)) or **Sarah Walter** ([swalter@nicsa.org](mailto:swalter@nicsa.org)) to schedule a time.



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