



INVESTOR SERVICES

The state of ETF share classes: Q4 2025

As a raft of US asset managers prepare to create exchange trade fund (ETF) share classes for their mutual funds, just how much potential does this technique hold for global markets across the US, Europe, and Asia and what challenges might its use present?

The fall of 2025 saw the US Securities and Exchange Commission (SEC) announce a landmark decision that should clear the way for fund managers to offer exchange-traded fund share classes within existing mutual funds.

By indicating it would grant Texas-based investment firm Dimensional Fund Advisors the right to add ETF share classes to its mutual funds¹ the SEC decision broke a long-running market impasse. Its decision could trigger the creation of a wave of new ETF share classes of mutual funds.

Following this signal of approval, over 60 sponsors (of the 80 original filings) have now re-filed ETF share class relief applications with the SEC². Previously, only one investment manager, Vanguard, had been able to create ETF share classes from its mutual funds via a unique patent which lapsed in 2023.

The multi-share class approach is not just a US phenomenon. It has long attracted interest at a global level. In fact, BBH has supported multi-share class outside of the US for many years.

In Europe – and to some extent in Asia – there continues to be significant interest among asset managers looking at ETFs as a means of expanding their distribution audience and capturing asset growth opportunities via the UCITS fund vehicle. Indeed, hybrid models, otherwise known as unlisted and listed share classes, have become a popular ETF entry point.

Under the latest US changes, could creating ETF share classes from existing mutual funds become a more viable alternative?

Why now?

Dramatic growth in ETF markets has encouraged many asset managers to consider ways of engineering and refashioning their mutual fund ranges to provide the benefits of ETFs. Since the first mutual fund to ETF conversion in 2021, conversions have become an increasingly popular approach.

Yet the conversion process can be challenging. In some cases, it presents constraints and complexities for distribution, necessitating brokerage accounts for all investors.

The potential benefits of ETF share classes in the US

For investors, permitting a fund to offer both mutual fund and ETF share classes more widely could:

- Promote tax efficiency
- Foster a more competitive marketplace
- Allow providers to bring lower fees and real-time trading to clients while offering greater portfolio flexibility
- Expand investor choice through the development of new products

For sponsors, ETF share classes provide the ability to:

- Demonstrate a longer performance history and track record
- Expand tax efficiency across a broader group of investors
- Optimize ETF baskets for liquidity
- Increase investor access to their investment strategies
- Harness economies of scale

Technical details and contrasts between structures

The SEC remains particularly focused on ensuring equitable treatment of investors across all share classes in this novel structure, specifically related to cross-subsidization of expenses and the overall tax impact to investors in a shared pool of portfolio assets.

Because most individual investors are buying and selling ETF shares with each other through the secondary market, ETFs have a mechanism to shield them from a high volume of direct portfolio transactions. Unlike mutual funds, most ETFs can also reduce or eliminate the possibility of capital gains distributions through the ‘in-kind’ delivery of securities – the mechanism for creating or redeeming ETF shares directly with the fund, often referred to as the primary market.

The in-kind process limits trading costs associated with portfolio management, and further, any costs associated with cash trading are typically reimbursed by an Authorized Participant. This is in direct contrast to the portfolio management process that requires cash trading in a mutual fund, where trading costs and taxes are inherent to the structure and shared by end investors.

Finally, ETFs are primarily fully invested while mutual fund managers typically reserve an allocation of cash to support efficient portfolio management and fund redemptions. This potential ‘cash drag’ on performance introduces a unique variable to the ETF in a multi-share class structure.

Considerations for launch under the new US share class approach

Distribution

The commercial ramifications of this structure for a sponsor’s distribution strategy cannot be overlooked. Dealer platforms are already examining treatment of multi-share class structures, where the mutual fund and ETF share classes may create conflicts with the Reg BI rule³.

The multi-share class structure promotes a product agnostic approach to distribution, providing breadth of choice to investors. However, the addition of ETFs may introduce new channels or investors (in addition to a new product type) to the asset manager, creating a need for training and education. Firms might also consider new sales support resources (like ETF specialists) to equip teams with specific ETF knowledge and/or effective prospect targeting in these new channels.

Existing sales compensation plans will need to be calibrated to appropriately incentivize ETFs while accounting for the unique structure and nuances of ETF distribution. Lack of transparency of the underlying shareholders or buyers of an ETF requires additional consideration when structuring sales compensation plans.

It will also be important for sponsors to consider pricing relative to other share classes and understand the potential uncertainty that exists with the duplication of an investment strategy, now in an ETF.

Finally, conversions or exchanges (when mutual fund shareholders want to move to the ETF share class) present operational complexities that currently have no industrywide solution.

Given their complexity, sponsors, dealer platforms, and administrators will need to partner closely to determine an appropriate frequency, ineligible dates (dividend periods), and processes to successfully implement (this assumes widespread appetite for participation in exchanges by these platforms).

The to-do list for launching a share class under SEC guidance

The following deliverables need to be prioritized to obtain approval, implement, and exhibit sound governance post-launch:

- The development of an effective accounting allocation methodology for expenses and tax at the fund and share class level (where appropriate)
- The creation of an initial advisor report outlining the anticipated benefits for investors across share classes
- The construction of a governance framework of ongoing monitoring
- Formal Board oversight through a regular examination and report that assesses whether the structure still serves in the best interest of each share class. This will include factors such as trading expenses, capital gains, and cash drag.

The story in Europe and Asia

While the latest US moves have placed a spotlight on domestic mutual fund ETF share classes, the picture in Europe and Asia continues to evolve with distinct regional features.

Spotlight on Europe

Luxembourg and Ireland are the two main domiciles for ETFs in Europe and, as major UCITS jurisdictions, the most obvious centers to consider launching ETF share classes of mutual funds. Even though share class structure is not new to Europe, there has not been much traction in adding ETF classes to mutual funds.

This might shift however, with the Central Bank of Ireland recently relaxing naming conventions, bringing it broadly in-line with the practice in Luxembourg. According to some reports this has heightened interest in adding ETF fund share classes to the existing mutual fund ranges among a number of asset managers⁴.

What to know

The key advantages of setting up a European ETF share class come from their scale and efficiency. The lower costs are derived from not having to set up a distinct fund structure as the ETF share class of an existing UCITS mutual fund brings the ability to leverage existing strategies and distribute in a different wrapper.

Among their potential advantages, European ETF share classes of established funds do not require seed capital and, if the underlying mutual fund is of sufficient size with enough assets under management, can be offered to large institutional investors⁵.

However, one important point is that, unlike the US market, managers considering adding an ETF share class to a mutual fund in Europe may find themselves at a tax disadvantage to pure ETFs by losing access to some tax treaties.

Putting an ETF share class onto a mutual fund with underlying US assets in Europe could mean investors end up paying up to a 30% holding tax as opposed to 15% depending on the balance of assets in the structure.

While we see advantages in creating ETF share classes – including the ability to ‘swing’⁶ NAVs in the underlying mutual fund to protect investors from dilution of value (see below) – their construction can be highly complex.

In the swing? A question of pricing

When investors buy or sell shares or units of funds this can generate costs for them. So-called swing pricing, based on a calculation of net inflows or outflows of investment capital, allows fund managers to adjust their net asset value.

Swing pricing is designed to direct the costs of buying or selling shares/units directly to the individual investors triggering the trades, usually involving a formula or ‘swing factor’ approved by the fund manager. This technique protects the wider fund’s interest by shielding other investors from the specific actions of buyers/sellers (and associate costs) within the fund which they can otherwise be exposed to through an impact known as dilution.

Partial or full swing factors can be applied to funds, determined by pre-set thresholds of net flows in or out of a fund. In an ETF share class arrangement, swing pricing can be applied to the underlying mutual fund and excluded from the ETF share class.

Swing pricing can help ensure every investor is treated fairly. Additionally, the ability to selectively utilize swing pricing for mutual fund share classes and not ETFs ensures equitable allocation of trading costs (trading costs are directly reimbursed by Authorized Participants through the creation / redemption process with ETFs) to each individual investor. Swing pricing can be particularly useful when applied across multi share class structures.

Asian prospects

While the European picture evolves, ETF share class or hybrid structures are also gaining traction across key markets in the Asia-Pacific (APAC) region, with the ETF share class structure now available in Hong Kong, Australia, and Singapore.

We expect additional regional markets to review allowing sponsors to have this optionality as part of their product structuring plans in the future. Significant local market progress in this area centers on the following markets:

Hong Kong

The Hong Kong Securities & Futures Commission implemented changes to its fund regulations in early 2019 to allow unlisted share classes to be added to ETFs and the option to add listed share classes to mutual funds.

Later that year saw the first set of ETFs that added unlisted or mutual fund share classes to existing products. Driven by the core benefits, this has become a popular option when sponsors are bringing new products to market and has been broadly utilized in Hong Kong. BBH supported one of the first sponsors in Hong Kong to add unlisted share classes to their ETFs.

Singapore

The first actively managed mutual fund in Singapore to introduce a listed share class launched in September 2025. This new share class provides investors with the flexibility of ETFs while accessing an active investment strategy. Specifically, it represents Singapore's inaugural active bond ETF listed on the Singapore Exchange (SGX).

Australia

Australia's dual access model has been structured to allow investors to access a single product through an on-exchange listing as well as traditional unlisted distribution channels.

One of the unique aspects of the model is that it supports investors in converting their holdings between the listed and unlisted channels. This mechanism has been popular with active fund managers as it has facilitated offering their flagship active strategies to the Australian market.

While regional interest in ETF share classes has been mixed, some industry experts believe it will likely grow over time, creating new demand for auxiliary service providers.

Choosing the right support services

With global interest in ETF share classes growing, service provider capabilities are becoming essential to fund managers and their distributors.

When coupling listed/unlisted share classes in a single vehicle, service providers play a critical role in the operational elements needed to construct and operate a product structure with intricate demands. Among these factors, administrators need to provide:

- A unified, consistent, and integrated technology platform for accounting of both mutual funds and ETFs.
- Experience with unique aspects of ETFs, such as basket construction, and custom in-kind process to support tax efficiency across share classes (US).
- A sophisticated and flexible data and reporting engine to easily enable oversight and monitoring, with the ability for asset managers to self-provision customized reports.
- Expertise with multi-share class structure and its unique nuances in each market. Capabilities to support the appropriate allocation of expenses and taxes across share classes in each market.
- A consultative approach that guides asset managers entering the ETF space and/or navigating the complexity of this structure through all aspects of a successful ETF strategy.

Shifting sands and closing out

As global interest in ETF share classes continues to rise – and as new issuers enter the market – the continuing evolution of the industry is likely to pose both opportunities and challenges for both investment managers and their service providers.

Those managers and service providers best equipped to adapt to change may well harvest significant business dividends from the changes ahead. And while time will tell, the signs and outlook for ETF share class related business do look increasingly positive.

¹Confirmation was subject to public feedback before finalization at time of press.

²FT. SEC clears way for ETF share classes in challenge to US mutual funds. 30 September 2025.

³The Regulation Best Interest (Reg BI), is a rule requiring broker-dealers of financial services to act in the best interest of their clients when making investment recommendations. Source: Investopedia. Regulation Best Interest (BI): Definition, Broker Obligations. 24 August, 2024.

⁴Ignites Europe. State Street in talks with a dozen clients over ETF share class launches. 09 October 2025.

⁵LSEG Lipper. Monday Morning Memo: What Happened to ETF Share Classes? 07 April 2025.

⁶Swing pricing is designed to protect existing investors from the dilution of value caused by trading costs resulting from subscription and redemption activity on the fund. Source: Franklin Templeton.

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