Win The Future

Why Asset Managers Need
An Etf Strategy

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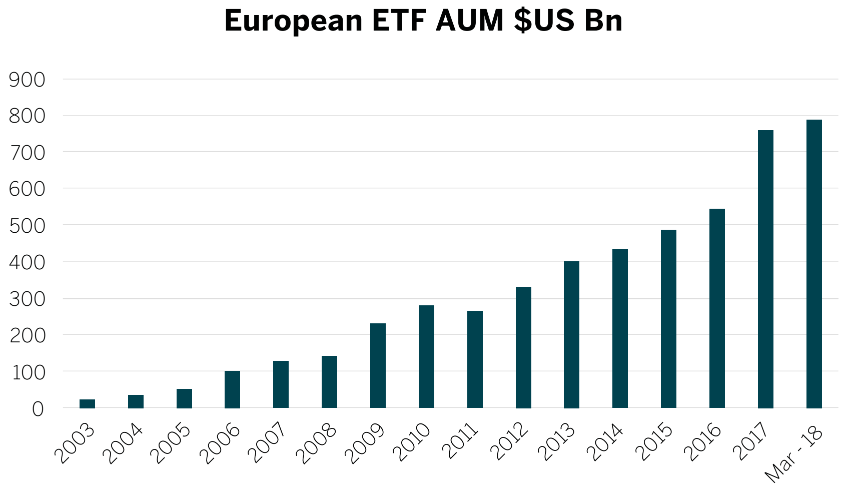
future is spelled with e-t-f

European ETF assets grew by an unprecedented 40% over 2017, accelerating significantly faster than the U.S. market for the first time on record. By the start of 2018, there were more than ~$4.8 Trillion[1] of institutional and retail assets invested in ETF, much of that market share won from traditional mutual funds across the world.

Lipper data[2] underscores the scale of this subtle revolution, revealing that ETFs contributed an incredible €23.1 Billion to the overall €35 Billion of European fund flows in February, 2018. This land grab is all the more impressive considering that ETFs are dwarfed by the $47.4 Trillion of global assets that ICI[3] estimates are held in mutual funds – funds which have benefited from over 100 years of promotion and distribution in a market with historically high sales incentives, poorly informed consumers and few competitors.



European ETF Asset Growth: Source ETFGI

Double-digit growth in the European ETF market is likely to be the 'new normal' as, after just 20 years of existence, ETFs find themselves superbly positioned to take advantage of a convergence of mega-trends that are driving changes in investor behaviour and the delivery of investment and wealth management solutions.

Smart asset managers are remodelling their businesses to adapt to these trends, recognising the important role that ETFs will play in determining future success and driving growth.

[1] https://etfgi.com/
[2] https://www.funds.reuters.wallst.com/UK/pdf.asp?language=UNK&dockey=1523-75581-7AEM9CP7B8H7M8I4DP9PKABHSM
[3] https://www.ici.org/research/stats/worldwide/ww_q3_17

trend 1 – self directed investment / empowered investors

The first trend is the global shift towards self-directed saving and investing. In the UK alone, an estimated 1.8 million people have invested over £250 Billion in a Self Invested Personal Pensions (SIPP), many of which are ETF users as are investors in other personal savings products such as ISAs which can also include ETFs.

In yesteryear, investment products in Europe were predominantly distributed through banks and advisors who received kick-backs from fund providers. This incentivised the sale of high cost / high commission products and put the interests of investors after the compensation of the salesperson. With less reliance on intermediated sales processes and greater autonomy in terms of fund selection, self-directed investors are looking at ETFs and liking what they see.

ETFs have characteristics that make them extremely appealing to self-directed investors and highly competitive compared to traditional mutual funds. ETFs are transparent and the underlying strategy and daily holdings can be easily understood and compared.

This is in contrast to many mutual funds that only tend to reveal their top 10 holdings - and then often on a delayed basis. ETFs are often referred to as "democratic" investment products – the individual investor gets the same fund, the same information and the same trading optionality as an institution – so no special share classes, no special treatment, no information imbalances, just a level playing field.

ETFs are also cost efficient and generally have low minimum investment thresholds, making them an accessible option for even small retail investors. As retail platforms and brokerages widen the availability of fractional trading – buying a portion of a share of an ETF to ensure all sums are invested at all times - barriers to participation are lowered even further. This inherent flexibility is further enhanced when trading is considered – ETFs are able to be traded intra-day enabling investors to quickly enter or exit positions without the hassle and delay of once a day pricing and a T+1 or T+2 settlement cycle.

trend 2 – regulation, transparency & icebergs

Regulators in Europe are keeping pace with increased ETF investor participation by improving the quality, timeliness and transparency of information available. For example, MiFID II reporting requirements enable investors to better understand the level of trading activity in European ETFs – for despite the 'E' in its name, the European ETF markets had seen about 2/3rds of trading occur in opaque, bilateral over-the-counter transactions.

Prior to MiFID II there was no requirement for European ETF trades to be reported, meaning investors could only view the tip of the iceberg relative to the real level of underlying activity. Under MiFID II European ETF new trade reporting requirements investors can finally gain a complete view of the breadth of ETF trading activity across all European venues.

This is an important development because liquidity begets liquidity. In this case, the comparative lack of transparency is often cited as a reason why some European investors had not participated in ETF markets on the scale they otherwise would.

It was a case of 'information under load'. Deprived of an aggregated view of trading volumes, European investors perceived a far less vibrant, far smaller, less energized market than really exists. Unimpressed with the view, some looked across the Atlantic for the liquidity they could not see in Europe.

Revealing the breadth of European ETF market activity and volumes should mean that European investors have less incentive to look abroad for trading efficiency and can begin to repatriate liquidity back to domestic markets. Add to this the convenience of local trading hours and European-listed UCITS ETFs should stack up well versus their US cousins which don't start trading until the European afternoon.

trend 3 – fees & value

As individual investors take more responsibility for their own portfolios, they are understandably focussed on costs, fees and value. The move towards "all-in" fee disclosure under MiFID II is predicted to make it easier for both institutional and retail investors to understand and compare fund charges. This is likely to be a boon for ETFs that are typically priced at far lower levels than traditional funds with equivalent exposures. For example, according to Hargreaves Lansdown, the Virgin FTSE All-Share Tracker Fund has a net ongoing charge of 1%, in contrast the Vanguard FTSE UK All Share Index ETF, which provides exactly the same exposure, at an ongoing charge of just 0.08%.[4]

With the information to compare the costs of core portfolio exposures such as FTSE 100, MSCI Emerging Markets or S&P 500 on an apples-to-apples basis, investors can judge the most cost-effective means to obtain the exposure they want and switch to the option that provides the greatest value for money.

Why buy an apple for £1 when you can buy one from the next stall for 10p?

Intense media coverage of asset management fees has led many investors to examine the attritional impact of high fees on long-term portfolio returns – a few extra basis points in fees can cost £100,000's over an individual's lifetime investment journey and £1,000,000's of assets to an institutional portfolio. If investors were confident that these fees represented good value, there wouldn't be an issue, but more awareness of active under performance and benchmark hugging has meant that many investors are declining to pay for consistent failure or expensive tracking. To paraphrase Churchill, "Never has so much been paid to so few by so many for so little result."

Industries like telecoms, utilities, media, airlines and fashion are already easy to cost compare - it's fast and straightforward to find the best price for a broadband package, set of golf clubs or a LHR-JFK flight. All things being equal apart from price, do you care if you fly BA or Virgin? Many travellers say no – just get me there safely, on time and at the best price. Investment products will increasingly be judged and selected in a similar way. This is great news for managers with unique IP and strong track records, worse news for the closet trackers and performance laggards.

With more product choice than ever, European ETFs provide a range of low-cost core building blocks, thematic twists and active strategies to build a huge range of portfolios. ETFs are superbly positioned to be big winners in an age where value-for-money is under the spotlight and comparisons between investment products are straightforward to perform.

[4] www.hl.co.uk

trend 4 – technology & the distribution revolution

"Etfs Continue To Take Market Share Away From Other Products, And Firms Will Either Have To Launch Etfs Or Create Other Investment Vehicles Which Are Competitive With The Performance, Tax Efficiency, And Costs Of Etfs"

Pwc, Etf 2020: Preparing For A New Horizon

Across Europe and the majority of the developed world, Millennials are poised to be the recipients of the largest generational wealth shift in history - inheriting the assets of their baby boomer parents. With trillions of dollars preparing to change hands within the next generation, asset managers who seek to remain competitive will need to understand the expectations of Millennial investors.

The Millennial generation do not shop like their parents did, they do not consume media like their parents did and they will not invest like their parents did. They are used to a personalised 'on-demand' world where immediacy and responsiveness are valued and where purchasing decisions are informed and influenced by online peer reviews and a broad range of expert voices. Intermediated products from high-cost, low-service providers are ill-suited to the browsing and selection behaviours of this demographic - this may be why in 2017, more than 50% of Millennial investors said ETFs were their investment of choice.[5]

As a new generation emerges that values simplicity, ease of use and immediacy, technological advancements are bringing ETFs to a wider audience in a way that aligns with their needs. ETFs are now widely available on European retail brokerage platforms, bank D2C platforms and mobile trading apps. ETF model portfolios and fractional trading have made it easier for investors to begin building a diversified portfolio – often at a very competitive cost compared to traditional funds and portfolio services.

New companies are also emerging to provide packaged ETF-based solutions for a new generation of investors. Retail brokerages, ROBO[6] advisors and round-up payment cards are increasingly providing ETF-based model portfolios and wealth management services. These next generation asset allocators are growing in importance - there are now close to 100 ROBO advisors in Europe and many are now ETF-only, leveraging the inherent tradability, transparency and cost-effective exposure that ETFs offer.

[5] https://www.marketwatch.com/story/millennials-love-affair-with-etfs-is-nowhere-near-over-2017-09-07
[6] https://www.techfluence.eu/investtech.html

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not "should i launch?", but "how do i launch?"

This convergence of trends means that asset managers adopting a 'business as usual' frame of mind stand to lose the future. Without an ETF offering their products risk becoming irrelevant to the next generation of investors and unfit for use in modern distribution technologies – the Wall Street equivalent of the VHS rental store in the age of Netflix. The end result of such lack of vision will be watching their asset base drained off by more forward-looking and nimble competitors.

The largest asset managers understood the ETF opportunity early on- 17 out of the top 20 largest asset managers in the 2017 IPE survey already offer ETFs with others preparing to launch products in the near future. The 2017 EY Global ETF survey gave further reason to expect a more diverse and competitive ETF industry, reporting that 67% of respondents believed that most asset managers will provide some type of ETF offering by 2022.[8]

Ipe Rank	Company	Offers Etfs?	Offers Active Etfs?
1	Blackrock	Yes	Yes
2	Vanguard	Yes	Yes
3	State Street Global Advisors	Yes	Yes
4	Fidelity	Yes	Yes
5	BNY Mellon		
6	JP Morgan	Yes	Yes
7	PIMCO	Yes	Yes
8	Capital Group		
9	Prudential Financial	Yes	Yes
10	Goldman Sachs Asset Management	Yes	
11	Amundi	Yes	
12	Legal & General	Yes (via Canvas)	
13	Wellington Management	Yes (via Virtus)	
14	Northern Trust	Yes (via Flexshares)	Yes
15	Nuveen	Yes	
16	Natixis	Yes	Yes
17	Invesco	Yes	Yes
18	T Rowe Price		
19	Deutsche Asset Management	Yes	
20	AXA Investment Management	Yes	

There are fewer and fewer active strategies that cannot be replicated in an ETF format and all but the most illiquid asset classes such as physical real estate are within reach of ETF issuers. This means we are likely to see more active ETFs, including non-transparent ETFs, come to market with 'active-like' fee structures that include performance fees or high water marks. Asset managers need to develop their ETF strategy rapidly as it's not far-fetched to imagine that almost all mutual fund strategies will have been translated into an ETF format within the next 15 years.

[7] https://www.ipe.com/Uploads/m/m/t/IPE-Top-400-Asset-Managers-2017.pdf
[8] http://www.ey.com/Publication/vwLUAssets/ey-global-etf-survey-2017/$FILE/ey-global-etf-survey-2017.pdf

The scale and rapidity of ETF growth is such that they have become a factor that fewer and fewer asset managers can afford to ignore. The question in many boardrooms has changed from "Should we launch ETFs?" to "How do we launch ETFs and what do we launch?"

Active Managers & Etfs

Asset managers considering launching ETFs may view ETFs as synonymous with 'passive' (index-tracking) investing. There is some justification for this idea as the majority of assets today still sit in plain-vanilla, market capitalization weighted equity ETFs - this is great for investors who want low cost core beta and great for the funds who got to market early and gathered assets.

But perceptions are evolving and active managers are less likely to view ETFs as competitors, instead viewing them as a valuable technology for distributing investment ideas in a market characterised by changing regulation, technology and investor expectations. Active ETFs are nothing new - they have been available in the U.S. for over a decade and the European market is starting to move in the same direction with a flurry of active equity and fixed income strategies, previously available as mutual funds or separately managed accounts coming to market in an additional ETF format.

It's worth pointing out that many of the largest ETF issuers on both sides of the Atlantic have well-established active asset management businesses too. The lessons of the U.S. show that traditional active fund managers can be extremely successful in leveraging their existing research and product development capabilities to provide ETFs that sit alongside their active fund ranges and act as alternative distribution mechanisms for key strategies.

These developments have helped ETFs to be re-understood as a universal fund distribution proposition, relevant to active and systematic asset managers, as opposed to a proxy for index investment. Indeed, asset managers increasingly see ETFs as way to extend and modernise their distribution strategy, breathing new life and extending accessibility of existing funds or flagship strategies in the modern digital fund distribution landscape.

three routes to market

For the asset managers asking "How do I launch ETFs?", there are three options: 1) build their own business from the ground up 2) acquire an existing business or, 3) partner with a white-label platform. There are pro's and con's to each approach:

Building a European ETF business from scratch can be a time consuming and expensive exercise –24 months or more are needed to establish a team, build a fund platform, perform product R&D, develop marketing strategies and formulate sales plans. There are also significant overheads to consider in terms of staff, office space and legal fees. All in, an asset manager could spend between £5-£10 Million before a penny of assets are raised.

Asset managers that want to build their own business also face a steep learning curve in terms of a building a specialist ETF architecture and expertise required in capital markets, product management and distribution strategies – all of which function in a very different way to mutual funds. While companies with large scale and extensive resources may be able to commit to this level of investment, this route may not make sense for firms with fewer internal resources or those that want to launch a smaller ETF product range.

Many companies have launched ETFs in Europe and then failed to raise assets as they did not fully appreciate the specific complexities of European ETF distribution or believed they could sell ETFs in the same way as mutual funds – these often proved to be expensive and embarrassing mistakes. For these reasons, build-your-own is a high commitment, high risk and high cost approach that is open only to large companies with significant time and resources to commit.

Buying entry to the market is also likely to be a high commitment and high cost approach – on the assumption that a suitable target can be found. In Europe, there are few takeover targets remaining to make this route to market seem appealing or possible. Buying up a third-party fund range also comes with the potential difficulty of buying up products that could conflict with a managers' core offering or future strategy. Reliant on chance and opportunity, this approach cannot be utilised by the majority of asset managers and does not provide capacity for many new entrants.

If building is too expensive and buying too difficult then asset managers can look at a third option – full service white-label ETF platforms.

A white-label platform, like HANetf, can enable any asset manager to launch an ETF without having to build their own ETF business from scratch. By providing the complete regulatory, technological and distribution infrastructure necessary to bring funds to market, white-label platforms make it faster, more cost effective and simpler to launch ETFs, whilst retaining the brand identity and investment skills of the underlying asset manager.

three routes to market

Almost any asset manager – indexed, systematic or active – can bring their investment IP to a white-label ETF platform to get a product launched, but it is important to note that not all white-label platforms provide the same combination of services. Some platforms merely provide the regulatory and operational infrastructure to manage ETFs.

Other platforms, like HANetf, take a different approach, providing a comprehensive service that goes beyond launch to provide ongoing sales, distribution and marketing programs. With a full-service offering, asset managers do not need to establish their own platform, expert sales teams, capital markets relationships, service provider relationships or marketing programs and can focus on what they do best – developing and refining investment ideas.

Three routes to European ETF market entry compared

	Build-Your-Own	Buy	White-Label
Cost	High - €10's Millions	High	Cost-efficient
Speed-to-market	1-2 years	Variable	2-3 months
Complexity	High	High	Low
Product range	Need to launch many ETFs to justify investment	Product range may not reflect purchaser's core strategies	Launch just one ETF or full suite
Overheads	Staff, office space, marketing	Staff, office space, marketing	Low annual fees

embracing the future

Asset managers who dismiss ETFs because "We are active and don't do passive" are missing the point. The ETF is just a distribution technology for any investment style or strategy. ETF growth continues to be propelled by strong regulatory, demographic and structural tailwinds, with the European ETF market predicted to triple to $3 Trillion by 2020[9]. Clearly, there is a significant fee-base for asset managers to win, retain or lose.

Asset managers positioning themselves to compete for this growing fee base recognise that ETFs will be a core part of their future growth strategy, but understand the challenge is not just launching an ETF but creating a sustainable long-term and successful ETF business.

Only the largest firms will be able to approach the complexity of the European ETF marketplace with their own in-house ETF offering and team. Some firms will lack the internal resources to create their own business while others may only want to launch a smaller number of ETFs for flagship strategies and funds and not have the scale to warrant the development of a standalone platform. The ETF opportunity is not just limited to the largest companies who can dedicate years of time and millions of dollars of investment in starting an ETF business. ETFs are democratic investment products and companies like HANetf are making it easier for asset and wealth managers of all shapes and sizes to participate in the growth of the market and better serve their clients by removing the structural, commercial and operational barriers to entry that they have encountered.

As trillions of dollars of assets migrate towards ETFs, we believe that every asset manager needs an ETF strategy – now.

[9] https://www2.deloitte.com/content/dam/Deloitte/lu/Documents/financial-services/performancemagazine/articles/lu_growth-etf-in-europe-012017.pdf

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about han etf

About Hanetf White Label Etf Platform

HANetf is Europe's first independent white-label ETF provider. HANetf has been established to provide the full range of services needed by asset managers who seek to launch UCITS ETFs in Europe.

The full technological and regulatory infrastructure necessary to successfully manage ETFs is augmented by an experienced local-language sales and distribution team who understand the nuances and complexities of promoting ETFs in their respective markets.

The HANetf platform reduces costs, increases speed to market and lowers barriers to entry for traditional and alternative asset managers.

www.hanetf.com

Hector McNeil
Co-Founder & co-CEO of HANetf

Hector is a veteran of the ETF industry, being instrumental in establishing Susquehanna's ETF desk in Europe as Head of Business Development. Hector then joined ETF Securities as Joint Managing Partner and co-Founder, before going on to found BoostETP with Nik Bienkowski in 2011.

BoostETP was purchased by US ETF provider WisdomTree in 2014 and following the completion of this buyout in 2016 Hector stepped down as Co-CEO of WisdomTree Europe.

Hector established HANetf, Europe's first independent 'white label' ETF platform, with business partner Nik Bienkowski, to provide asset managers with a fully managed solution to enter the European ETF market.

Hector, a Fellow of the Securities Institute, holds a BA in Economics and received an MBA from Warwick Business School. HANetf is Europe's first independent white-label ETF provider. HANetf has been established to provide.

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