



SPONSORED ARTICLE

# Q&A

With **Joe Keenan**, Managing Director,  
Head of Global Exchange-Traded Fund Services  
at **BNY Mellon Asset Servicing**



Joe Keenan

**Q:** Given your role as head of BNY Mellon Asset Servicing's Global ETF Services, you've got a finger on the pulse of the ETF industry. From your vantage, what new developments in the ETF space are you observing?

**KEENAN:** Exchange-traded funds represent one of the most, if not the most, innovative spaces in the financial products arena. That innovation is attracting extraordinary interest from a broad range of asset managers.

Because of the exponential growth in these products, established asset managers are noting their potential as short-term trading vehicles as well as for long-term buy-and-hold strategies. Because of this, many asset managers are trying to figure out how to enter the ETF space.

Given the number of passive ETF products, it's a



## SPONSORED ARTICLE

crowded space but we believe they still offer potential both for new entrants, and also new innovative products from existing providers.

Among those innovations are extremely low-cost ETFs, with discount brokers like Charles Schwab and Ameritrade developing low total expense ratio and/or zero-commission products, making it even easier for retail brokers and advisors to incorporate these products in their clients' portfolios.

At the other end of the spectrum, we're seeing a much greater interest in actively managed ETFs, although there is an inherent conflict between the transparency that ETFs demand and the opaqueness that stock pickers rely on.

Where we've seen the greatest traction in active ETFs is in the fixed income space. PIMCO, for instance, is looking to expand on its early success by replicating an ETF that's designed to deliver performance akin to its famous Total Return Fund.

A lot of product remains on the drawing board, with some funds not yet launched or potential sponsors still seeking approval to enter the fray by the U.S. Securities and Exchange Commission. For instance, our client Grail Advisors was purchased by Columbia Management Investment Advisers earlier this year, and it can be expected that they would look to expand their offering via more actively managed products into 2012.

Nevertheless, for actively managed ETFs, it's still the early days. These products will need to demonstrate multiple quarters of consistent outperformance to get that Morningstar rating and to be perceived by end users as delivering excess return at a greater expense ratio.

**Q:** With so many ETF choices available for investors, are you still seeing new product classes being developed?

**KEENAN:** We're noting a further expansion of the ETF structure to allow penetration into previously difficult-to-access asset classes like precious and industrial metals.

There are benefits to ETFs holding physical assets versus derivatives. For one, investors should gain comfort if they hold a share that represents gold bullion, instead of futures contracts, which can suffer issues such as contango or backwardation.

A number of BNY Mellon clients are looking at other precious metals like platinum and industrial metals. We'd expect to see more products in that space, with more ETFs that represent physical assets.

A number of products have also been launched where it simply isn't feasible to rely upon physical assets to deliver investors access to a particular commodity or basket of commodities. Examples would include ETFs from our clients Teucrium and GreenHaven, whose products rely upon futures

contracts to seek to deliver the performance of the underlying commodity or basket. We expect to see more broadly based commodity products, since there is appreciation for commodities being less correlated, especially in volatile market conditions. Advisers have begun to appreciate that some portion of a client's portfolio should be in commodities, and that may drive product expansion.

Volatility is also prompting advisers to use ETFs such as the Rydex CurrencyShares and the Dreyfus WisdomTree products as a way to gain currency exposure and hedge against other international holdings. Along those lines, we are also seeing greater interest in higher yielding emerging-markets fixed-income ETFs as investors pursue the higher yields the international markets offer.

**Q:** In terms of geography and product class, where are you seeing the most growth?

**KEENAN:** At BNY Mellon, our role as a service provider is to lay the groundwork for our clients to expand into the regions where they feel there is opportunity.

A number of clients we work with in the United States have expanded by bringing products to Europe, and our clients are also interested in cross-listing European products — those listed as UCITs — in Asia. We're in active dialogues with clients who have products in Europe but want to potentially



## SPONSORED ARTICLE

cross-list them in Singapore and Hong Kong so they can rely on a single core family of funds.

A number of the same clients are analyzing whether it makes sense to cross-list products in regions like Latin America, Singapore and Hong Kong, while a number of European clients are interested in looking at the U.S. market.

Wherever there is potential for asset growth, our clients are extremely keen to extend their models.

**Q:** Much has been made in the ETF space about the so-called “first mover advantage,” meaning that an innovative ETF is likely to have an edge by being the first to market. Does this phenomenon still hold true?

**KEENAN:** The first mover advantage does still hold, although an interesting twist is emerging. That’s the ability for firms to replicate a product, perhaps with a minor variation on an existing ETF, and then compete on price.

Take SPDR Gold Shares (GLD). There are a number of more cheaply priced funds that have been able to gather assets, such as iShares Gold Trust (IAU). In these cases, it’s often hard to quantify if they are cannibalizing the first mover advantage of the earlier existing product.

The lesson may be that the first mover has the advantage, at least until someone comes along and prices a competing ETF more cheaply.

**Q:** In Institutional Investor’s 2010 ETF and Indexing Report, you predicted that there would be consolidation in the ETF industry. With a year of hindsight, how has that forecast played out?

**KEENAN:** There has been some consolidation, Deutsche Bank, Scottrade and the previously mentioned Columbia Funds acquisition are recent examples. A number of firms interested in entering the ETF space are trying to decide if it makes sense to acquire an existing sponsor or to develop their own products. Some of the smaller ETF firms could be M&A targets, depending on the asking price and what the volatile and uncertain market will bear.

There is also a continuing rationalization of products. If some ETFs fail to gather assets, you could see more funds close in 2012. It’s still more of an art than a science to find out what products will resonate with investors.

For new sponsors who aren’t building the assets they expected, the question becomes whether to keep an ETF on life support or to continue trying to build the fund. The most successful sponsors are willing to wait two to three years to build their brands and get traction.

**Q:** How are regulators and their efforts affecting the ETF market?

**KEENAN:** Since the financial crisis of 2008, regulators are constantly watching the markets. Given concerns with derivatives and counter-party risk and with what feels like historic uncertainty in the market, it’s absolutely appropriate regulators are keeping watch and determining whether new rules should be considered and implemented to enhance the market’s safety.

ETFs have naturally been caught up in that ongoing review. There is a real review in Europe, both in terms of specific country funds and UCITs, to look at regulations surrounding conflicts of interest. It’s important for all investors to be aware that derivatives held by a fund may be offered by an underlying bank, because this carries an additional risk.

In the U.S., the SEC wants to make sure investors understand that leveraged and inverse leveraged ETFs are short-term trading vehicles. The issuers have done an extraordinary job of educating investors that these are sophisticated tools that aren’t buy-and-hold products. Most recently a panel was assembled and asked to present their views on the issues impacting the ETF industry to Congress. While it is too early to evaluate what will come of this recent testimony, one thing is certain – if ETFs continue their exponential global growth they will gain even more attention from the local regulators charged with policing the capital markets.



## SPONSORED ARTICLE

**Q:** ETFs have been getting blamed for contributing to the market's recent volatility. What do you make of this sentiment?

**KEENAN:** The vast majority of industry professionals who trade these vehicles, such as large institutions or hedge funds, would absolutely discount that ETFs are

driving the market's volatility. Many assert, and I am inclined to agree, that ETFs are a symptom of the market's volatility, not the cause. In other words, because these are typically baskets of securities, they are caught up in market volatility but aren't causing it.

The popularity of ETFs has also created benefits for investors. For instance, the tightness of the spread for the most popular ETFs may be as little as a penny wide,

giving investors the confidence that if they buy or sell intraday, they are getting a fair price that reflects the true value of the underlying portfolio.

Any thoughtful analysis on the impact of the extraordinary growth of the ETF business should recognize the positive benefits, including lower cost, trading flexibility and access to previously unavailable asset classes that this structure offers.

## JOSEPH F. KEENAN

*Managing Director*

Global Exchange-Traded Fund Services,  
**BNY Mellon Asset Servicing**



Joe is responsible for several key segments within the Global Financial Institutions sector of BNY Mellon Asset Servicing including: North American Banks, Third Party Asset Managers; Non-Registered, Closed-End and Custody Only Mutual Funds, and Unit Investment Trusts. Joe is also the Global Head of the Exchange Traded Funds Services business and the President of BNY Mellon Illinois Trust Company.

Joe has over twenty five years experience in the financial services industry. Prior to the merger of The Bank of New Company, Inc. and Mellon Financial Corporation, Joe joined The Bank of New York in 1985 in a customer service capacity for our mutual fund and unit investment trust company clients. He later served as the Bank's Business Manager for Mutual Fund Services in San Francisco and in 1998, Joe returned to the Wall Street headquarters to spearhead sales and marketing efforts for our Global Fund Services.

In early 2000, he was named Global Product Manager of Exchange Traded Products at the Bank, responsible for all sales and marketing of the Bank's specialized services to meet the needs of the rapidly expanding Exchange Traded Fund marketplace. Joe has been interviewed by leading financial publications and websites including: The Wall Street Journal, Financial Times, The New York Times, American Banker, Pensions and Investments, Global Finance, Business 2.0, Forbes.com, IndexFunds.com, and Morningstar.com.

Joe has a B.A. in English Literature and Communications from the University of Michigan, and an M.B.A. in Finance from New York University's Stern School of Business.