New ETF Products: Bond and Actively Managed ETFs
BNY Mellon ETF Symposium, Bloomberg Advantage Interview

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Announcer: You're listening to the Bloomberg Advantage with Kathleen Hayes and Vonnie Quinn on Bloomberg Radio.

Kathleen Hayes: And we are live at the BNY Mellon 2014 ETF Symposium here in Dana Point, California, with Steve Cook. He has been working on ETFs for a couple of decades now. BNY Mellon is where he is one of the top guys. Let's go look at some more very popular, even some new kind of ETFs, Steve. Bond ETFs aren't new, but there's a lot of new twists in the fixed income space.

Steve Cook: Yes, I think, again, you're going to see a lot of firms utilize fixed income as their entry into the ETF space. So, traditional large asset managers that really play in the mutual fund space can get into the active management of an ETF utilizing the fixed income space. Investors, really the issue is, firms are worried about their trades being front-run if they have to disclose their portfolio every day. In the fixed income world, you really can't replicate an institutional-quality fixed income portfolio, so firms don't worry about disclosing their portfolio holdings every day. They can go ahead and disclose that information and not give it away or not be forced to worry about front-running in there. So, a number of firms are going to come out with products across the spectrum.

Kathleen: And how about, boy oh boy, a lot of tongues wagging here about the new non-transparent, actively managed ETFs. What are they, and why are they controversial?

Steve: Yeah, so, it's not really an ETF, and these products were just kind of given the initial step of regulatory approval. They need to go through the final few steps, but in 2015, certainly we'll probably see the first one on the market. It's not really an ETF. It's not really a mutual fund. It sits in the middle. And the regulators really want them to be called Exchange Traded Managed Funds. So, that's the first kind of attempt at getting a non-transparent active fund.

Kathleen: What does non-transparent mean?

Steve Cook: So, basically, up to date, every issuer of ETFs has had to disclose the entire portfolio every day, so that investors and the folks who trade them every day can hedge themselves properly and understand what's in the fund. In order to move on to true active fund management like you see in a mutual fund, where the investment manager has to disclose the portfolio maybe 30 or 90 days in arrears, that's kind of where they want to move to allow true active management to exist in ETFs.

Kathleen: So, in other words, I can do things in this ETF if I have management, but my competitors won't know what I'm doing, so I can't be exposing my hand. I can show you my cards in a poker game every day.

Steve: Exactly. You'll show your cards 30 days after you've already played them. So, that's exactly what's going on. And the regulators have been a little reticent to allow that, because they're worried about potential liquidity issues in those products.

Kathleen: So, why are people here divided over whether or not it's a good idea?

Steve: Well, you know, again I think folks are worried about whether or not the liquidity providers, the professional traders who need to provide liquidity to these products every day, that given a credit crisis that might occur, will those folks continue to provide liquidity and will investors be able to get out of those products if in fact that liquidity dries up.

Kathleen: Quickly, so, what do you think, Steve?

Steve: I think there's going to be a lot of success in these products. I think all the folks, there's probably four or five different models that are out there, and I think all those folks are going to offer a way for investors to get out of those products in the event of a credit crunch.

Kathleen: Steve Cook, thank you so much.

Steve: I appreciate being here. It was great. Thank you for coming out to sunny California with us.

Kathleen: Well, it's tough duty. The sun is out. It's been so educational. I feel so smart now.