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Q&A

Two leaders in the exchange-traded fund industry—**Joe Keenan**, managing director and head of Global ETF Services at BNY Mellon and **Steve Cook**, chief operating officer for the Global ETF Services business—sit down to share their views on trends in the industry and what to expect in the coming year.

Q. Joe and Steve, 2013 inflows through Sept. 30 are slightly less than the same time in 2012, according to ETFGI. What's driving and impacting the ETF market this year?

Keenan: In some ways, the headline number isn't representative of what's going on in the industry. There's a lot of volatility in certain sectors, gold in particular. Putting gold aside, we probably have seen higher growth in assets than last year. There continues to be increasing use among retail investors and among fee-based planners. We also continue to see increasing institutional use.

Cook: One of the main things we've seen in 2013 is that the ecosystem around ETFs has broadened and deepened. From 2006 to 2012, early adopters moved their assets into the products. But now ETFs are becoming more widespread, with institutions using them for more than a small piece of their allocations, or to achieve exposure to one country, for instance. Many ETFs have achieved ratings from the National Association of Insurance Commissioners (NAIC), which now permit insurance companies to use ETFs in their general accounts. With more analysts and more brainpower being dedicated to the space, the industry is really developing and broadening.

Q. What are your expectations for 2014, in terms of the development of new products and investor demand/inflows?

Cook: We're starting to see traditional asset managers—those associated with mutual funds—develop and debut ETF products, which will drive the next leg of growth. For a while, they were happy to sit back and see if ETFs were a flash in the pan. Most people now have decided the industry is here to stay. That will drive product growth and set up new distribution patterns.

Keenan: In addition to traditional asset managers entering the space, there will be an increased number of active and less transparent products. Because so many initial sponsors have focused on indexed based products the space has gotten very crowded, very quickly. But if you look at PIMCO Total Return ETF (BOND), that's really the tipping point from pure passive to more active. Active management firms are watching the space. Those focused on fixed-income and without a product in the ETF space will likely be the first new firms to come to market.

Q. With so many new products coming to market in the past several years, is there still room for product innovation?

Keenan: Absolutely. Historically in the structured product space, the opportunity to launch an exchange-traded note was a lot easier because it required fewer regulatory hurdles, for example. But the logjam with regulators, who have had a focus on understanding the impact of derivatives use or a lack of total transparency in ETFs, is starting to ease up. Regulators understand there are more benefits in intraday trading, and that the ETF structure is simply another wrapper that resonates within certain distribution channels.

New innovations include currency

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hedged products. Gold-focused funds are an example from a few years back. There are still some spaces where there are opportunities, such as currencies and commodities that are illiquid and difficult for retail investors to access. Many of our clients are trying to figure out what the great new idea is before the competition brings it to market. For instance we helped Deutsche Bank launch the first China A-Share ETF (ASHR) in early November, and many expect that they will enjoy the regularly demonstrated first-mover advantage as other firms rush into the space.

Cook: For a long time, derivatives were frowned upon by regulators, but now they are willing to look at them and that is allowing some new product innovation to occur. Some of the broader investment themes have been taken and monopolized, but there is still room for a lot of different areas within distinct asset areas and strategies.

Q. Last year when we spoke, Steve predicted that we'd see innovative active ETFs come out in the fixed-income space. How has that played out in 2013? What's the next stage in the active ETF segment?

Cook: There has been a bit more of a lag than we anticipated in fixed income ETF strategies, due to delays on the regulatory front. Still, a lot of companies have filed, and while the proliferation of active ETFs weren't as immediate in 2012-13 as we had thought, more activity will develop as we close out 2013 and enter 2014.

Over the next 18 months, regulators will look at non-transparent actively managed ETFs, which have the potential to be another new segment of the ETF product landscape that could be a real game changer. Take, for instance, Eaton Vance's proposed exchange-traded managed funds, and what Precidian Investments is looking at with its blind-trust process for non-transparent active funds. There are a lot of opportunities if those products come to market.

Keenan: Among SEC watchers, there's a belief the agency will be very thoughtful and have the inclination to approve more than just one concept. In that way, if they pull the cover off active ETFs broadly, the industry would avoid a situation where one company would have a monopolistic advantage.

Q. Let's talk about how ETFs are being used. ETFGI recently found that between 2005 to 2012 there was a 92% increase in the number of institutions using ETFs. In 2012, about 60% of users were investment advisors. What are you seeing in terms of adoption and usage by investors? What's the role of fee-based planners?

Keenan: On the institutional side, it used to be that firms would use ETFs for short-term cash equitization, but only if they believed there was a cost advantage to holding listed futures. In the post-2008 world, there are some added considerations. Clearly, you have to be aware of counter-party risk. But as institutions gain greater knowledge about the flexibility and liquidity of ETFs, there is a comfort level that has caused more institutions to use ETFs both for short-term cash equitization and longer-term strategies.

Cook: A lot more intellectual capital is in the ETF space. That's building new strategies, from a distribution perspective, and it's driving more dollars and flows into the products.

Q. In the past few years, there have been a number of concerns raised about ETFs, such as finger-pointing at ETFs as contributing to market volatility. Is the ETF market still struggling with this perception?

Cook: More people have gained an understanding of the product, so that negative voice isn't as loud as it once was. For instance, look at the iShares National AMT-Free Municipal Bond ETF (MUB). When the municipal bond market blocked up, the fund itself and its sponsor elected to stop taking in-kind redemption. That was done to protect long-term shareholders. The ETF being in the market provided more liquidity to the muni market than if it had not been around.

Q. The market continues to be competitive, ranging from pressure on expense ratios to new approaches in ETF strategies, such as active ETFs. How do you view the competitive nature of the market? Is it a good thing, or is it stifling innovation from smaller entrants?

Keenan: The window for two guys in their garage to create an ETF is probably closed. That existed for several years, where large assets managers were happy to marginalize the ETF space. Going forward, smaller managers, those with less than $15 billion under management, might get acquired.

Fidelity has just entered the cheap beta space, which will further commoditize the more traditional products. Still, there is significant power in a brand, and investors will pay a few basis points more if they are already comfortable with, say, a BlackRock, Vanguard or PowerShares product. Still, there will be opportunity for smaller firms with novel ideas that can support higher expense ratios.

Cook: If a smaller entrant has an idea that's different, there are still avenues for people with great ideas to bring new products into the space. There is still opportunity for innovation, but for the me-too products, that ship has sailed.

Q. Let's look at international growth. Is demand for ETF products growing outside the U.S.? How is BNY Mellon

poised to serve markets outside the U.S.?

Keenan: There is increasing demand from existing clients and potential new clients to develop product outside the U.S., to move successful strategies to Asia and Latin America. We're focused on supporting our clients in the leading domiciles. We are building out our capabilities in Hong Kong and Singapore. We are and will continue to invest in our technology so that we can deliver a normalized and seamless service throughout, regardless of domicile. Our focus in 2014-15 is to help the globalization of our clients' products, including helping them identify opportunities for distribution, because when they win we win too.

Q. I'd like to touch on BNY Mellon's strategy and blueprint for success. As the ETF market matures, how is BNY Mellon anticipating and providing solutions for its clients?

Keenan: We look at the investment life cycle as a continuum, and we try to develop products along that cycle. It goes beyond simple servicing. We help our clients in the lab to engineer new concepts; then we aid our clients and their attorneys as they work with regulators to help them understand the products. Once a product is approved, we have execution expertise through our global capital markets desk, so we can minimize the cost as these products are built. When it comes to counter-party risk, we can help as an authorized participant.

We have helped to match our clients with asset gatherers to create large blocks of shares on their behalf and to shorten settlement time frames, such as T+3 settlement, which is more appealing to investors. We don't compete today with our ETF clients as our asset management group doesn't sponsor its own products.

Cook: We help our clients grow, so that everybody is winning in the space. That's what will drive innovation and client improvements going forward.

Joseph F. Keenan, Managing Director
BNY Mellon

Joe is the head of our Global Exchange Traded Fund (ETF) Services business which encompasses all services offered to the rapidly evolving ETF industry and includes those services we provide to Unit Investment Trust and Closed-End Funds as part of the Structured Products Services business in the United States. Joe is also a segment executive within the Global Financial Institutions (GFI) sector of BNY Mellon's asset servicing group and oversees a portfolio of the company's most important franchise clients. Since 2008 he has also acted as president of BNY Mellon Illinois Trust Company, and is a member of the Board of Directors for CIBC Mellon, our Canadian joint venture company.

Joe has over twenty-eight years experience in the financial services industry. He joined The Bank of New York in 1985 in a customer service capacity for our mutual fund and unit investment trust company clients. Joe later served as the business manager for Mutual Fund Services in San Francisco, and in 1998 returned to the Wall Street headquarters to spearhead sales and marketing efforts for Global Fund Services.

In early 2000, he was named global product manager of ETF Services, responsible for all sales and marketing of BNY Mellon's specialized services to meet the dynamic needs of the Exchange Traded Fund marketplace. At the time of The Bank of New York Company, Inc. and Mellon Financial Corporation merger in 2007, he led North American Asset Servicing Sales and oversaw Relationship Management for our Financial Institution clients.

In his role as the head of the Global ETF Services business, Joe has been interviewed by leading financial publications and websites including: The Wall Street Journal, Financial Times, The New York Times, American Banker, Institutional Investor, 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.

Steve Cook, Chief Operating Officer
BNY Mellon Global ETF Services

Steve Cook, the chief operating officer for our Global ETF Services business, is responsible for all aspects of the industry-leading product offerings of our Exchange Traded Fund, Unit Investment Trust and Closed-End Fund businesses. This includes managing our global client relationships, business development, product development and strategy and technology enhancements.

Steve is a sought after speaker at global ETF industry events, a contributor to articles and thought leadership pieces and is often interviewed by the media for his industry insight. After joining BNY Mellon in 1997, Steve held various senior roles within operations, relationship management and sales. In 2005 to 2009, Steve held the position of ETF Global Product Manager, guiding the product offering, business strategy and technology development for our ETF business.

Steve is a graduate of the University of Richmond and lives in New Jersey with his wife and two children.

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