How regulation is transforming ETF trading across regions

Antoine de Saint Vaulry, Director and Head of ETF & Flow Trading for Asia Pacific at Commerzbank, is a strong advocate of the value of ETFs to HNW portfolios. He told the Asian Wealth Management Forum how regulations for banks and distributors now clearly favour the ETF market.

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DE SAINT VAULRY IS ON A MISSION to convert as many clients to the appeals of Exchange Traded Funds (ETFs) as possible. He is backing a winner, as the sector - covering equities and fixed income funds - has enjoyed a remarkable explosion in volumes to reach a $4.5 trillion market share today.

What are ETFs? They are securities that track the value of an index, commodities or a basket of assets and trade like a stock on the exchanges. Antoine de Saint Vaulry is in charge of the ETFs Market Making platform at Commerzbank in Asia. He believes ETFs are the 'best thing since sliced bread' - or possibly croissants. "But I am biased," he did admit to the audience, jokingly.

His rationale for his bold assertion is that they are the perfect tool for portfolio construction, being cost-effective, liquid, transparent, and versatile in terms of asset class label.

ANTOINE DE SAINT VAULRY
Commerzbank

A $4.5 trillion worldwide ETF industry

De Saint Vaulry explained that the

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ETF industry is now valued at $4.5 trillion in terms of market valuation, having begun life only 30 years ago and having been worth only about $500 billion less than a decade ago.

He then focused on the key reasons for the dramatic growth. One reason is the shrinking bank balance sheets. "Anyone who has worked in a bank in the past decade knows that bank balance sheets continue to shrink," he noted.

Bye bye, retrocessions

Another core reason is the shift during the past 10 to 15 years from active to passive investment. "What does that mean?" he asked rhetorically. "It means that distributors, IFAs, advisers and private banks have moved or are moving globally to fee-based advisory. It is a sensible shift from a situation where the product issuer has been paying rebates [retrocessions] to the distributors who then sell their products to investors. And the shift is to a model where the investor is paying based on AUM, managed or advised on."

De Saint Vaulry further explained that market pressures have forced these changes, as well as regulatory demands, especially in Europe in the past decade. "There is," he reported, "a very conscious effort from regulators to actually get advisors to promote cheaper products for their clients instead of advising the products that reap them the most benefit in the form of fees from the product creators."

Regulators spur Australia's ETF sector

De Saint Vaulry cited the example of Australia, which around 10 years ago did not have an ETF industry of any note but today has an ETF industry worth $27 billion and that has been increasing by about 34% per annum since 2012.

"The regulator in Australia has forbidden distributors to receive any rebates from issuers and has therefore pushed them towards a fee-based model where they are paid based on the AUM that they manage. The push is them to advise for cheaper, more transparent products, and ETFs fit the bill perfectly."

Bank balance sheets shrink, fixed income ETFs explode

He then elucidated on the impact of shrinking bank balance sheets. "There has been massive regulatory pressure on bank balance sheets since the crisis of 2008, which has translated directly to the reduced holdings of corporate bonds, for instance, or any inventory of any assets whatsoever." Which in turn means that if the banks cannot hold inventory, they can't so easily sell feature products such as derivatives or leveraged derivatives.

A result of that has been a 24% compound annual growth in fixed income ETFs since 2009, while at the same time tier-one, common equity at the leading six global US banks has moved from about 10% to 14%. The rise of passive investing is another core factor driving ETF growth, driven partly be market forces, partly by the solid performance of ETFs in a broadly rising market environment, and partly due to regulator tightening on retrocessions and other 'hidden' fees passed between product creators and the advisory community.

Asia – a region of immense potential

Concluding, De Saint Vaulry noted that Asia has lagged the worldwide ETF explosions, which have been centred on the US first - more than 71% of the worldwide ETF market valuation - and also on Europe, which represents almost 16% of the market. Asia meanwhile represents less than 9% of global ETF valuations. And that, De Saint Vaulry concluded, presents firms such as Commerzbank with a world of opportunity in the Asia-Pacific region. ■