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ETF’s and Sustainability

Link ’n’ Learn

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Agenda

01 ETF landscape and future outlook

02 How the impact of current legislation is shaping the ETF landscape

03 Does the ETF regulatory landscape need to be reformed?

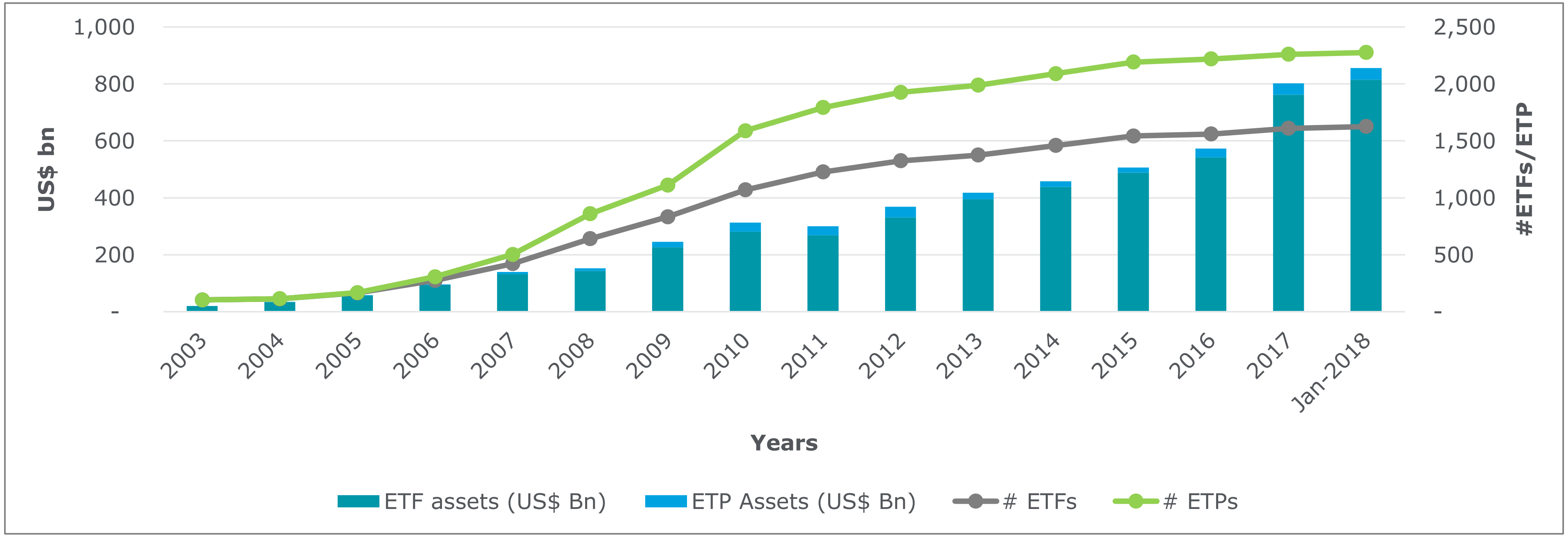
04 ETF and latest sustainability trends

ETF landscape and future outlook

Trends in the ETF Market

ETF Landscape

European ETF asset growth as at Jan 2018



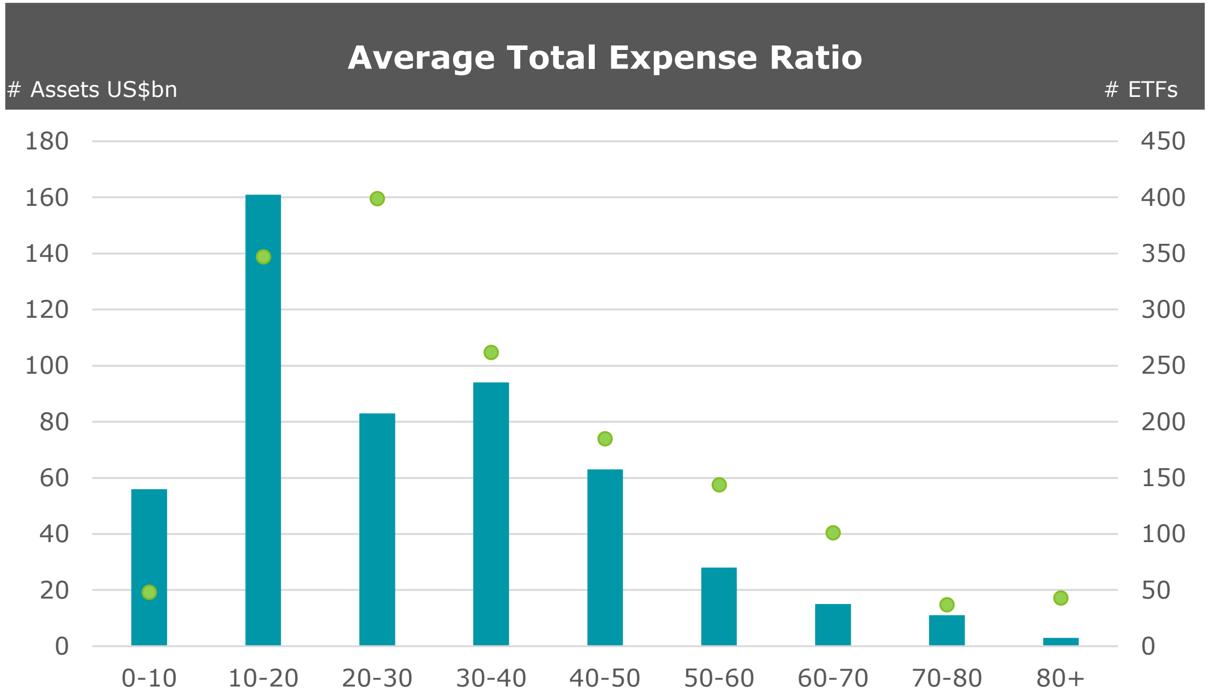
Year	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Jan-2018
ETF assets (US$ Bn)	20	34	57	94	132	143	226	281	268	331	395	438	488	542	762	815
# ETFs	103	113	165	274	422	640	833	1,069	1,227	1,325	1,375	1,459	1,542	1,560	1,610	1,626
ETP Assets (US$ Bn)	-	1	1	2	8	9	19	32	32	38	23	20	18	31	40	41
# ETPs	-	1	2	32	80	219	278	519	565	600	613	631	649	659	650	650

ETFs have witnessed a significant growth in past years due to:

- Diversification of market risk in a single vehicle
- Very competitive cost structure
- Wide product range and underlying products
- Strong liquidity resulting in narrow spreads
- Ability to deal intra day

Source: ETFGI.com

ETF Landscape
Total expense ratios: Europe



TER (bps)	0-10	10-20	20-30	30-40	40-50	50-60	60-70	70-80	80+
#ETFs	48	347	399	262	185	144	101	37	43
ETF assets (US$ Bn)	56	161	83	94	63	28	15	11	3

Source: ETFGI.com

Average TER (bps)

Asset class	ETFs
Equity	32
Fixed Income	26
Commodities	44
Alternative	77
Mixed	65
Active	34
Inverse	32
Leveraged	46
Leveraged Inverse	42
All	31

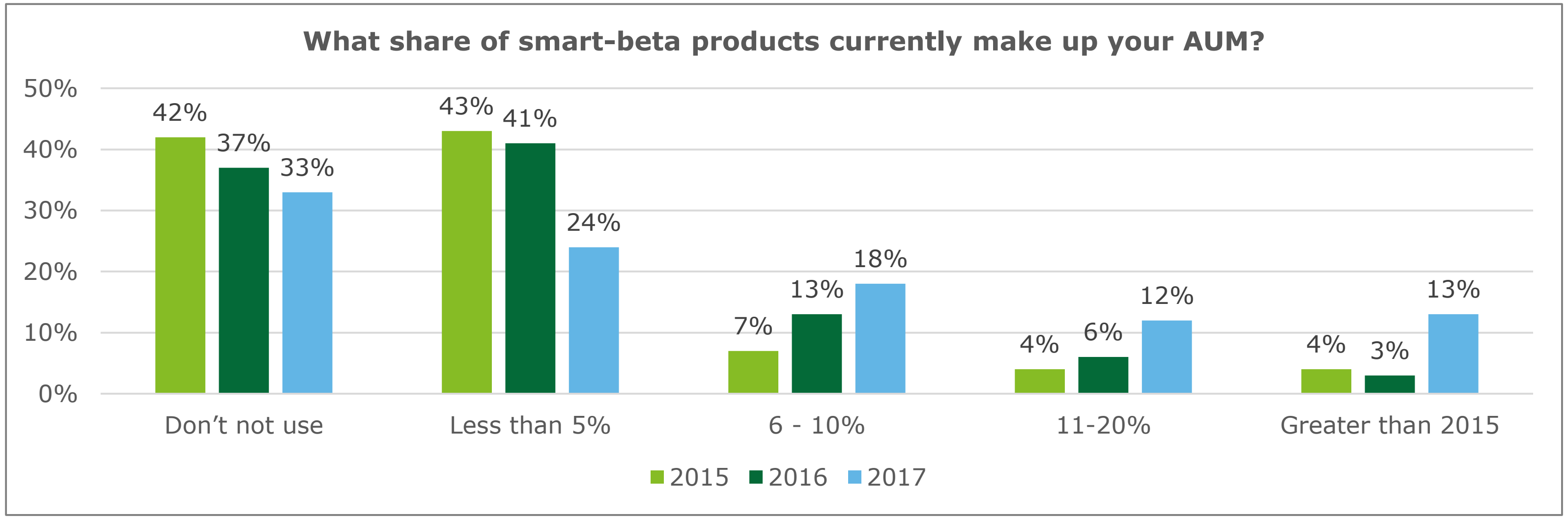
- Average expense ratio of 31 bps.
- Cheapest products track fixed income indices at 26 bps
- Most expensive are alternative ETFs at 77 bps.
- 48 ETFs with an expense ratio less than 10 bps
- 43 ETFs with an expense ratio greater than 80 bps.

What’s next – new generation of products

SMART BETA ETFs

Smart beta defines a set of investment strategies that emphasize the use of alternative index construction rules to traditional market capitalization based indices. Smart beta emphasizes capturing investment factors or market inefficiencies in a rules-based and transparent way. The increased popularity of smart beta is linked to a desire for portfolio risk management and diversification along factor dimensions as well as seeking to enhance risk-adjusted returns above cap-weighted indices.

Source: Investopedia http://www.investopedia.com/terms/s/smart-beta.asp#ixzz4gPzg6yHW



Even if the product is attractive to investors, they consider it as an add-on to their portfolio but their share is increasing

- 33% do not use smart beta ETFs
- 43% hold at least 6% in Smart Beta ETF (21% in 2016)

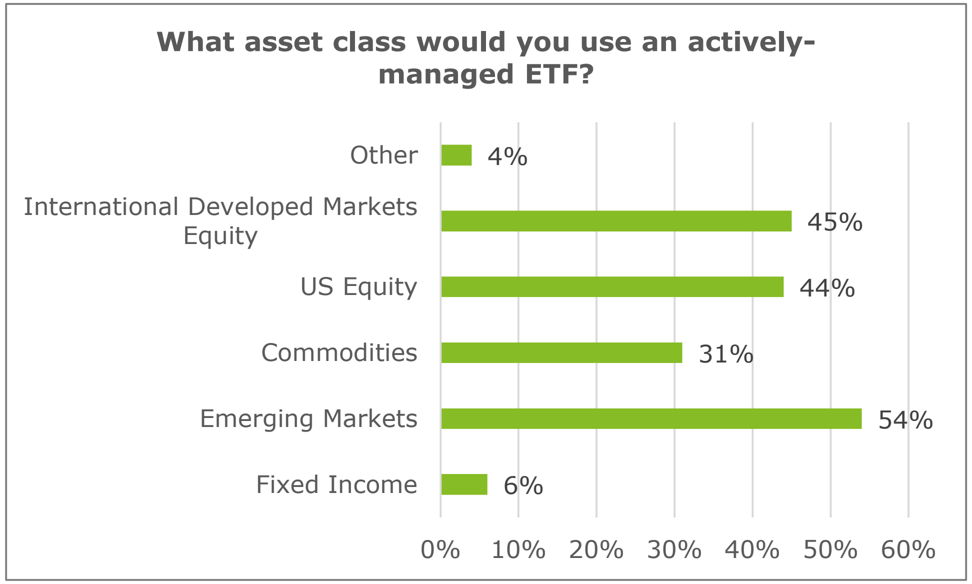
Source: BBH ETF Survey 2016 and 2017

What’s next – new generation of products

Active ETFs

An exchange-traded fund that has a manager or team making decisions on the underlying portfolio allocation or otherwise not following a passive investment strategy. An actively managed ETF will have a benchmark index, but managers may change sector allocations, market-time trades or deviate from the index as they see fit. This produces investment returns that will not perfectly mirror the underlying index.

Source: http://www.investopedia.com/terms/a/actively-managed-etf.asp#ixzz4gQC8wMTM



Source: BBH ETF Survey 2017

Active ETFs represent only about 1% of the total AUM invested in ETFs, however we have seen demand for these products picking up in recent years.

54% would use active ETFs for emerging markets.

Expense ration is really important for investors – 36bps average

The demand for actively managed equity ETFs across emerging markets, international developed, and the US suggest these strategies can support more choice for investors with the development of additional active ETFs.

Growth through action

Investment managers battle a challenging environment

From changing client preferences to greater scale benefits, IM firms are countering challenges on multiple fronts

CHALLENGES AHEAD

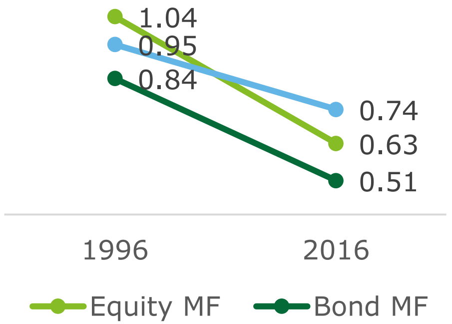
CHANGING PREFERENCES

$15 trillion

Wealth of Millennials could amount to $15 trillion in the United States over the next 15-20 years

Source: "Digitization of asset and wealth management", Create Research

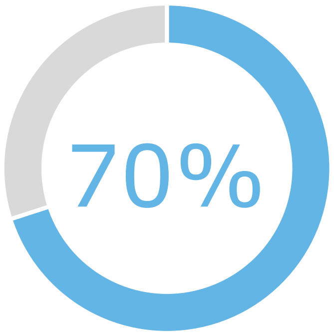
PRESSURE ON FEES



Expense ratios have declined substantially over the last 20 years

Source: Investment Company Institute, Research Perspective, May 2017

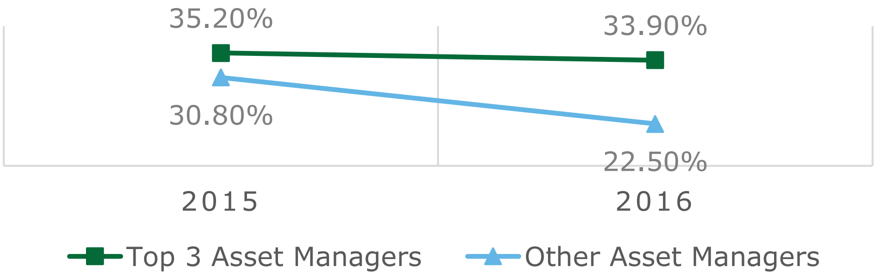
SCALE IS GOOD



BlackRock, Vanguard, and State Street captured more than 70 percent of the net cash collected globally by ETFs and mutual funds in 2016

Source: "Wave of M&A in asset management industry", Reuters, 20 April 2017

MARGIN COMPRESSION



In the past year, the top three IM firms reported steady margins of about 34 percent while other public IM firms reported an 8 percent margin decline to 23 percent

Source: Deloitte analysis of 10-k data

Which growth options would work in such an environment?

Whether pursuing new growth, delivering the latest innovations or entering new markets, organizations have to be agile to stay ahead in designing effective new business strategies

GROWTH STRATEGIES

ORGANIC

ADVANTAGES

- In-house investment research and decision-making process differentiation provide competitive advantage
- Incremental flows can be gained at lower marketing spend or expenses

DISADVANTAGES

- Meeting changing customer preferences quickly is a challenge
- Difficult to handle and manage structural changes in market cycle

INORGANIC

ADVANTAGES

- Quickly acquire new skills and capabilities including:
  - Greater distribution reach
  - Diversified talent pool
  - Broader product portfolio
- Achieve cost efficiencies

DISADVANTAGES

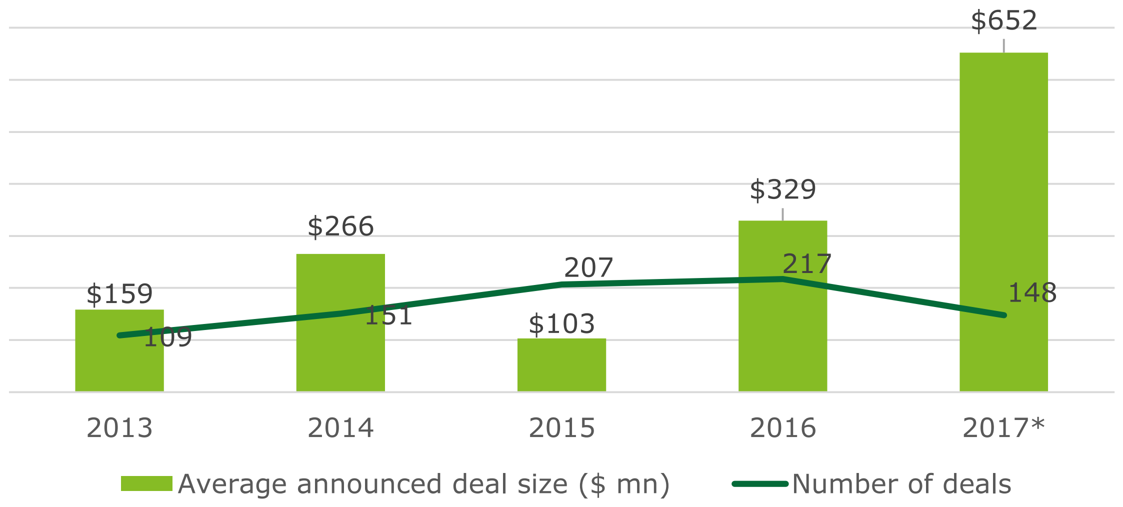
- Paying premium / stretched valuation for target IM firm
- Significant time required to integrate target operations

Growth through M&As seems compelling

Inorganic growth is proving to be an effective approach for the IM leadership to achieve scale, product breadth, and analytical capabilities quickly

Global IM M&A deals

Average announced deals size (in $ mn) and number of deals



- **Deal numbers surge** –IM firms have almost doubled the number of M&A transactions as compared with 2013
- **Strategic perspective** – The strategic importance of these deals is clear from the fact that the average transaction size has jumped as well, with 2017 witnessing a few big-ticket transactions

**Note – 2017 data is as of 1-Oct 2017 (sourced from SNL - Data and analytics provided by S&P Global Market Intelligence)*

Recent use case

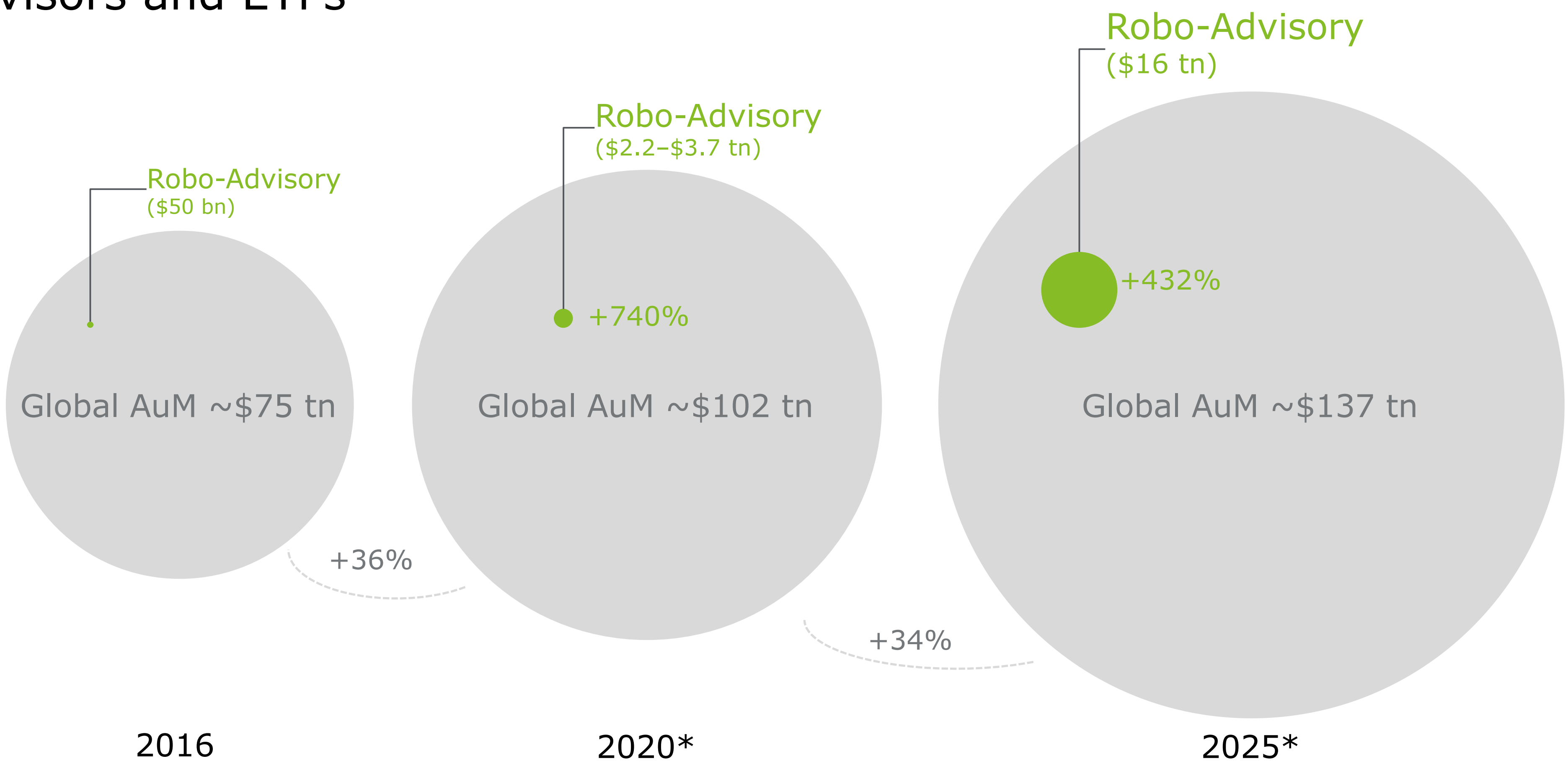
Goldman, Barclays among bidders for Commerzbank ETF unit

ADVANTAGES OF THE DEAL

- **Entrance** – Access new market
- **Greater geographic reach** – Provides access to new clients in a growing market.
- **Enhanced capabilities** – Broadens investment skills and capabilities across asset classes.
- **Cost efficiencies** – No initial investment in skills, technology and distribution channels.

Source – Ignites.com

Robot advisors and ETFs



Expected Growth in Assets under Management (AuM)**

* Estimated forecast

** Assets managed globally by Wealth and Asset Management firms

Sources: Bloomberg, Deloitte Research

Robot advisors and ETFs?

Active Management

- Ongoing data collection and analysis of the market
- Proposes (optional) shifts in asset allocation
- Aiming at outperforming the market

~42% of Robo-Advisors with pure active management*

Passive Management

- Based on pre-defined parameters
- Frequently restoring the pre-defined asset mix
- Taking human emotion out of investment-decisions
- Aiming at long-term growth in analogy with the market

~25% of Robo-Advisors with pure passive management*

Besides, ~19 % of Robo-Advisors offer both options. Clients can choose between active and passive management styles.*

- ETF providers are looking for new distribution channels

→ Robot provides low cost solution

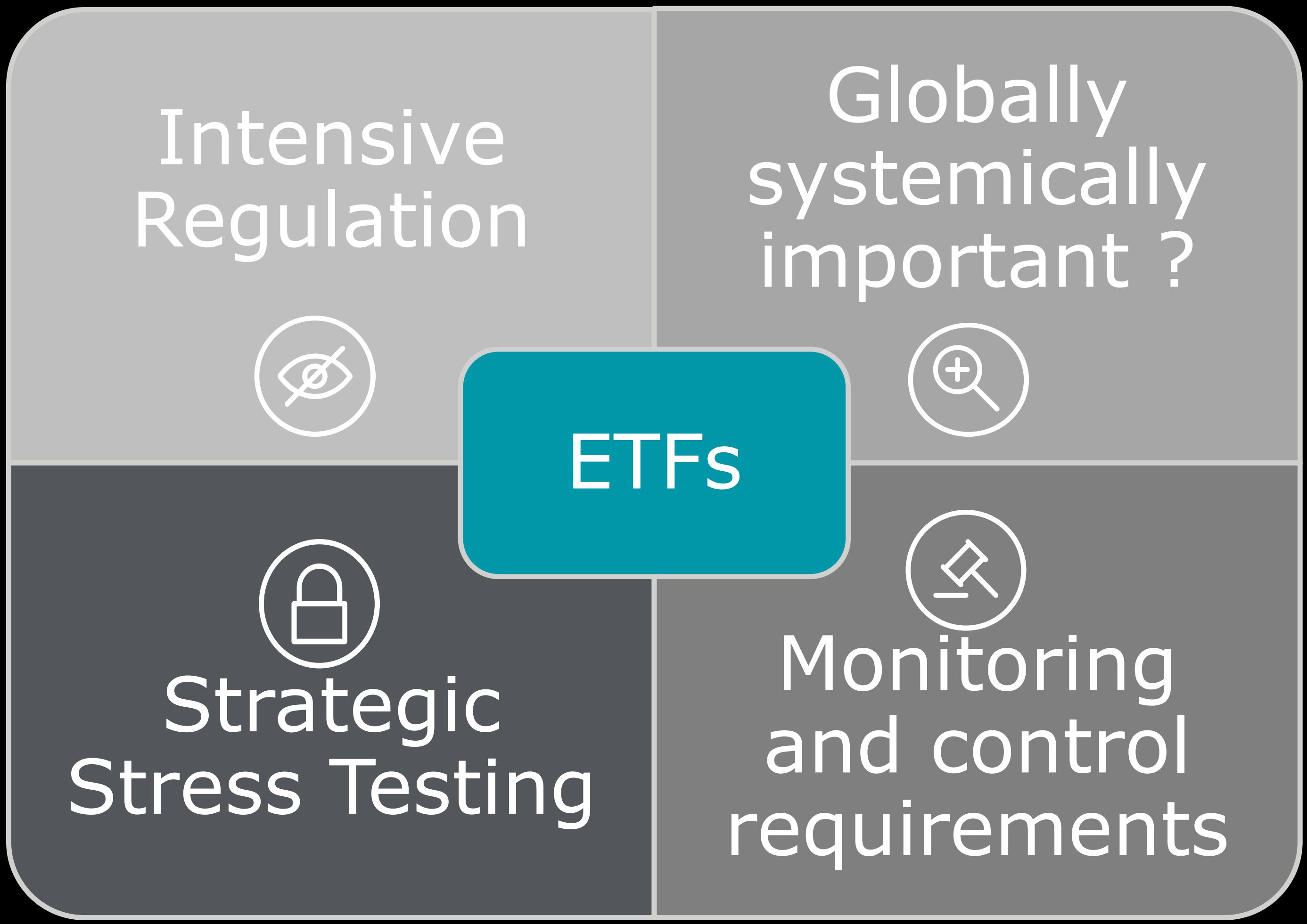
2 options have been growing:

- Acquiring / partnering with an existing robo-advisor (BlackRock, Lyxor,…)
- Building its own robo adviser with dedicated team (Deutsche Asset Management, Charles Schwabb etc…)

* Based on a Deloitte analysis of the Robo-Advisory landscape with over 70 Robo-Advisors in 2017. These figures do not include Robo-Advisors that do not manage portfolios for their client because they only suggest trades on request.

How the impact of current legislation is shaping the ETF landscape

Systemic Risk Concerns



Regulatory Developments

FSB published policy recommendations to address structural vulnerabilities in the asset management sector

IOSCO is reviewing how national authorities have implemented the recommendations

ESMA

ECB

Liquidity monitoring

Valuation issues

Counterparty default

Tracking errors

MiFID II

A Positive Development

- **Previously ETFs were not MiFID instruments** and there were no legal requirements to make trading volumes public
- MiFID II means that **it will be easier to see the demand and liquidity within the European ETF market**
- MiFID II requires **reporting of ETF** trades for the first time
- investors will be able to see **the true depth of liquidity in European ETFs**
- MiFID II will enable **investors to see all trading activity** across the whole ETF market
- Impact for ETFs will be the **mandatory trade reporting for OTC trades and a consolidated tape**
- New window into the liquidity in the ETF market will give investors a **clearer picture of the market**

BREXIT

the impact of Brexit on the legal and regulatory ETF landscape is not yet know.

we do know that it will have a multi facted and multi layered, impact on the asset management industry

UCITS ETFs typically have a local EU management company, which should shield the investment manager from any Brexit risk as the management company should still be allowed to delegate investment management activities to a London-based manager

In Europe, an ETF may be established as a UCITS or an AIF however the majority of ETFs have been set up under the UCITS regime. UCITS ETFs benefit from the high level of acceptance of the UCITS framework by regulators worldwide due to the investment rules, investor protections and risk management safeguards

Central Bank of Ireland

Discussion Paper

Investor Expectations	Outcome awaited and it will be an opportunity for the Irish ETF Industry to discuss their ideas and the future of the ETF landscape
Liquidity	
Additional Regulation requirement	Feedback expected in April 2018
Industry Discussions	

Does the ETF regulatory landscape need to be reformed?

Does the ETF regulatory landscape need to be reformed ?

Overview

A difficult question to answer and need’s significant industry debate and analysis

Collective participation in consultations and discussions by the ETF industry

1. Changes

- What would radical change look like ?
- Who would it impact ETFs ?
- Regulatory alignment
- Is the current regulation suitable with minor changes ?

2. Industry Standards

- Best practice and industry standards
- Regulatory framework in place
- European supervisory discretion reduced
- Common industry application of legal and regulator requirements

Investor Protection

In any industry discussion we need to focus on the right issues.

As such, concerns have been raised in relation to the gap in investors education :

- Do investors understand the definitions of active and passive investing
- Is the industry clear on its own definitions

Are ETF's changing the capital market structure ? How is the role of increased automation affecting the capital market ?

Authorised Participant ("AP")

- AP's are at the centre of the ETF industry
- Their role is key to the creation and redemption mechanism
- Critical role in the liquidity of the ETF market

- ETF Liquidity providers
- Exclusive rights
- AP standards and best practice
- Trading processes

IOSCO

International Organization of Securities Commissions.

2013 Principles for the Regulation of Exchange Traded Funds

2018 New paper

Looking Ahead

Innovative ETF Strategies

Evolving Political and Regulatory Landscape

Investor Education

Costs

Industry Best Practice and Industry Standards

Policy plans with industry consultation

Reformed Regulatory Framework

ETF AND LATEST SUSTAINABILITY TRENDS

ESG – Latest trends

Summary

- ✓ ***New trends (COP21, green bonds, SDGs, climate change,…)***
- ✓ ***TCFD requirements***
- ✓ ***EU non-financial disclosure for large listed entities***
- ✓ ***HLEG recommendation on sustainable finance***
- ✓ ***Example of the French regulation (art 173)***

The Task force on Climate-related Financial Disclosures (TCFD)
Introduction

What is the TCFD?

The TCFD is a private sector-led, policy-neutral task force that seeks to develop recommendations for voluntary climate-related financial disclosures that are **consistent, comparable, reliable, clear, and efficient, and provide decision-useful information to lenders, insurers, and investors.**

Who make up the TCFD?

The TCFD was established by the Financial Stability Board (FSB) of the G20 countries. The FSB is chaired by Mark Carney. The TCFD was founded and chaired by Michael Bloomberg. **Deloitte is represented on the TCFD by Eric Dugelay (Global Leader, Sustainability Services).** The task force has 32 representatives, including C-Suite representatives from major corporates and financial sector actors, including both users and preparers of disclosures from across the G20's constituency covering a broad range of economic sectors and financial markets.

What is its mission?

The FSB Task Force on Climate-related Financial Disclosures (TCFD) developed voluntary, consistent climate-related financial risk disclosures for use by companies in providing information to investors, lenders, insurers, and other stakeholders. Its report was published on 14 December, 2016, and is proposed for public comment for a period of two months.

The Task force on Climate-related Financial Disclosures (TCFD)

Sectors on which the TCFD focused its attention

Guidance is produced for the financial sector, then four groups of non-financial sectors (Energy, Materials & Buildings, Transportation & Agriculture).

Sectors and key industries for making disclosures	
Financial	Banks
	Insurance Companies
	Asset Owners
	Asset Managers
Non-Financial	Energy
	Transportation
	Material & Buildings
	Agriculture, Food, and Forest Products

The financial and non-financial industries highlighted are those seen as most constrained by reliance on three key factors:

- Greenhouse gases
- Energy
- Water

Sector and industry-specific guidance is provided in the TCFD's Annex document *Implementing the TCFD's Recommendations (2016).*

The French regulation Article 173
ESG reporting requirements

Less than 500 Million Euro Balance sheet

ESG Reporting

- ESG policy must stipulate the content, frequency and resources used to inform investors, Beneficiaries and clients
- Integration of ESG criteria in investment policies
- “Distinctions by activity, asset class, investment portfolio, issuer, sector or any other relevant breakdown”
- For asset managers, it must include a list of the funds integrating ESG criteria, as well as the share of these funds in the overall assets under management, together with any adherence to a specific charter, code, initiative or certification

More than 500 Millions Euro Balance sheet

ESG reporting + Climate reporting

- Management of climate change-related risks and their contribution to the financing of the green economy
- Risks must be explained with data and scenario
- Carbon footprint should be disclosed

Entry into force from June 30, 2017

The French regulation Article 173

Information required (comply or explain)

	Decree content
Information regarding the entity	Presentation of the Responsible Investment approach
	Means implemented to inform stakeholders
	% of AuM that integrate ESG criteria
	Memberships
	Processes and procedures to assess ESG risks
ESG criteria and investment policy	Details on ESG criteria
	Sources of information
	Methodology and analysis results
	Impact of ESG analysis results on the investment policy
Climate criteria and investment policy	Details on climate criteria
	Sources of information
	Carbon footprint
	% of AuM that contribute to the energy transition (CBI categories)
	Exposure to climate change risks
	2°C alignment of the investment policy
	Existence of targets
	Implementation of a shareholder stewardships policy regarding energy transition

High Level Expert Group on sustainable finance
Recommendations

1. To introduce a common sustainable finance taxonomy to ensure market consistency and clarity, starting with climate change
2. **To clarify investor duties to extend time horizons and bring greater focus on ESG factors**
3. **To upgrade Europe’s disclosure rules to make climate change risks and opportunities fully transparent.**
4. To empower and connect Europe’s citizens with sustainable finance issues
5. To develop official European sustainable finance standards, starting with one on green bonds
6. To establish a ‘Sustainable Infrastructure Europe’ facility to expand the size and quality of the EU pipeline of sustainable assets
7. **To reform governance and leadership of companies to build sustainable finance competencies.**
8. To enlarge the role and capabilities of the ESAs to promote sustainable finance as part of their mandates

ESG – Latest trends

Impact for ETFs providers

- ✓ ***Need to provide data to institutional investors***
- ✓ ***Need to reinforce their range to cope with investor demand***
- ✓ ***Need to work on non-financial reporting to follow on best practice***

Q&A

Next Link'n Learn
Date: Thursday 22nd March 2018
Topic: Investment Management Funds