

Seizing Opportunities in Asia Pacific's Expanding ETF Market



ETF launches in Asia-Pacific this year appear on track to exceed last year's total, with 254 new ETFs as of September, according to ETFGI. That compares with 284 new ETFs for the whole of 2020, which in itself was more than the US and EU combined.



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Exchanges and regulators in Hong Kong, Singapore and Australia have been taking steps to promote growth in the exchange traded fund (ETF) industry, encouraging asset managers to develop local products in Asia.

It seems to be working, as the new ETF launches in Asia last year outstripped those in the United State (US) and European Union (EU) combined. As they seek to capitalise on rising opportunities, the region's asset managers must ensure they have the right operating model in place.



A Supportive Environment



A Focus on Local ETFs



Active ETFs on the rise in Australia



Gearing Up the Operating Model



A Supportive Environment

ETF launches in Asia-Pacific this year appear on track to exceed last year's total, with 254 new ETFs as of September, according to ETFGI.¹ That compares with 284 new ETFs for the whole of 2020, which in itself was more than the US and EU combined.

Growth has picked up since the Hong Kong Exchange (HKEX) took steps to improve liquidity and turnover in the ETF market last year. First, they enhanced the trading regime by forcing market-makers to provide continuous two-way pricing with a prescribed size and spread for 80 percent of the trading day.

Second, they introduced a spread table, which narrowed the minimum achievable spread by between 50 percent and 90 percent.² This resulted in trading spreads for ETFs with underlying securities in the Hong Kong and China markets narrowing by 50 percent and 25 percent respectively, while US dollar-denominated products saw a 40 percent reduction.

Combined, these steps resulted in investors saving Hong Kong Dollar 825 million (\$106 million) in transaction costs last year, a key metric for asset managers needing to evidence best execution.

Figure 1: Global growth in the ETF market

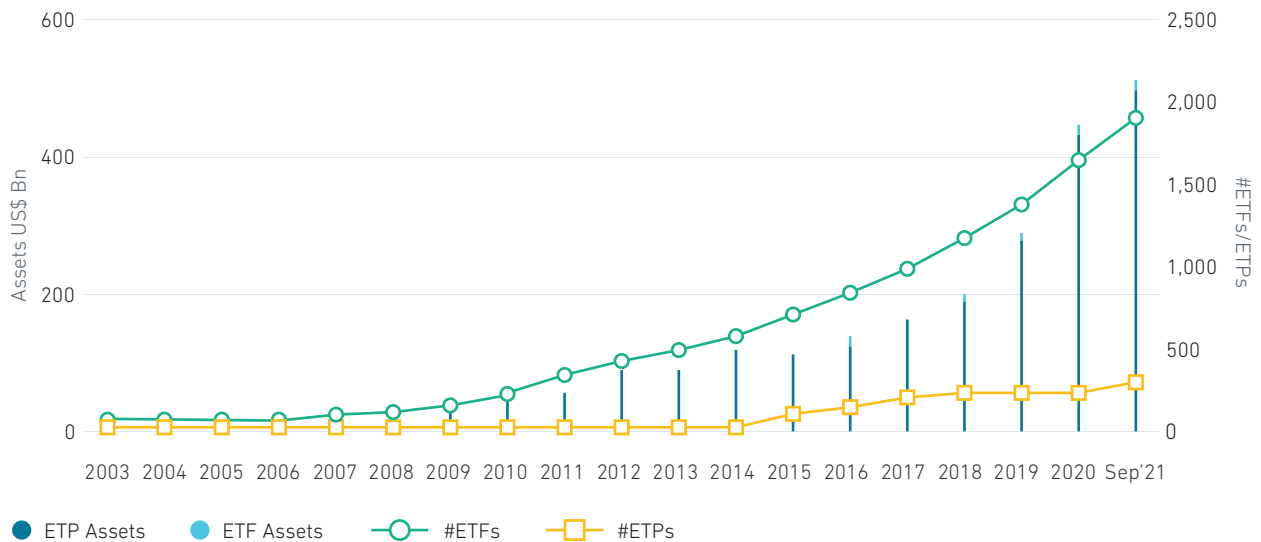
Year-End	Number of ETFs	Increase	Percentage Increase	AUM (Bn)	Percentage Increase
2018	6,483	–	–	\$4,661	–
2019	6,970	487	7.5%	\$6,118	31.3%
2020	7,602	632	9.1%	\$7,737	26.5%
2021 (end Sept)	8,243	641	8.4%	\$9,266	19.8%

Source: ETFGI

¹ <https://etfgi.com/>

² https://www.hkex.com.hk/-/media/HKEX-Market/Products/Securities/Exchange-Traded-Products/Attachment/HKEX--Assessing-the-impact-of-HKEX's-ETF-liquidity-enhancements_whitepaper_en.pdf

Asia Pacific ETF and ETP Growth



Source: ETFGI data sourced from ETF/ETP sponsors, exchanges, regulatory filings, Thomson Reuters/Lipper, Bloomberg, publicly available sources, and data generated in-house.

Source: ETFGI³

In a further boost for its local market, Hong Kong waived stamp duty for ETFs listed on its exchange and trading domestic stocks, creating a further 10 basis points of savings for institutional investors. Managers were also allowed to rebalance the underlying stocks in an ETF without the need to pay stamp duty on those transactions, a significant move for ETFs that either track a popular index such as the Hang Seng, or invest in Shanghai A Shares.

And Hong Kong hasn't finished there. This year, with the aim of further internationalising the local market, attention has turned to fixed-income ETFs, with a focus on reducing fees and costs and improving efficiency.

Singapore has taken a slightly different approach. It focused initially on improving market infrastructure, such as deal processing and settlement, in order to catch up with international norms. It also relaxed rules that initially classified ETFs as complex financial instruments, that were previously restricting investor access.

² ETFGI reports record assets and net inflows into ETFs and ETPs listed in Asia Pacific (ex-Japan) of US\$518 billion and US\$64 billion respectively at end of September 2021, ETGI, October 22 2021

The introduction of the Variable Capital Company (VCC) Act in January 2020 created a flexible fund structure with significant tax breaks and other incentives designed to attract asset managers looking to establish new funds – including ETFs – or re-domicile overseas funds to Singapore.

Singapore's ETF market is also benefitting from its rising status as a hub for FinTech companies. Robo-advisory platforms are an increasingly popular investing solution, and they tend to rely more heavily on ETFs for their ease of trading versus traditional mutual fund-type structures. Singapore is fast becoming a domicile of choice for these platforms and this is helping to drive growth in its ETF markets.

Meanwhile, in Australia's more mature ETF market, regulators are now turning their attention to crypto-asset exchange traded products (ETPs). Although crypto ETPs and crypto ETFs have gained some traction in Europe and North America respectively, none of these products have been originated in Asia-Pacific yet. But Australia looks set to be a forerunner in the region.

In October 2021, the Australian Securities and Investments Commission (ASIC) took the market by surprise by releasing guidelines on crypto-asset related investment products.

The regulator has voiced concerns about whether crypto-assets can be reliably priced, how crypto-assets should be classified with respect to underlying asset rules, and how product issuers can ensure these products comply with Australia's regulatory framework, including for custody, risk management and disclosure.

But its October announcement that providers of exchange traded crypto funds could advance, providing they had detailed custody arrangement and certain disclosures, is seen as setting a path for the first crypto-backed ETPs in Australia.

Within days of this announcement, Betashares launched their Crypto Innovators ETF (ASX: CRYP) and by the end of the first day of trading a new record of AU\$39.7 million in volume traded was set. Additionally, the fund set a new record for a single day's net inflows for an ASX ETF.⁴

⁴ [https://www.betashares.com.au/insights/cryp-smashes-
aus-etf-record/](https://www.betashares.com.au/insights/cryp-smashes-aus-etf-record/)



A Focus on Local ETFs

The goal of the region's regulators is to support those asset managers that want to invest in Asian stocks and encourage them to do so via Asian ETFs. This is becoming more relevant as Asia's – and in particular, China's – weighting in global indices continues to rise in tandem with the region's proportion of the world's gross domestic product, drawing in more index-tracking investment funds.

Hong Kong-based CSOP Asset Management launched a Singapore-listed ETF in September 2020 that tracks the China Government Bond Index. Within two months, it surpassed US\$1 billion in assets to become the single-largest China bond ETF outside of China, helped by the fact the Financial Times Stock Exchange Russell World Government Bond Index announced that China's bonds would be included for the first time from 2021.

The region's asset managers are also seeking to capitalise on institutional and retail investor demand for thematic products – such as technology- or environment, social, governance (ESG) -focused funds – using ETFs. An ETF gives immediate exposure and a cost-effective means of building allocations to a specific theme – or even sub-theme, such as electric vehicles.

Asian ETFs come with the added advantage that securities can be traded intraday on local exchanges. By contrast, a US-listed China ETF, for instance, or a mutual fund, uses the daily closing price in New York for its net asset value (NAV), leaving an investor with potentially unhedged risk exposure for the entire Asian trading day.

In China late last year, four fund managers, including China Asset Management Co. Ltd, launched ETFs that track the Shanghai STAR 50 Index, which is made up of China's top 50 technology companies and has a lower barrier to entry than trading individual stocks, many of which are restricted to "savvy" investors due to their extreme volatility.⁵

Due to the lower regulatory hurdles, an ETF can now be created quicker than a mutual fund, allowing investors to jump on a new trend. Since the CSI Wind Power Industry Index debuted in China at the end of April, 11 ETFs tracking the index have been launched.

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⁵ <https://www.asiafinancial.com/chinas-first-star-50-index-etfs-start-trading>



Active ETFs on the rise in Australia

Australia's ETF market has a rather different look to those in Hong Kong and Singapore, however, with a pivot towards actively managed strategies underway.

Since the launch of the first actively managed ETF six years ago, these strategies have risen to account for more than 20% of the Australian ETF market today. As of October 2021, there were 41 active ETFs listed on the ASX, and 16 quoted managed funds (QMFs) on the Chi-X exchange, with several more expected in the coming months.⁶

This shift has been driven both by managers converting existing listed investment companies (LIC) into ETFs, and a spate of new listings. And it has been spurred by the innovative dual access model now available to managers listing ETFs in Australia.

The dual access structure enables active managers to run a single register for both unlisted and listed investments. As a result, managers can gain greater operational and investment efficiencies, and investors now have a choice in how they access their fund of choice.

In April 2020, Magellan launched the Airlie Australian Share Fund, and earlier this year, AllianceBernstein launched their Managed Volatility Equities Fund on the Chi-X exchange—both leverage the dual access model.

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⁶ The rise of active ETFs challenges Listed Investment Companies and Trusts, Australian Investment Exchange Limited, October 22 2021



Gearing Up the Operating Model

The fact that Hong Kong and Singapore have taken a different approach to supporting ETF markets also highlights one of the main challenges in the Asian industry—regulatory fragmentation. Asia presents greater complexity when it comes to scaling an ETF business as opposed to the single markets of the EU or the US. So, while the authorities have helped by easing regulations, support is also needed to follow them correctly—and in a way that keeps costs down.

Using an experienced international service provider therefore presents a distinct advantage for firms looking to expand their ETF footprint in the region. For example, ETFs are required to make daily NAV announcements. Across Asia, these announcements need to be made at different times and in different languages depending on which exchange they are listed on. This process can quickly become time-consuming and there is a risk of financial penalties for incorrect filing. International providers should already have an automated system in place to facilitate this process for their existing global clients, making it easy to add another at marginal cost.

They can also offer end-to-end servicing to ETF managers, including accounting, custody, basket generation and unit registry. Outsourcing the bulk of these administrative burdens not only offers economies of scale, but also allows a fund manager to spend more time managing the portfolio and delivering investment performance for investors.

As Asia-Pacific managers expand their ETF businesses, they may want to launch complex products, such as multi-asset, crypto and actively managed strategies. Rather than grappling with myriad different regulatory regimes across the region, managers can turn to a single provider that has experience supporting such products in Europe and the US, and can help them navigate and bring these products to market efficiently and economically.

Importantly, this growth will enable managers to tap into scale benefits and evaluate the processes that can be streamlined through greater automation. A great example of this is in the primary market where manual process and outdated methods of connectivity between counterparties is still prevalent. Technology is now removing these legacy processes through online trading portals that allow for the creation and redemption of ETFs, designed as a single point of access to multiple sponsors. These robust and automated trading solutions provides direct access to ETFs in multiple currencies, including cryptocurrencies and supply direct links between authorised participants, distributors, transfer agents and sponsors.

The combination of regulatory tailwinds, the availability of professional service providers and the natural increase in demand flowing from rising global weightings, make a compelling case for more asset managers to create ETFs in Asia and, for Asia. Even though Asian ETFs had their best year in 2020, they still only account for 10 percent of the global ETF market, suggesting there is significant scope for further growth.

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