STATE STREET

The changing economics of ETFs

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Introduction

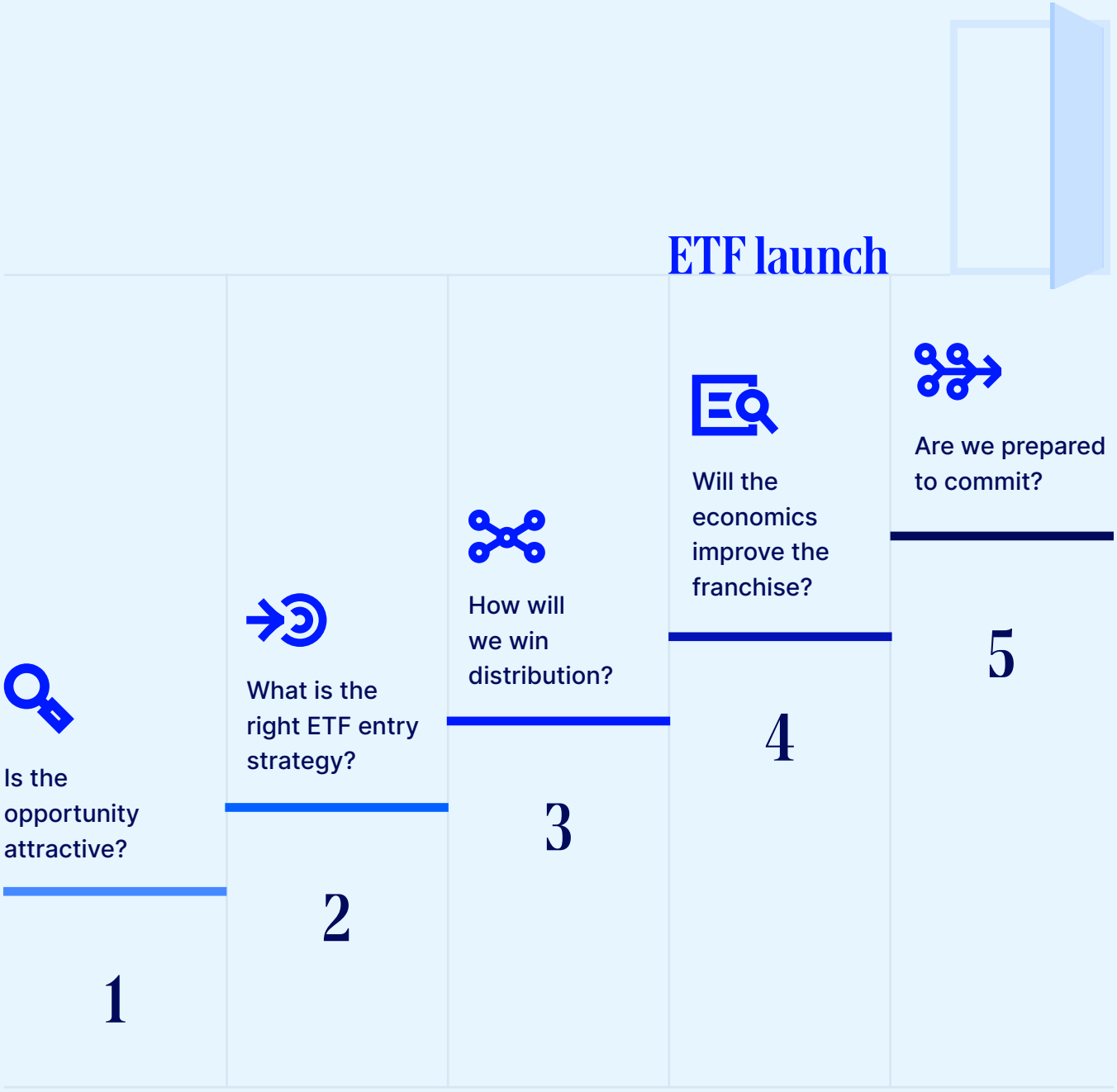
The ETF industry continues to grow at remarkable speed, creating new opportunities for managers to retain assets, reach new investors, and modernize product delivery. But the economics underpinning that growth is shifting. Firms that succeed will be those able to translate demand into durable revenue, broader distribution, and stronger franchise growth.

ETF demand is no longer in question. At the end of June 2026, Global ETF assets had surpassed US$23 trillion supported by record first-half net inflows of more than US$1.3 trillion.[1] The ETF market has moved beyond the point where asset managers can treat the wrapper as a specialist product decision. However, a critical challenge is translating investor adoption into sustainable economics for issuers.

For traditional asset managers, new routes such as conversions, ETF share classes, and Section 351 exchanges have broadened the strategic options for entering the ETF market, while active and outcome-oriented strategies offer greater potential for differentiation and pricing. But an ETF can broaden access to an investment capability, open new distribution channels, and strengthen client relevance, while at the same time changing the revenue profile of the fund. The fee may be lower and distribution paradigms and investor targets may shift. A listed ticker creates availability, but demand still has to be earned through platform access, model relevance, sales commitment, data quality, and credible trading experience.

As the economics of ETF participation evolve, asset managers face a series of strategic decisions around market entry, distribution, operating models, and franchise value. This paper outlines five critical decision points that can help managers evaluate ETF opportunities and determine whether growth is likely to strengthen long-term franchise economics (See Exhibit 1).

Exhibit 1: Five management decisions to determine whether ETF growth creates long-term franchise value



[1] ETFGI, "Global ETF Industry Reaches Record US$23.09 Trillion as YTD Net Inflows Hit All-Time High of US$1.33 Trillion at the end of June," July 15, 2026.

Is the opportunity attractive?

The evolution of the ETF market has significantly expanded the opportunity set for asset managers. The first generation of ETFs was built around broad passive exposures where scale and price were decisive.

The next generation used thematic, factor- and rules-based strategies to create differentiation. The post-Rule 6c-11 era opened a broader path for active management and accelerated product innovation. More recently, conversions, multi-class structures, and tax-efficient asset migration transactions have given managers additional ways to bring existing capabilities and assets into ETFs.

Active and complex ETFs widen the opportunity — and the burden

Active ETFs represent the broadest opening for many traditional asset managers because they allow a firm to bring an existing investment capability into a wrapper that advisors, models, and platforms increasingly use. Their growth is meaningful: Active ETFs held in excess of US$2.5 trillion globally at the end of June 2026 and gathered more than US$500 billion in net inflows during the first six months of the year.[2]

The opportunity is broad, but the most attractive economics will vary by strategy and channel. Active fixed income, income-oriented, options-based, and outcome-oriented strategies have gained attention because they solve recognizable portfolio problems and can support higher fees than broad passive exposures. They also attract competitors quickly.

While complexity can create differentiation, the operating model must be designed so that additional requirements do not erode the economic opportunity. Options-based income, buffered, defined-outcome, leveraged, digital-asset, and other specialized strategies may require stronger scenario analysis, derivative oversight, collateral management, valuation, tax review, disclosure, liquidity monitoring, and advisor education.

[2] ETFGI, "Global Active ETFs Gather Record US$500.88 Billion in YTD Net Inflows as Assets Climb to US$2.56 Trillion at the end of June," July 27, 2026.

The question of governance is equally important. Management should decide whether the strategy is consistent with the firm's brand, risk appetite, and ability to explain outcomes through different market environments. A product can perform as designed and still disappoint an investor who did not understand the trade-off.

The changing investor base

The opportunity has expanded not only because the ETF wrapper has evolved, but also because the investment value chain has changed. Digital brokerage platforms and robo-advisors have lowered barriers to entry and broadened access to markets, bringing a larger and more diverse investor base into ETFs. At the same time, the structural advantages of ETFs, including accessibility, transparency, low cost, liquidity, and tax efficiency, have made them the preferred vehicle across many digital and self-directed investing platforms. Together, these shifts have accelerated ETF adoption among a new generation of investors, further reinforcing the wrapper's central role in portfolio construction.

Risk-adjusted economics

Complex strategies can support higher fees, but those fees must be weighed against the additional costs they create. Governance, advisor education, surveillance, risk oversight, and operational support all carry economic implications. As a result, gross revenue potential is not the same as risk-adjusted profitability.

US$2.5T+

Global active ETF assets*

US$500B+

Net active ETF inflows during the first six months of 2026*

*ETFGI, "Global Active ETFs Gather Record US$500.88 Billion in YTD Net Inflows as Assets Climb to US$2.56 Trillion at the end of June," July 27, 2026.

What is the right ETF entry strategy?

ETF entry is often considered a launch decision, but that framing is too narrow for today's complex market.

The right path depends on the business objective, the assets already in place, the strategy's tax and liquidity profile, the firm's time horizon, and the capabilities it is prepared to own. The key question to ask is this: Which route best fits our objectives and capabilities? (See Exhibit 2).

Conversions are no longer experimental. They can allow a firm to modernize product delivery, retain assets, and preserve a strategy's history without starting from scratch. The relevant question, however, is not whether conversion is possible. It is whether the converted shareholder base, target channel, and future economics justify the change.

ETF share classes create different opportunities. The potential benefit is the ability to serve multiple access points through one portfolio. The governance challenge is ensuring that costs, tax outcomes, liquidity, and shareholder activity remain fair and operationally manageable across classes.

Issuers may face costs via both revenue share and soft dollars or how the balance of trade is managed with partners. In some cases, brokerage or platform economics may become a more visible negotiation between ETF issuers and distribution partners.

This is more evident now than ever before with the addition of active ETF share classes as they are designed to provide a frictionless off-ramp for investors from the mutual fund class to the ETF class. This feature has not been available historically, creating natural inertia for many long-term mutual fund investors. This challenge is particularly acute for newer entrants and smaller issuers, as restricted platform access or unexpected distribution costs can make it harder to achieve scale despite a sound product strategy.

Section 351 exchanges can provide another pathway for taxable investors to contribute eligible diversified securities to an ETF in exchange for shares without an immediate taxable sale, subject to the requirements of the tax code and the facts of the transaction.

For the issuer, these transactions may provide meaningful initial scale. They also require disciplined review of diversification, tax, portfolio construction, execution, and investor suitability. These transactions can be viewed as an asset-migration capability, not simply a seeding technique.

The important decision on entry is not which structure is newest. It is which path best matches the objective: new growth, retention, modernization, tax efficiency, model access, or capability acquisition.

Exhibit 2: ETF entry strategies to consider

Path	Best suited for	Primary economic consideration
Standalone launch	A differentiated strategy with a defined buyer, channel commitment, and credible path to scale.	Requires new asset gathering, seed, and sustained distribution investment.
Mutual fund-to-ETF conversion	An established strategy whose investors and distribution profile are increasingly ETF-oriented.	Can preserve track record and assets, but changes holder experience, distribution, and operating requirements.
ETF share class	A strategy that can serve both mutual fund and ETF investors within one portfolio.	May create product-operational leverage but requires careful tracking and enhanced board reporting.
Section 351 exchange	Taxable investors or advisors seeking to contribute diversified securities into an ETF without an immediate taxable sale, subject to applicable requirements.	Can provide day-one assets but requires transaction expertise, suitability discipline, and, most importantly, regulatory awareness.
Acquire or partner	A manager seeking talent, capabilities, speed to market or an established ETF platform.	Trades build cost and time, for acquisition price, integration risk, shared economics, or potential reduced control
Selective non-entry	A strategy with capacity, liquidity, transparency, economic, or channel characteristics that do not support an ETF.	Protects IP and management attention; the opportunity cost should be assessed.

How will we win distribution?

While new ETF entry pathways have made participation easier, building a durable ETF franchise remains challenging. Distribution is the often-overlooked requirement to achieve this goal.

A newly listed fund enters the US market with thousands of other ETFs and listed equities competing for attention, screens, models, and trading volume. To put that in perspective, there are 5,000+ ETF tickers in the US and 5,500+ listed equities. A listing creates access; focused distribution turns that access into a business.

In practice, distribution power has become more concentrated. Individual advisors still matter, but portfolio construction is increasingly influenced by centralized models, home offices, broker-dealer platforms, RIAs, digital interfaces, and due-diligence teams. These gatekeepers evaluate more than performance. They look at the role a product plays, the stability of the issuer, liquidity, spreads, portfolio transparency, fee discipline, data completeness, and the manager's ability to support the product after launch.

Model inclusion can produce immediate scale, but it also changes the commercial equation. The first credible buyer may require a meaningful track record, minimum AUM, trading history, or operational proof before allocating. The issuer can therefore face a sequencing problem: Assets help create credibility, but credibility is often required before assets arrive.

This is why distribution commitment needs to be established before launch. The product team should be able to identify the likely first buyer, the client problem being solved, and the sales resources accountable for adoption. "The market is large" is not a distribution plan.

Will the economics improve the franchise?

A credible ETF business case must reconcile product-level economics with franchise-level economics. That means evaluating how the decision affects the broader enterprise, not just the expected fee revenue of a new fund.

At its core, the decision comes down to a simple question: If the ETF succeeds, how does the economics of the firm improve? If growth comes primarily from migrating existing assets into a lower-fee wrapper, what strategic benefit compensates for the revenue compression? The answer may be increased asset retention, access to new distribution channels, stronger client outcomes, improved competitive positioning, or the development of capabilities that create future growth opportunities. Whatever the rationale, the economic trade-off should be explicit and measurable.

Management should also distinguish product breakeven from franchise breakeven. A single ETF may remain subscale while still supporting a client relationship, model mandate, or broader product family. Conversely, a product can appear profitable before the enterprise costs of distribution, technology, risk, and shared services are fully recognized. Both perspectives are useful. Neither should be confused with the other.

The analysis should also be run through more than one scenario. A base case often assumes market appreciation, steady inflows, and timely platform access. The downside case should test slower flows, fee pressure, a market decline, delayed model inclusion, higher seed requirements, and a longer support period. The upside case should identify what additional investment is required if adoption arrives faster than expected. Growth can create margin leakage and control risk when operating capability is built too late.

Management teams should evaluate the full economic impact of an ETF initiative across the franchise (See Exhibit 3). This framework can help management distinguish growth that is accretive, defensive, or dilutive but strategically necessary by evaluating revenue, cost savings, retention, cannibalization, and longer-term strategic value.

Exhibit 3: The franchise economics assessment framework

Existing revenue at risk

Which mutual fund, SMA, CIT, or other assets could migrate? What revenue yield and contribution margin do they produce today?

Cost to serve

Which expenses scale with products, assets, complexity, and markets? Which can be shared across the franchise?

New ETF revenue

How much AUM is expected by year, at what net fee, and from which buyer or channel?

Cannibalization

Are assets new to the firm, shifted from a higher-fee product, or moved from a competitor?

Retention value

What assets are likely to leave the firm if an ETF option is not offered? How much of that risk is observable versus assumed?

Breakeven and downside

What AUM and revenue level covers direct and allocated cost? What happens if flows arrive later, fees fall, or markets decline?

Cost to launch

What seed, legal, board, exchange, listing, staffing, data, index, trust, and service provider cost is required?

Strategic value

Does the launch create reusable capabilities, data, relationships, or a product family that improves later economics?

Cost savings and avoidance

What costs can be eliminated or spread across a wider asset base? What existing infrastructure (fund complexes, regulatory approvals, resourcing, etc.) can be leveraged? What taxes or transition costs can be avoided? What future costs become unnecessary if the product set is simplified?

Cost to access

What platform, sales, marketing, model, data, analytics, and capital markets investment is needed to win adoption?

Understanding market costs

Market access has both explicit and implicit costs, or put another way, revenue-sharing arrangements and the allocation of soft dollars across partners. These can include seed capital, lead market-maker support, platform data, portfolio analytics, sales coverage, marketing, wholesaler education, due-diligence support, and capital markets engagement. In some cases, the economics are also embedded within broader relationships with platforms and intermediaries. The full cost may not appear in the product P&L, but it remains an enterprise cost of gathering assets.

Trading experience is part of product experience. Investors and advisors experience an ETF through bid-ask spreads, market depth, premiums and discounts, execution quality, and the ability to obtain support on larger trades. Capital markets capability is therefore not a post-launch service. It is part of product design, distribution, and brand.

Building lifecycle discipline

ETF entry benefits from clear lifecycle discipline. The business case should establish review dates, AUM and revenue milestones, commercial indicators, reinvestment triggers, loss tolerances, and closure or merger criteria.

These gates help management direct resources toward products with the strongest prospects and prevent underperforming product inventory from consuming sales attention, operating capacity, and management time without improving franchise economics.

Management should also distinguish product breakeven from franchise breakeven. A single ETF may remain subscale while still supporting a client relationship, model mandate, or broader product family.

Are we prepared to commit?

Successful ETF franchises are built through organizational commitment, not product launches. By the time a firm reaches this stage of the decision process, it should already have assessed the attractiveness of the opportunity, selected an entry pathway, evaluated its distribution strategy, and tested the economics.

The final question is whether the organization is prepared to commit the resources, governance, and leadership attention required to succeed.

This matters because ETFs create dependencies across functions that do not always exist in other investment vehicles. Product, distribution, capital markets, operations, legal, compliance, finance, technology, and service providers must work from the same assumptions and pursue the same objective.

A product can clear every investment and commercial hurdle yet still fail if internal alignment is weak, accountability is unclear, or critical capabilities are under-resourced.

Before treating a launch date as the objective, management should be able to answer a series of strategic questions (See Exhibit 4). These questions help determine whether the organization is aligned on the desired outcome, understands the economic trade-offs, has identified a credible path to adoption, and is prepared to operate and govern the product throughout its lifecycle.

Exhibit 4: Management questions to resolve before launch



What business outcome are we trying to create or protect?

Growth, retention, modernization, tax efficiency, model access, and brand repositioning require different products, pricing, and success measures.



Is expected AUM new, retained, migrated, or cannibalized?

Asset growth can coexist with revenue compression. Management needs to understand the enterprise impact, not only the ETF's AUM.



What must be true operationally and from a governance perspective?

Daily precision, liquidity oversight, trading support, disclosures, controls, and fast decision rights need to be in place before scale arrives.



Why do we have the right to win with this strategy, buyer, and channel?

A differentiated investment capability, client franchise, distribution advantage, or credible brand matters more than simply entering a growing market.



What is the full cost to access and serve the market through breakeven?

Seed, market-making, platform, data, capital markets, legal, service-provider, sales, and operating costs materially affect profitability.



What are the three-year milestones, downside triggers, and exit criteria?

Leadership should define success beyond AUM and avoid supporting subscale products indefinitely.



Who is the first credible buyer, and what commitment exists today?

A launch is more credible when there is a defined use case, distribution owner and path through platform or model due diligence.



Which entry pathway best fits the objective?

A standalone launch, conversion, share class, Section 351 exchange, acquisition or partnership can produce different timing, control and economic outcomes.



What is the consequence of waiting or not entering?

Not every manager should enter every category, but the cost of losing relevance, assets, or channel access should be assessed.

The purpose of these questions is not to eliminate uncertainty. Rather, it is to ensure the organization is making informed trade-offs. In many cases, an ETF launch may be strategically attractive even when near-term economics are modest or initially dilutive. What matters is that the rationale, expected outcomes, investment requirements, and risks are clearly understood across the organization.

Governance and accountability

Strategic alignment is necessary, but it is not sufficient. ETF markets move quickly, and even well-designed products can struggle if decision rights are unclear or internal processes are too slow. In practice, governance failures can be just as damaging as product failures.

Management should establish clear ownership across critical areas, including pricing, platform spending, market-maker relationships, product enhancements, risk acceptance, and closure decisions.

Accountability should be defined before launch, not after a product reaches scale. Without clear governance, firms often find that operational complexity and internal coordination become constraints on growth.

Success also requires a balanced scorecard. Assets under management are an important measure of progress, but they are not a complete measure of success. Management should track performance across a broader set of indicators, including net new versus migrated assets, revenue yield, margin contribution, distribution wins, trading quality, sales productivity, client concentration, operating performance, and progress against breakeven expectations.

Ultimately, ETF success depends on organizational alignment as much as investment capability. The firms best positioned to succeed are not necessarily those with the most products, but those with a shared management agenda, clear accountability, disciplined governance, and a willingness to invest consistently behind their chosen strategy.

Conclusion

Focus on the quality of the next dollar of AUM

ETF demand is established. The opportunity now facing asset managers is determining whether ETF growth strengthens the economics, reach, and relevance of the franchise.

AUM growth has long been treated as a proxy for business success, but asset growth and economic value are not the same thing. Rising markets can increase assets even when organic growth is weak, and a higher fee strategy does not automatically produce higher margins. Likewise, the firms with the largest ETF asset bases are not necessarily the firms generating the greatest economic value.

Against this backdrop, ETF decisions should be evaluated through the lens of the next dollar of AUM. Management needs to understand whether that dollar is new, retained, migrated, or cannibalized; what it costs to acquire and serve; and how it affects the broader economics of the firm. In practice, an ETF decision may be accretive, defensive, or dilutive but strategically necessary. What matters is that the trade-off is fully understood and intentional.

For many firms, offering an ETF is both a growth opportunity and a strategic means of retaining assets, expanding distribution channels, reaching new investors, modernizing product architecture, and maintaining relevance in a changing marketplace. The strongest opportunities will be those where the wrapper improves investor outcomes, and the business model supports sustainable scale.

The firms best positioned for the next phase of ETF growth will not necessarily be those with the most products or the most assets. They will be the firms that make disciplined decisions about where they have a right to win, where ETFs improve investor outcomes, and where the resulting growth strengthens long-term franchise economics.

Ultimately, ETF entry is a franchise decision, not a product decision. The objective is not to participate because the market is growing. It is to participate where the wrapper improves client access and the firm can build durable economics around that access.

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