QAP Analytic Solutions

EXECUTIVE SUMMARY

January 2017

Study on ETFs, Active Funds, Robo Advisory and Regulation in German Wealth Management

In late 2016, QAP Analytic Solutions conducted a survey in cooperation with German wealth managers. The structured questionnaire encompassed the topics ETFs, active funds, regulation and digitalization. The structure of the survey enabled a free dialogue with the managers. They were able to express their views, opinions, concerns and solutions to challenges throughout the conversations. The following summary contains selected results and insights from the survey.

86% of the respondents invest in ETFs for their client accounts. All of the respondents, who are not utilizing ETFs, are also not planning to invest in ETFs within the next twelve months.

33% of wealth managers that have been using ETFs for a relatively short time consider ETFs as very important for their own company. Unexpectedly, wealth managers who have been using ETFs for a longer period of time, consider ETFs as less important for their own company.

Low costs are the main reason to implement ETFs. In this matter the survey covered the product costs as well as the internal costs of the wealth manager. On average, the respondents mentioned two triggers for using ETFs. The second most important reason is asset allocation / investment strategy. Obviously, ETFs serve wealth managers better than active funds in that respect. The performance of active funds is on third place.

96% of wealth managers investing in ETFs allocate to equity ETFs. 58% utilize bond ETFs. Those who use Alternatives ETFs in their client portfolios do not often allocate to bond ETFs.

Almost half of the wealth managers who work with ETFs, mentions their own asset allocation decision as one value added for their clients.

An ETF user is significantly more likely to allocate to bond ETFs, if he named transparency as an added value of ETFs. If asset allocation or timing is stated as an added value, commodity ETFs are likely to be used. This indicates a tactical allocation of the asset class through ETFs.

ETF AND ACTIVE FUND SELECTION

By far the most important ETF selection criterion is physical replication. The provider support is mentioned even before costs and risk return figures. This fits with the result that the ETF issuer's website is named as the first and most used source of information.

It has been known that ETFs replace active funds. 96% of respondents divested from active funds in favor of ETFs. Only a very small number divested from hedge funds to increase ETF allocation.

There is a good indication that the replacement of active funds by ETFs is at saturation level in the portfolios of early adopters. ETFs seem to have a clearly defined role in those wealth manager's portfolios. Early adopters have more often determined to allocate into active funds for certain asset classes.

The ratio of determination for ETFs towards active funds is the highest for US equities and the lowest for corporate bonds, emerging market equities, and commodities.

Outperformance received the lowest score among all explicit advantages of ETFs compared to active funds. Surprisingly, as the low costs of ETFs implicitly contribute to performance. However, only 10% say that ETFs perform worse than active funds in the long run. The listed advantages that received the highest scores from respondents are "total costs / effort for the company" and "customer acceptance".

Respondents did not agree on one segment or topic for which an ETF might be missing or for which product choice is not sufficient. Thus the most relevant asset segments and investment topics seem to be adequately covered.

On the subject of Smart Beta ETFs, once again there exists a divergence between early and newer ETF investors. Only 20% of the early adopters use Smart Beta products in their portfolio while more than half of the wealth managers with less ETF experience invest in this category. A clear and consistent definition of the Smart Beta term is missing.

The new ETF investors among wealth managers take their time for ETF selection and apply more criteria. At the same time, more than half of this group does not compare the selected

ETFs with active funds on a continuous basis. On the other hand, approximately 70% of the early ETF investors compare ETFs with active funds, on quantitative figures alone.

The early adopters use active funds for markets which are commonly viewed as not being the most efficient ones and for markets outside of their home bias. Therefore, allocation to external managers takes place for segments where those managers expertise can add most value. In general, we assume that the early ETF investors use plain vanilla ETFs and apply more time and effort on the analysis of active funds.

ETF TRADING AND REGULATION

90% of all market participants who mentioned timing with ETFs as an added value, trade on stock exchanges

Only one third of the wealth managers who use ETFs receive pre-trade analysis.

Only 20% consider tradability and trading costs in the ETF selection process.

Trading of ETFs has still a lot of potential. The concern to violate best execution requirements leads to implementation of the requirements with the smallest effort for the daily investment process. This results in the renouncement of trading opportunities for 35% of the respondents.

DIGITALIZATION NOT WITHOUT ETFS

The biggest challenge for wealth managers on their sales side is to reach customers and potentials through digital channels. Again, there are significant differences between the two groups of wealth managers. Relatively young ETF investors mentioned this challenge more often.

Regulation is the biggest challenge in the sales department of early ETF investors.

80% of the wealth managers think that ETF are an appropriate vehicle to tackle their individual challenges. This large number of agreement on ETFs as a solution provider is even higher for the group of new ETF investors.

Not even half of the wealth managers have implemented or plan to implement online wealth management. Here, too, the younger ETF investors seem to be more progressive in this topic and show a higher rate. The wealth managers, who are not investing or not planning to invest in ETFs, are also not planning to offer Robo Advisory.

CONCLUSION

- **New ETF users among the wealth managers show stronger commitment to ETFs (relevance for their company, less attracted by active funds, trading setup). Furthermore, they put greater trust in ETFs to tackle upcoming challenges**

- **The replacement of active funds by ETFs has boundaries. Especially, wealth managers that invested early into ETFs still demand actively managed funds**

- **Digitalization and Robo Advisory go hand in hand with implementation of ETFs**

The study, which contains the results of the survey, guest contributions and other articles, can be ordered (print copy) through the website of QAP www.qap-analytics.com/en/etf-studie2017 or via phone +49 6431 / 2842475

ABOUT QAP ANALYTIC SOLUTIONS

QAP Analytic Solutions GmbH is a consultancy with focus on financial market topics. Broad and in-depth knowledge on funds, ETFs, alternatives and expertise in asset management processes are combined with internal IT competencies.

Besides fund and manager selection, for which the company has built and operates Fund-Analytics.com, an innovative information collection service, the team of five increasingly works with FinTechs and financial intermediaries on concepts and implementation of digitalization strategies.

In terms of time to market, the German company scores with internally developed modules for simulation and visualization of investment information. The software is offered as a service, for instance to the Robo Advisor Diversifikator.

QAP was founded by Christian Schuster, CAIA in late 2014. The privately held company is independent.

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