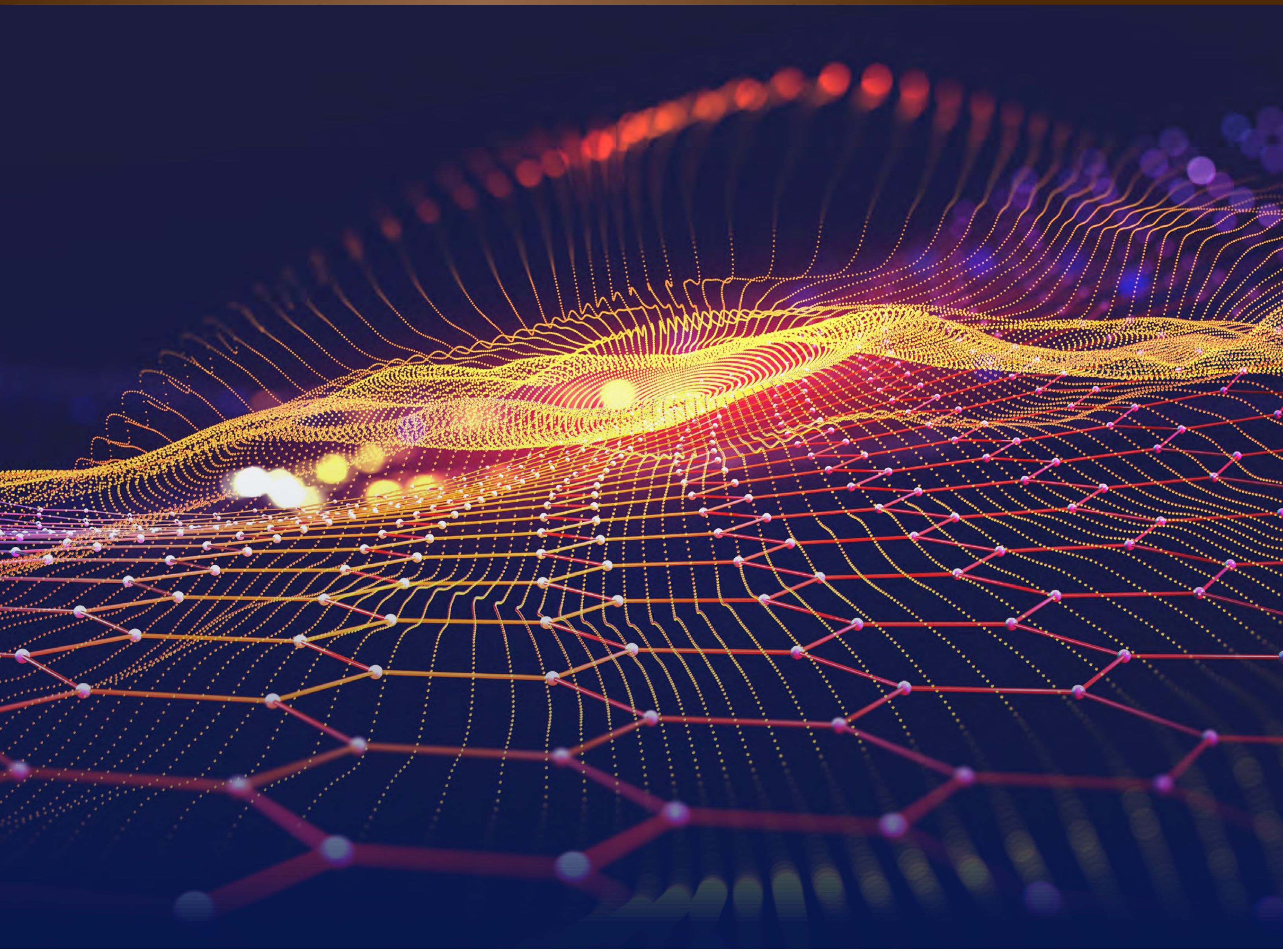
The Active ETF State of Play: A Worldview of the Growing Trend

How asset managers can capitalize on varied investor demand globally.



March 2025

J.P.Morgan

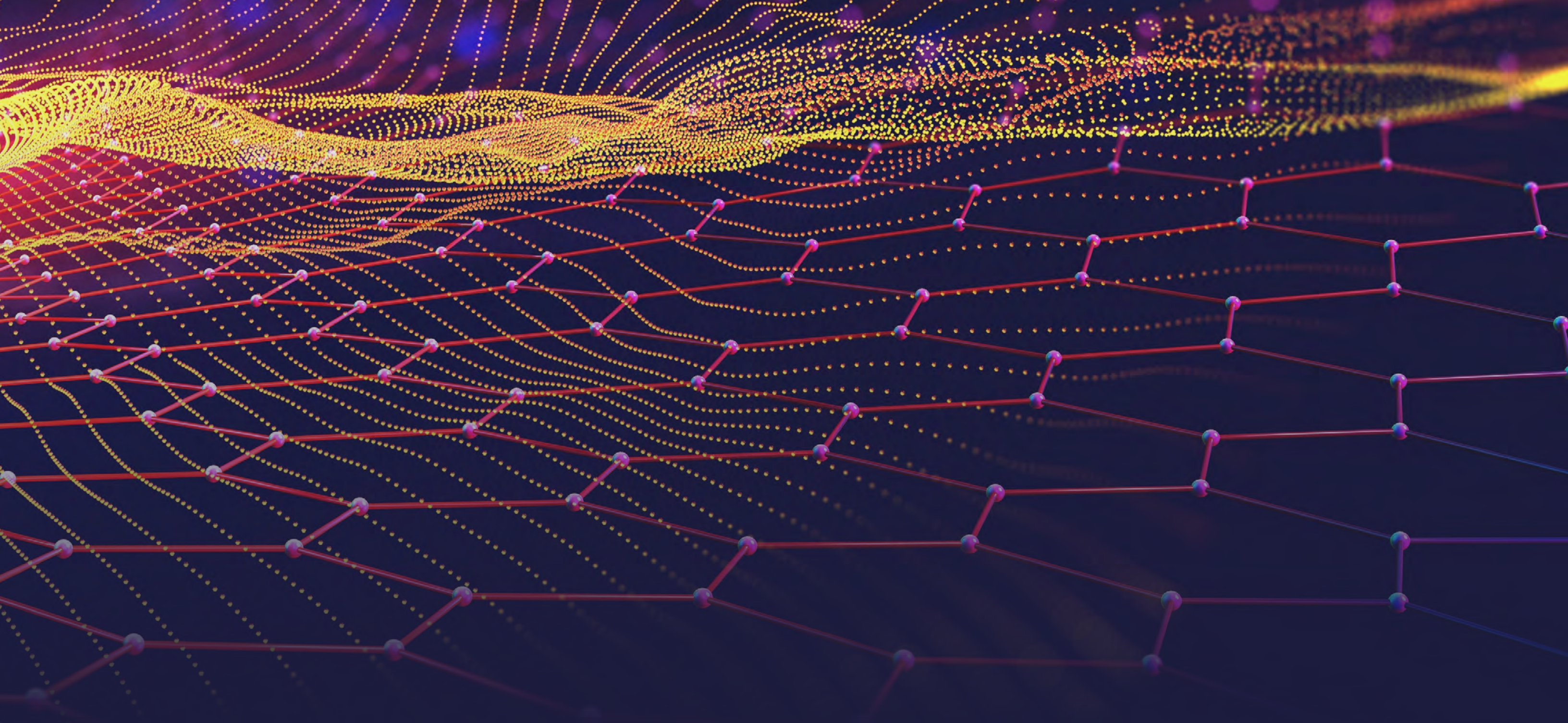
ETF Landscape: Where We Are Now

Since their inception in North America in the early 1990s, ETFs (exchange-traded funds) have appealed to end investors thanks to their simplicity and transparency.

Call it ETF 1.0, an era that embraced ETFs as passive, index-tracking vehicles offering low expense ratios, tax advantages, and region-specific benefits while also enabling intra-day trade flexibility and fully visible holdings. The rest of the world followed suit, with ETFs launching in Japan in 1995 and throughout Asia and Europe soon thereafter. The ETF found widespread appeal as a piece of technology that facilitates the broadening of an asset manager's investment offering by providing a strategy across the primary and secondary markets.

By the mid-2010s, ETF 2.0 emerged with the rise of smart beta and factor-based products, further propelled by the Securities and Exchange Commission's 2019 passage of Rule 6c-11, the so called ETF rule which increased the ease with which fund managers could use custom creating and redemption baskets, allowing increased tax efficiency and reducing transaction and tracking costs. These benefits were particularly acute for actively managed ETFs. The utilization of custom baskets generated further momentum, and despite asset manager fears that opportunists would trade ahead of them, active manager success reduced concerns around alpha leakage in portfolios with daily holdings transparency. While the option to launch a semi-transparent ETF in the U.S. existed, the majority of active managers entered the ETF market with fully transparent products. In actuality, initial fears around the ability for investors to access the fund IP without direct investment in the fund, and around negative impacts on fund performance from the transparency provided seemed to have not materialized.

The low cost, tax efficiencies, and structural advantages of the ETF wrapper continue to drive growth of the asset base for issuers. Acceleration of the asset base has, in turn, made ETFs more interesting to institutional investors



as tools in their own portfolio management. Here in 2025, with consensus built around the merits of the wrapper, a new shift has emerged: ETF 3.0. What started out as simple building blocks utilized in consumer portfolios are becoming more complex toolsets to deliver complementary exposures. An exchange traded wrapper, originally passively managed and filled with vanilla assets classes (equities and fixed income), increasingly has developed the capability to hold more sophisticated portfolios, both actively managed and with the possibility to include some more exotic instruments (swaps, futures, bank loans, and securitized products). This complexity is a critical part of the next ETF generation.

There are some 12,000 ETFs listed globally holding $14 trillion in assets, and though active ETFs globally hold less than 10% of ETF AUM, they took in 20% of ETF net flows for 2023.[1] That momentum has only continued: as of June 2024, the global active ETF/ETP market reached some $923 billion in AUM among 2,682 funds, having expanded at a compound annual growth rate of 40% over the last 10 years and boasting a 25% rise in the first half of 2024.[2] That trajectory shows no sign of slowing down: among asset management firms that do not currently have an ETF business, a Blackwater survey reports 92% are planning to launch ETFs or undertake due diligence of the space within the next two years, up from 9% in 2021.[3]

As the U.S. has seen its market share of actively managed ETFs soar, with Europe and Asia consequently positioned for growth, it is vital for every asset manager to understand how this complexity can manifest in the real world to meet end investors' demands. That is especially necessary given that such demands vary according to regional and country-specific nuances.

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[1] *J.P. Morgan Quantitative and Derivatives Strategy, Bloomberg Finance L.P. Data as of end of May 2024, 2024 Global ETF Handbook, J.P. Morgan*
[2] *Bloomberg Finance L.P. ETFGI*
[3] *"What European Mutual Fund Managers Think About ETFs," Blackwater, March 2024*

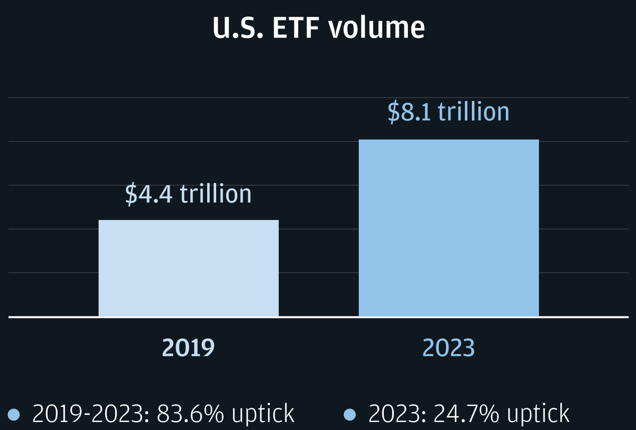
Regulatory Boosts **in the U.S.**

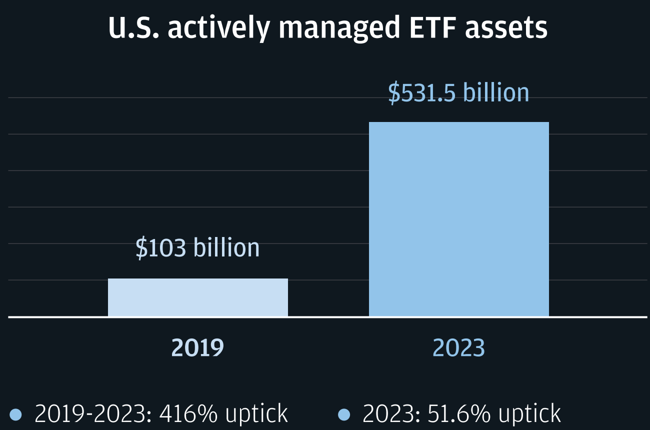
American regulatory shifts are likely to continue encouraging the global rise of complex but more accessible actively managed ETFs, a phenomenon asset managers must be ready to handle.

Though the share of passively managed ETFs still dwarfs that of actively managed ones, the meteoric 2023 global growth of assets in actively managed ETFs (37%) did eclipse that of their passive counterparts (just 8%) – a surge particularly pronounced in the U.S.[4] Actively managed ETFs have been available in the U.S. since 2008. But while the overall U.S. ETF volume has soared since the advent of the ETF Rule – nearly doubling from $4.4 trillion in 2019 to $8.1 trillion in 2023 – U.S. actively managed ETFs expanded more than four-fold over that period to $531.5 billion as investors sought benchmark-beating returns. With $696 billion in AUM as of June 2024, the U.S. active ETF/ETP market represents 75% of global active ETF AUM.[5] In addition, 74% of new U.S. ETF listings from May 2023 to May 2024 were actively managed.[6]

There is a simple explanation: as a result of the ETF Rule, ETF issuers have more easily and efficiently been able to create actively managed ETFs that appeal to retail investors. Retail investors have increased their appetite for the expanded menu of issued actively managed ETFs, which quintupled in the U.S. from just 300 strategies back in 2018 to 1,500 by May 2024.[7] That demand then likely validates issuers' creation of new customized baskets all the more. Beyond allowing for increasingly complex customized investment baskets geared toward growth and diversification, the ETF Rule has also motivated fund providers to create new efficiencies in bringing ETFs to market such as converting mutual funds to ETFs. From 2021 to May 2024, there were 77 conversions to active ETFs from mutual funds with assets worth $110 billion.[8] And given that ETFs have no minimum investment amount, unlike mutual funds whose minimums can be as high as $5,000, that enthusiasm for

[4] *Morningstar, Yearly Flows Report, 2023*
[5] *Ibid.*
[6] *J.P. Morgan Quantitative and Derivatives Strategy*
[7] *Ibid.*
[8] *Bloomberg Finance L.P. ETFGI*





accessible actively managed ETFs has been democratized for a broader population of retail investors.

AUM for actively managed ETFs is supposed to more than quadruple to $4 trillion by 2030, largely at the expense of active mutual funds rather than passive ETFs, per Blackrock.[9] Already we witnessed in the 32-month period ending June 2024 negative outflows from mutual funds to actively managed ETFs.[10]

It bears mentioning that while we have seen a large number of traditional mutual funds and separately managed accounts (SMAs) converted to ETFs in the past two and a half years, it is also critical that the existing strategy be a successful one. Converting assets to an ETF is not a panacea to a poor performing strategy.

Looking ahead, the newfound asset manager ease in creating actively managed ETFs could get another stateside regulatory boost. The SEC may soon allow several major asset managers to pursue a multi-share class structure that enables the replication of existing investment strategies in ETF form. That could mean, for example, that issuers could efficiently append an ETF share class to an existing mutual fund. As of July 2024, there are 18 applications submitted to the SEC for this structure. Should the SEC give the green light, ETF volume may surge as asset managers launch existing mutual-fund strategies in ETF form. Like the ETF Rule before it, such reform could fuel massive growth in the creation of actively managed ETFs and magnetically attract fund flows to these investment vehicles.

With market supply of active ETFs rationalized, given the current conversions of mutual funds to ETFs and the potential for more of that activity, there is further advocacy pressure to saturate the vehicle across broad distribution channels – such as expansion into the 401(k) plan sponsor arena (pending exemptive relief) by introducing ETF share classes on mutual funds and mutual fund share classes on ETFs.

But the U.S. is not operating in a vacuum. Amid the proof of concept in the U.S. that has legitimized the fervor surrounding actively managed ETFs and the potential for more growth, the rest of the world is also embracing this strategic investment vehicle. That said, while the U.S. is a single market, regions such as Asia and Europe are very fragmented with different buyer appetites and regulations in each country that asset managers need to consider before launching an ETF strategy.

[9] *Decoding Active ETFs, Blackrock, July 2024*
[10] *Ibid.*

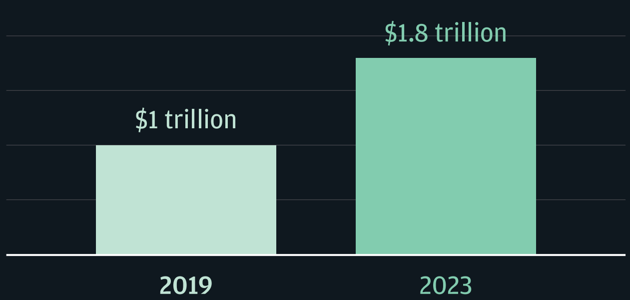
Active ETF Retail Investor Surge
in Europe

Of course, no "big bang" type event such as the ETF Rule is fueling the expansion of ETFs in Europe. But while Europe's ETF volume lagged the U.S.'s from 2019 to 2022, it pulled ahead by 2023 in percentage growth. Diversification is the top motivation for asset managers to select an active ETF.[11]

Part of the European growth in actively managed ETFs with complex, bespoke investment baskets stems from the emergence of retail brokerages in the region that allow greater access to these increasingly intricate investment vehicles. European retail investor zeal for actively managed ETFs amid this new access mirrors that seen in the U.S. This is fueled by the increasing complexity of the basket of investments along with general advantages of ETFs like intraday liquidity. The potential for lower withholding tax rates on dividends from stocks listed overseas represents another benefit for European investors in ETFs. While ETFs have primarily been an institutional product in Europe up until now, asset managers will increasingly need to consider how to create, sell, and market ETFs to a growing bevy of retail investors.

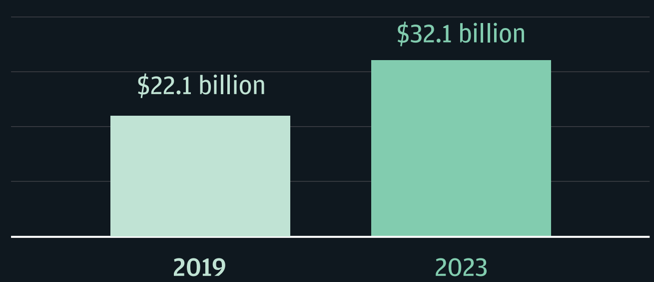
Ireland, the leading ETF domicile in Europe, has structures in place that facilitate retail investment in active ETFs. There, the Central Bank allows for a flexible scenario that permits both listed and unlisted shares within an ETF, encouraging customized baskets for active ETFs, particularly appealing to retail investors. In fact, 20% of 2023 net flows of Undertakings for Collective Investment in Transferable Securities ETFs (UCITS ETFS), created to give retail investors transparent and regulated cross-border investment opportunities,

Europe's ETF volume



- 2019-2023: 76.4% uptick
- 2023: 28.2% uptick

Europe's actively managed ETF assets



- 2019-2023: 145% uptick
- 2023: 51.2% uptick

[11] *Ibid.*

went into active ETFs.[12] In addition, the recent advent of incorporating listed shares into a non-ETF umbrella and the recasting of non-ETF funds as UCITS ETFs represent further ETF market entry points for asset managers building a wrapper that provides UCITS opportunities for retail investors. It is worth noting that the Commission de Surveillance du Secteur Financier, the Luxembourg financial regulator, has announced that it will relax portfolio transparency requirements for active ETFs. This move to lessen regulatory burdens for asset managers would help Luxembourg compete with Ireland as a hub for domiciling ETFs.[13]

Regulation, such as the Retail Distribution Review in the U.K. and the Markets in Financial Instruments Directive across Europe, is focused on ensuring managers are selling the most suitable product to their clients. This, in turn, is likely further helping the growth of ETFs.

Asset managers will also have to navigate catering to the rising cohort of active ETF retail investors across different countries in Europe who have varying tax demands, currencies, and languages that make distribution more complicated than in the U.S. where there is a single market, currency, and trade settlement location.

Retail investors in Europe are also more focused on sustainability and thematic investing. In terms of catering to the rising crop of retail investors in Europe, for example, asset managers may do well to take note of their enthusiasm for thematic investing within actively managed ETFs, particularly around custom baskets of ESG equities that follow a narrative and set of values they hold in high regard. That has been all the more appealing following the enactment of the Sustainable Finance Disclosures Regulation (SFDR) in March 2021. In 2022, global ESG ETF volume rose to $400 billion from just $50 billion five years prior.[14] This European growth likely stands to be all the more robust ahead:

In the active UCITS ETF space, assets under management totalled more than $35 billion, with 87 active UCITS ETFs trading. So there is still limited supply on active UCITS ETFs. 23 active ETFs were listed on European exchanges over the past 12 months.

the EU's Corporate Sustainability Reporting Directive (CSRD), which took effect in January 2023, is aiming to provide comprehensive disclosures about company sustainability practices that may, in turn, allow investors to make more intentional and green-conscious decisions about their investments. This type of thematic investing with an anchoring premise is possible with the customization and transparency available in actively managed ETFs. And though the underlying investments within the customized baskets may be more complex, it is incumbent upon the asset manager to create ETFs that simplify the value proposition for potential retail investors. In doing so, asset managers must also seek service partnerships that streamline and support their needs as issuers.

[12] *Ibid.*
[13] *Luxembourg Regulator to Relax Transparency Requirements for Active ETFs, ETF Stream, Dec. 19, 2024*
[14] *ETFGI Global ESG ETF and ETP Industry Insights, December 2022*

Growth in Australia, Canada, and Beyond

With the advantages of actively managed ETFs catching on globally – particularly on account of their diversified exposure to several sectors, lower fees, and the transparency of assets held – fund managers must be prepared to meet the growing global demand for this vehicle and the relevant country-based specifications.

Retail investors continue to dominate the ETF landscape in Australia, accounting for 74.6% of ETF investors.[15] Australian investors specifically have a robust appetite for actively managed ETFs. At the end of 2023, Asia-Pacific (ex-Japan) ETF assets totaled $784 billion – more than 15% of which derived from Australian ETFs. APAC's 160.5% overall growth in ETF assets from 2019 through 2023 outpaced that of both the U.S. and Europe, and the region's actively managed ETF growth saw particularly massive gains over that period, rising nearly 10-fold to $87.3 billion.[16] Australia, where actively managed ETFs first emerged in the region in 2015, has led the charge: actively managed ETFs now constitute upwards of 15%[17] of total ETF assets in Australia, with the number of Australian actively managed ETFs hurtling to 82 in 2023, up from just 35 three years earlier[18] and active strategies representing 55% of new ETF launches in 2023.[19] In Australia, it has been the preference of new entrants to the market to adopt the semi-transparent ETF structure.

Though actively managed ETF momentum in Australia was initially propelled by asset managers' propensity to convert listed investment companies (LICs) to ETFs, asset managers now must be able to maneuver the complexities of issuing dual-access ETFs. In the dual-access structure, investors have the choice to access investment funds via an exchange or traditional unlisted distribution channels.

Canada is another important ETF market asset managers are prioritizing with its own distinct characteristics. At the end of 2023, Canada boasted ETF assets of $313 billion, double its 2019 total. Canada's actively managed ETFs grew by 148% from 2019 through 2023, and it leads the world in terms of active ETF adoption,

Asia-Pacific ex-Japan

$784 billion

total ETF assets in 2023

APAC

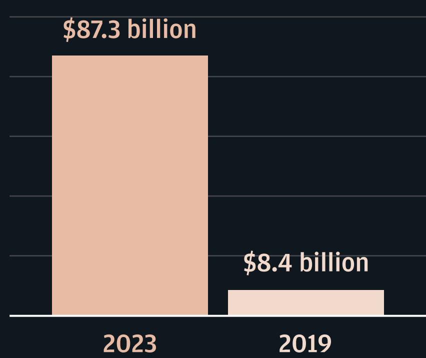
160.5%

growth in ETFs for 2019-2023

937%

growth in actively managed ETFs for 2019-2023

APAC's actively managed ETF assets



Canada

$313 billion

total ETF assets in 2023

99.4%

growth in ETFs for 2019-2023

148%

growth in actively managed ETFs for 2019-2023

[15] *2024 Computershare ETF Insights, Computershare*
[16] *ETFGI ETF Asia Pacific (Ex Japan) Industry Insights, December 2023*
[17] *Ibid.*
[18] *How Australia's ETF Industry Grew From $100k to Over $150bn, Investor Daily, October 20, 2023*
[19] *Why the popularity of active ETFs is surging, Investment Markets, April 3, 2024*

with nearly a third of its total ETF assets in actively managed funds.[20] Asset managers enjoy regulatory flexibility in Canada, with ease of ETF market entry and confidentiality around strategies. This is thanks to the ability to launch ETFs as a share class of a mutual fund there and the country's discretion in revealing disclosures to a lead market maker without disclosing to the broader marketplace. From a regulatory standpoint in Canada, Client Relationship Model 2 (CRM2) is zeroed in on selling the most appropriate products to clients, a phenomenon that is also boosting ETF adoption. Following CRM2 implementation in 2016, ETF flows were about 60% higher than mutual fund flows as of 2022, with active ETFs constituting more than a quarter of AUM.[21] ETF growth in the Great North has maintained momentum: as of November 2024, the ETF industry in Canada garnered $55.37 billion in net ETF inflows for 2024, $21.01 billion of which came from active ETFs. That brought total ETF inflows in Canada to $404.60 billion, almost quadrupling ETF AUM since 2016.[22]

As actively managed ETFs continue to rise around the world, asset managers must approach each robust market as a growing opportunity that also requires them to surmount a series of challenges. Japan, which has a particularly insular ETF market and a modest one in size, is one to watch: overall ETF volume actually dropped to $454 billion in 2022 from $541 billion the year before, but it jumped up again in 2023 to $535 billion, in part due to actively managed ETFs emerging for the first time.[23] As of June 2024, the Japan ETF market reached $560 billion in AUM, of which more than 80% is held by Bank of Japan, and the 11 actively managed domestic ETFs grew by more than 10x to reach an AUM of $3.8 billion.[24] Strict regulations have created high barriers to entry in Japan, but policy changes set to take effect in May 2025, will remove these impediments and map more closely to global standards.[25]

Elsewhere in Asia, Taiwan's ETF market has strong retail participation and is overall fast-growing, with a 22% CAGR from 2019 to 2023 and, as of June 2024, $163.3 billion in AUM across 252 listed ETFs.[26] Dual-listed currency is permitted, and active ETFs are set to enter the market, following the lifted ban on active and multi-asset ETFs, which will open the market for global issuers and expand opportunities for servicers.[27] With some 15 global and domestic firms showing interest in launching active ETFs, the active ETF market in Taiwan is predicted to hit $6.25 billion by the end of 2025.[28]

Though ETF growth overall in Latin America remains in the low double-digit billions, rising by 64.3% from 2019 through 2023, 2023 alone brought a 35.3% spurt to the region's ETF volume — enabled in part by actively managed ETFs, which emerged there in 2021 and grew to $187 million by the end of 2023.[29]

Advantages of the Dual-Access Structure

To asset managers:

Active ETF managers run a sole register for listed and unlisted assets to boost their efficiencies from an operational and investment standpoint.

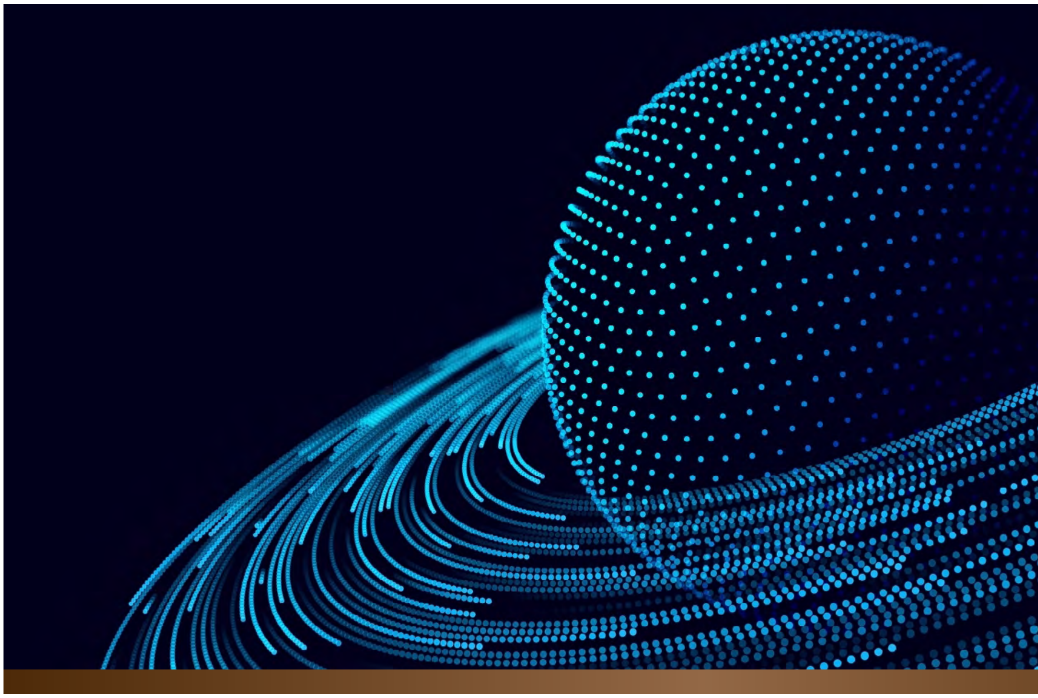
To Investors:

Investors have ease of access to their chosen fund. They can access the same unit class of a fund through an on-market access point (such as the stock market) or by trading directly with an asset manager through a wrap platform as an unlisted managed fund.

[20] *ETFGI ETF Industry Insights, December 2023*
[21] *ETFGI Canada ETF Dec. 31, 2022*
[22] *ETFGI Canada ETF Dec. 11, 2024*
[23] *ETFGI ETF Industry Insights, December 2023*
[24] *J.P. Morgan ETF Market Research | EY: J.P. Morgan ETF Research Engagement, October 2024*
[25, 26, 27, 28] *Ibid.*
[29] *ETFGI ETF Industry Insights, December 2023.*

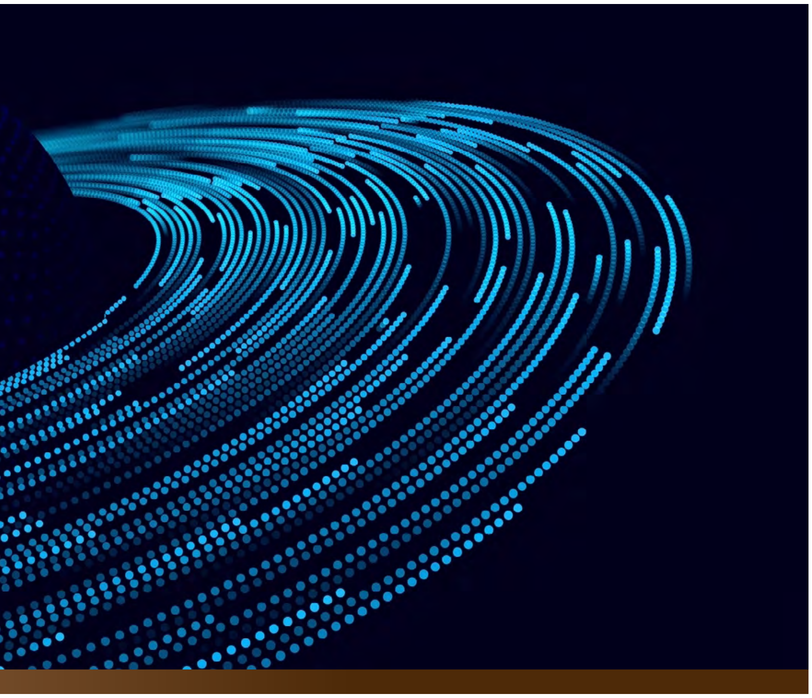
Global Expertise
Is Essential

Given that each region, and often each particular country within, has its own specific nuances regarding how issuers approach launching an ETF to meet end investors' demands while abiding by regulatory subtleties, familiarity with these intricacies can help ETF issuers comprehend the demand for the investment vehicles they have created (focusing on product development, model usage, and intermediary shelf space), how it impacts the appetite for them by liquidity providers (both market makers and authorized participants), and who is best positioned to maintain, support, and service those products as a service provider.



It is important to acknowledge that the drivers that have led to successful inflows into the traditional mutual fund structure will likely be different than the drivers leading to successful ETF growth. Things like branding, advisor channels, and investor types can often be completely different than previous traditional products. Of course, asset managers should take advantage of legacy distribution tailwinds when appropriate, but they should not allow an entrenched point of view to cloud the need to adapt emerging business models. Model portfolios, Turnkey Asset Management Programs (TAMPs), Robo-Advisers and self-directed brokerage accounts can all be factors contributing to the success of an ETF.

For asset managers, it is also important to appreciate that simple outcomes are still essential to the end consumer. Of course, asset managers have begun to realize that acknowledging and expressing each firm's distinct investment identity and brand amid the growing complexity of the active ETF product is critical to success. It can be difficult to issue ETFs of increasing complexity, meet investor demands, and adhere to compliance and tax strictures. As such, it would advantage asset managers to enlist knowledgeable partners with a global footprint to maximize their execution abilities. Hiring external



ETF market expertise to sell the product alongside the existing mutual fund range can be beneficial as it helps to ensure that the ETFs are front and center as opposed to an add on.

When selecting an ETF service provider to partner with, it is important to focus on the people, the expertise, and the technology that J.P. Morgan has across our global ETF servicing model.

J.P. Morgan can draw on adjacencies across market making, primary market origination, and asset servicing to render insights and provide iterative guidance as asset managers expand their line-ups and seek to better understand nuanced demands within the industry landscape. After all, active ETFs require an increased servicing effort from both an operational and set-up perspective. To that end, the close proximity of these functionalities allows for an intimate understanding of the ETF ecosystem, helping to enable positive outcomes for customers and stakeholders.

Given the global growth of actively managed ETFs and regional idiosyncrasies, it is critical for asset managers to work with service providers that offer a worldwide understanding of how different markets work. J.P. Morgan's expertise and reach stretches worldwide. It offers holistic, end-to-end ETF services, providing asset managers with deep subject matter expertise, product development, market making, and liquidity, as well as an ETF securities-lending program and support to create, to trade, and to value the ETF's basket of securities. The J.P. Morgan index team, for example, helps issuers identify and create the most suitable strategy for their investment requirements. And to increase alpha, the bank's innovative tools enable asset managers to analyze and refine their index requirements with cross-asset data and analytics.

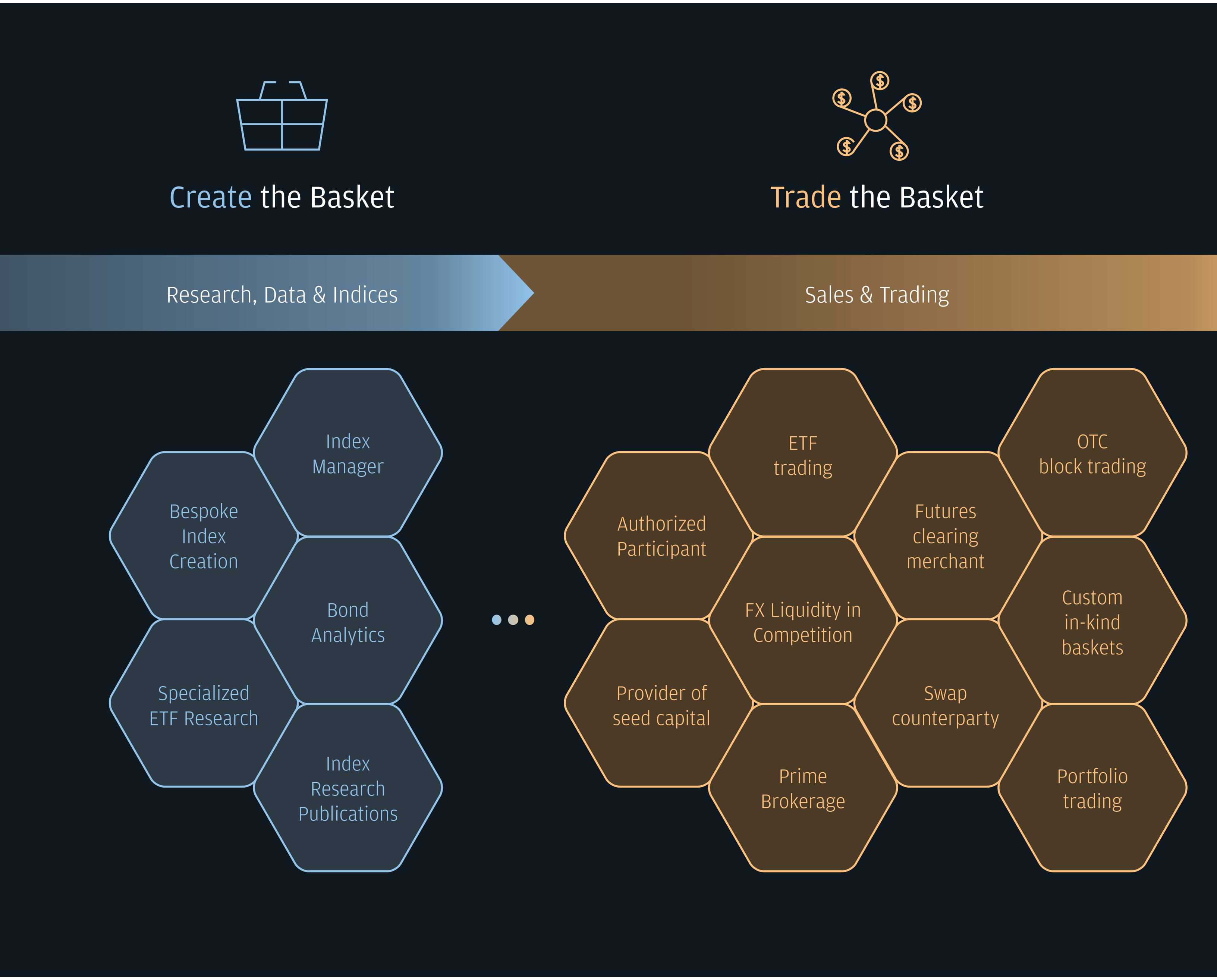
To help asset managers mitigate the currency risk of their international investor base and boost operational and execution efficiencies while providing transparency and governance to their underlying investors, J.P. Morgan offers a suite of FX services to hedge this exposure as an outsourced currency overlay provider. We deliver the distinctive Liquidity in Competition offering, on both a principal and agency basis, as well as benchmark or at market pricing, all of which can be implemented by a custom rules based program. All of this is complemented by independent Transaction Cost Analysis and a range of post-trade hedging analytics, which can assist asset managers in identifying opportunities for improved hedging economics, delivering additional cost savings to underlying investors.

From a technology standpoint, J.P. Morgan also offers a global platform with a centralized ETF service team – distributed across Sydney, Dublin, and Boston.

All told, J.P. Morgan has the extensive infrastructure in place to help empower asset managers and investors to service their assets throughout the trade lifecycle.

J.P. Morgan teams provide capabilities across the end-to-end ETF lifecycle

ETF consultation providing solutions across the lifecycle



Value the Basket

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