Index Providers: Whales Behind the Scenes of ETFs

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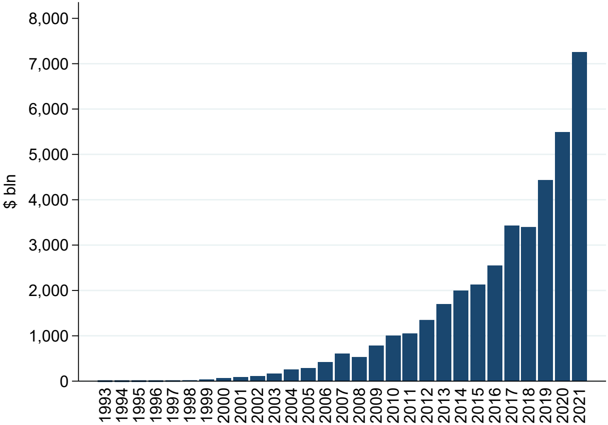
Motivation

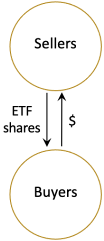
- ETFs have become one of the most important intermediaries



- Most ETFs passively track an index
- What does index-tracking entail? Where does the index come from?

Motivation

- So far, the attention to ETFs has been focused on secondary market investors, authorized participants, and the ETF sponsor



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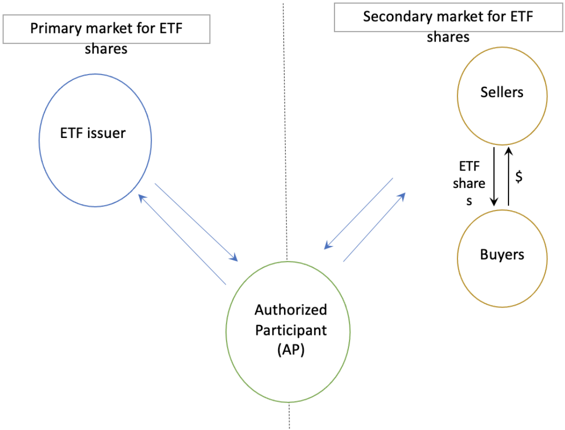
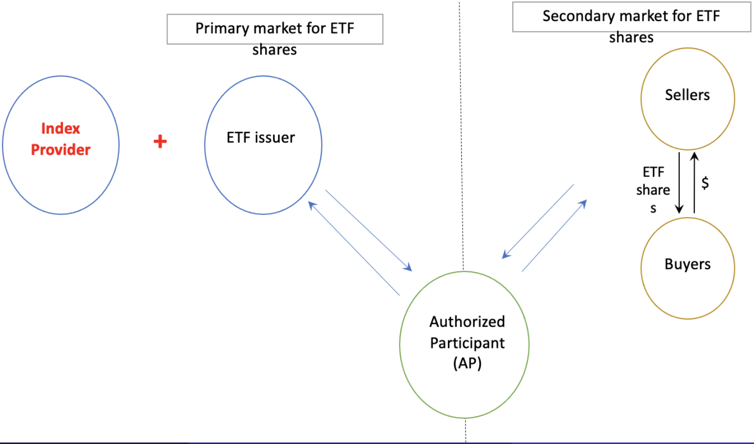


Motivation

- So far, the attention to ETFs has been focused on secondary market investors, authorized participants, and the ETF sponsor
- This is the first paper to uncover the important role of index providers



Summary of Main Results

1. Novel and important facts:
    - Index provider market is highly concentrated
    - Investors value the identity of index providers
    - Over one third of ETF management fees go to index providers
2. Structural model
    - 60% of fees to index providers involve markups
    - Allowing entry of new index providers has limited effect
    - Increased elasticity of ETF sponsors to index providers' licensing fees is effective and reduces ETF fees by 30%

Main Comments

- This is a very important paper about the previously unknown role of ETF index providers!
- Execution is careful and thoughtful

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- Execution is careful and thoughtful
- Suggest to think more deeply about the economic relationship between index providers and ETF sponsors
  1. Who do investors value?
  2. Econometrically, can we distinguish between them?
  3. What do the counterfactuals mean?

Who do Investors Value?

- Paper focus: index providers have brand value to investors
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Who do Investors Value?

- Paper focus: index providers have brand value to investors
- But do investors value the identity of index providers or ETF sponsors?
- Can they really tell the two apart?
- ETFs and Indexes often have the same name!
  - Easier for better known indexes, e.g., SPDR S&P 500 ETF
  - Less clear for others, e.g., iShares iBoxx Investment Grade Corporate Bond ETF

Who do Investors Value?

- Further, the mapping between index providers and ETF sponsors is to a large extent 1 to 1

	Mean	SD	25th	50th	75th
Panel A: ETF level					
AUM ($ million)	2,037.29	9,121.63	47.70	209.16	814.13
Monthly return (%)	1.07	0.47	0.91	1.06	1.20
Management fee (%)	0.37	0.20	0.20	0.35	0.50
Turnover ratio (%)	62.85	209.15	16.19	32.32	61.14
Panel B: ETF sponsor level					
Total AUM ($ million)	16,939.70	68,657.61	35.43	142.25	1,154.38
# of ETF	6.79	15.56	1.00	1.77	4.14
# of matched index providers	1.68	1.58	1.00	1.00	1.89
Panel C: Index provider level					
Total AUM ($ million)	15,635.70	77,678.42	45.52	126.43	1,136.98
# of ETF	5.91	18.16	1.00	1.00	3.00
# of matched ETF sponsors	1.43	1.45	1.00	1.00	1.00

- Can investors really tell ETF and index sponsors apart?
- How much do they value the bundle vs. the index provider per se?

Econometrically, can we tell?

- The effective variation comes from the sample that is not a 1 to 1 mapping beween ETF sponsors and index providers
- Suggest to provide more information about this subsample versus the general sample
    - Why do some ETF sponsors use different index providers while others stick to the same one?
    - For those using different index providers, is there any pattern for why one index provider is used for some but not other funds?
    - Is there any sign of market segmentation as opposed to concentation within the same market
    - Is there any sign of selection?

Econometrically, can we tell?

- In the structural model, it would be interesting to report γ_{ij}

$$\ln(s_{kt}) = -\alpha f_{kt} + \beta X_{kt} + \gamma_{ij} + \gamma_t + \xi_{kt},$$

- Examining the variation in γ_{ij} may help to think which other dimensions the match value could depend on
- These match characteristics could then be included as observed covariates
- This matter for which counterfactuals we can run

Interpretation of Counterfactuals

- Recall: current ounterfactuals find that the effective way to reduce fees from index providers is through increasing their competition
- That is, increase σ, which captures how elastic ETF sponsors are to licensing fees
- But what does this mean? How can this be achieved?
- Need to understand along which dimensions index providers and ETF sponsors match
  - and include them as (time-varying) covariates
- If it is high switching costs once a match has been formed
  - then the resolution would be to increase the number of ETF sponsor — index provider pairs

Summary

- Important paper to uncover the role of index providers
- Nice execution combining novel facts and a structural quantificaion
- Suggest to dig deeper into the economic relationship between ETF sponsors and index providers
    - Do investors value the index provider, the ETF sponsor, or the bundle?
    - What are the economic drivers of the match between ETF sponsors and index providers?
    - How to interpret and achieve the counterfactual result? of increasing ‘ competition between index providers”?