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ETFs in 2020: One Board or Two (or More)?

The recent advent of non-transparent, semitransparent, and other actively managed exchange traded funds (ETFs) within existing mutual fund complexes raises the issues discussed below that the boards of mutual funds in such complexes currently face. Non-transparent, semi-transparent, and other actively managed ETFs often are essential or actual "clones" of existing mutual funds, which suggests strongly that a unitary board structure is appropriate for these new types of products. This dominant preference exists even if a board separate from the mutual fund board already oversees passively managed, transparent ETFs within the complex, as these are fundamentally different products from mutual funds and actively managed ETFs.

ETFs entered the markets nearly 30 years ago and after a slow start have gained increasing momentum for the last 10, now accounting for close to 20 percent of total net assets managed by investment companies. The first ETFs pursued passive and transparent index-based strategies, attracting investors with lower fees than traditional mutual funds. While passive ETFs still abound, actively managed ETFs are absorbing an increasing share of investor assets.

Many actively managed ETFs are sponsored by mutual fund advisers looking to enter or expand their footprint in the ETF landscape. With the initial wave of ETF launches, ETFs' novel structure and operations often led mutual fund advisers to establish a separate ETF board. But the emergence of standardized ETF operating conditions and nontransparent, semi-transparent, and other actively managed ETFs presents the question anew and, in the context of ETFs that are basically well-worn affiliated mutual fund strategies in a different wrapper, more sharply.

In this piece we review recent market and regulatory developments involving ETFs, discuss the shared and distinct responsibilities of mutual fund and ETF boards, and suggest factors that advisers and boards should consider when questioning whether or not to employ a unitary1 board as ETFs are introduced alongside existing mutual fund offerings. In fund complexes where separate ETF and mutual fund boards already exist, advisers launching new actively managed ETFs should also consider these factors when proposing whether the new ETFs will be overseen by the ETF board or the mutual fund board.

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