Article

25 years of ETF evolution in Europe: A look at the past, present and future

Key takeaways:

- For much of the past two decades, the European ETF market was dominated by index products and institutional investors.
- ETFs now function less as index trackers and more as strategy wrappers, with a growing number of managers using them to distribute active strategies.
- Fund platforms, retail investors and other new market entrants should continue to drive the growth of ETFs for the next 10-20 years.

2025 marks the 25th anniversary of the launch of the first European ETF. Over that time, the product has evolved significantly to accommodate market demands and, in the process, continued to show incredible growth.

At this quarter-century milestone, we wanted to explore the development arc of ETF history over the last 25 years to provide insight into where they could be heading in the years ahead. We spoke with two industry experts who were on the ground floor of the first ETF introduction 25 years ago: Tony O'Brien, Chief Commercial Officer for Ireland at U.S. Bank, and Manooj Mistry, Chief Operating Officer at HANetf.

In this article we'll:

- Look at how the function and use of ETFs has expanded since their inception
- Examine some of the trends in how they're being used today
- Discuss what the future could hold for these type of funds

A look at the past:

From passive index tracker to flexible strategy wrapper

In the late 1990s, ETFs were already relatively well-known vehicles in the U.S. but had not penetrated the European market. Seeing the potential, fund managers were eager to replicate their success and find a way of introducing the product to Europe. Meeting the regulatory requirements for Undertakings for Collective Investment in Transferable Securities (UCITS) funds in Europe required a little ingenuity.

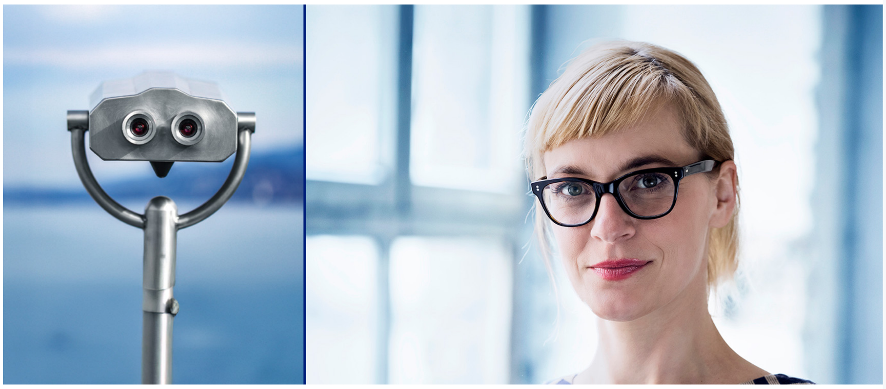
"In the U.S., the ETFs at the time were mainly based on grantor trusts. That trust structure provided a lot of flexibility," says Tony. "Fitting that type of product into the UCITS regulatory framework was more challenging than it would appear on the surface – specifically, we had to ensure we were tracking indexes that met the UCITS concentration risk requirements and in some cases lobbied index providers to modify the index constituents to meet the UCITS requirements."

The U.S. and European markets differed in other ways as well. The U.S. was dominated by retail investors entering and exiting the products quickly, requiring a flexible and scalable investor servicing capability and a large order-processing infrastructure. In Europe, the investor base was much more institutional.

"The primary audience in Europe was wealth managers, pension funds and institutional investors," says Manooj. "Instead of using ETFs as quick exposure products to get in and get out, they'd use them as asset allocation tools to equitize cash quickly, easily and cheaply – with much more of a 'buy and hold' approach."

Upon introduction, interest in European ETFs, even among institutional investors, started off slow and sluggish. Institutions were geared more toward funds of funds at the time. Wealth managers steered toward mutual funds, viewing their role as that of actively managing, not buying the index.

By the mid-2000s, things started to change. Interest grew as more managers recognized ETFs as a way to do tactical and strategic asset allocations at a lower cost and with more transparency than by allocating to mutual funds.



Momentum really started to build around 2007-08," says Manooj. "The market took off in the institutional space and that produced a surge of growth with new entrants, more providers and product innovation."

With product innovation came a shift toward making ETFs more active.

"From a product perspective, it's all about access to new markets, new asset classes and new benefits that aren't available in structured products like mutual funds – and, obviously, cost," says Manooj. "We started seeing more innovation and granularity, with ETFs at the forefront of bringing more accessibility to more asset classes and strategies in general."

It's also worth noting that ETFs showed remarkable resilience in weathering the shocks and market volatility of various financial crises.

"There were regulators and industry commentators who were worried that ETFs would somehow become a blockage in times of market stress," says Tony. "But what actually happened was the exact opposite. They functioned more like a safety valve because they enabled clients to quickly redeploy capital from one asset class to another."

A look at the present:
A shift toward actively managed

For much of the past two decades, the European ETF market was dominated by index products. ETFs played a big role in helping to make index products popular, democratize investing and bring index investing into the mainstream. In that context, an ETF was generally viewed as an end in itself – as a retail investment, index tracking product and easy way to gain exposure to an index to equitize cash.

Today, however, managers are getting more inventive with how they use this type of securities basket. ETFs are taking on new life as strategy wrappers – no longer an end in itself, but a means to an end.

"There is a significant trend in clients wrapping ETFs around their strategies, whatever those strategies might be," says Tony. "And because of that, we're seeing more thematic ETFs emerge and people talking about ETFs in much more flexible terms."

This shift opens new avenues of innovation and accommodates a more entrepreneurial mindset.

"We've drifted away from ETFs as a pure exposure play, and we're seeing more of them based on active strategies," Tony continues. In today's landscape, traditional active managers are recognizing ETFs as a more efficient vehicle for them to distribute their strategies versus a mutual fund.

"This trend has really started to take off over the last year or so," says Manooj. "At HANetf, as a white-label platform working with U.S. Bank, we can see it very clearly. In the early days, most of our products were index, but over the last 12 months, the majority of them coming through are actively managed."

Today, ETFs are seen as a flexible delivery mechanism rather than something exotic, and more traditional asset managers are choosing to launch strategies with ETFs rather than mutual funds.


"I think more managers are seeing the skyrocketing growth of ETFs and the access to investors," says Tony. "There's a fear of missing out and an 'if you can't beat them, join them' outlook leading more managers to offer their mutual fund strategies in an ETF wrapper."

There's also a push-pull dynamic at play. More retail investors are entering the market, directing their own investments into ETFs and, in a sense, pulling advisors in that direction. And many institutional investors are pushing asset managers to launch their strategies in an ETF wrapper because they like the transparency and the price discovery.

"With ETFs, you can get a price for your investment on an exchange at any point in time," says Manooj. "You're not waiting till the end of the week, or the end of the month or even the end of the day for a daily fund to get a valuation. Investors are seeing ETFs as a fundamentally better product and a more evolved product."

A look at the future

Fund platforms and more new entrants

In the U.S., many managers opt to launch their products on ready-made architecture. Instead of building their own 40 Act structure and going through the legal and regulatory maze of the approvals process, they launch a "series" from an existing Multi-Series Trust (MST). This has allowed a much quicker turnaround in terms of getting strategies to market, and it tends to be more cost effective, as common costs are shared across the platform.

The MST is a well understood structure in the U.S. for collective investment schemes and allows managers and issuers to focus on what they're good at – picking stocks and managing strategies. The MST itself takes care of structuring and backoffice concerns.

> Right now, everything is **moving** toward **actively** managed.
>
> **Tony O'Brien,** Chief Commercial Officer for Ireland at U.S. Bank

In Europe, this idea is catching on fast. There are now a number of available European white label platforms that offer this type of readymade infrastructure. By far the most successful of these is HANetf with whom U.S. Bank operates a UCITS ETF platform. For clients who see the value in having experts, service providers and the UCITS itself alread in place, this is proving to be an ideal solution to help managers expand into Europe.

In addition to the growth of ETF platforms, the number of new entrants into the market should continue to drive growth into the future.

"The market has long been dominated by a few big players in the index space," says Manooj. "But as that shifts toward more active management, we'll continue to see an influx of new entrants. If you're a U.S. manager and you want to come to Europe, why set up a mutual fund? I think you'll see more of managers skipping that step and jumping straight to an ETF."

Based on the trends and trajectory of the last 25 years, all signs indicate that the ETF wrapper will become the dominant wrapper for investment strategies in Europe into the future.

"They're growing now, and they'll continue to grow," says Tony. "And at some stage, I think ETFs will overtake mutual funds in terms of assets and number of products. It's hard to pinpoint when that will happen – most likely within the next 10 years. I think that's the next stage in terms of the evolution of the investment industry."

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