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Pensions and insurers give new impetus to Asia's ETFs

Cost-conscious institutional investors are embracing exchange-traded funds (ETFs) to lower transaction fees and achieve higher returns. Hong Kong Exchanges and Clearing (HKEX) explores the theme of yield-chasing among insurers in Asia's expanding ETF market and why ETFs with a global or regional focus represent a low-cost channel to gain overseas exposure

With interest rates still close to record lows, lukewarm fixed-income returns are prompting pension funds and insurers to hunt for other investment options. These cost-aware institutional investors have been increasingly embracing exchange-traded funds (ETFs) to lower transaction fees and achieve higher returns.

Hot in Asia

Yield-chasing has been a persistent theme among Asian insurers. "As low interest rates reduce the income-generating ability of fixed-income investments, insurers are looking to diversify their return sources," says Brian Roberts, senior vice-president and head of exchange-traded products at HKEX. "Investors can't control market returns, but can control fees that eat away at their returns. The low-cost, tax-efficient nature of ETFs is one of the reasons we're seeing stronger interest among insurers."

According to data compiled by research provider ETFGI, Asia's ETF market has grown by around 10% in the first six months of the year to US$458.1 billion. The appetite for ETFs shows no signs of waning – a survey by the Asia ETF Forum revealed around 70% of institutional investors expect to increase allocation to ETFs in the future.[1]

Insurers' ETF playbook

Asia's ETF market presents an expanding palette of choices. With new exchange-traded product launches such as smart beta ETFs and leveraged and inverse products, insurers are increasingly turning to ETFs as a sub-account option to implement sophisticated tactical strategies. Defined-benefit plans have already started using ETFs; with the introduction of target-date and target-risk ETFs, defined-contribution funds are training their sights on ETFs too. Such products are potentially well suited as balance-sheet assets for insurance companies.

The impact of pension money fuelling ETF assets growth becomes apparent. This high growth comes at a time when the insurers are struggling to achieve a 3–4% return to cover payment obligations to policyholders. Currently, Asian term deposits yield as low as 1% while assets higher up the risk curve such as equities are saddled with high transaction costs.

[1] *The survey was conducted by the Asia ETF Forum in Taipei, Hong Kong, Seoul, Bangkok and Singapore between April 17 and June 28, 2018. Seventy-three forum attendees responded to the question.*

Brian Roberts, HKEX

Jackie Choy, Morningstar Investment Management

Going global

As the liberalisation of Asia's developing markets and its swelling retirement savings spur demand for overseas investment, offshore investment restrictions are increasingly painful for money managers who want to go global. In this regard, ETFs permit insurers to overcome some overseas investment restrictions.

ETFs with a global or regional focus represent a low-cost channel to gain overseas exposure. Insurers now get customised products from fund managers to target certain exposures that boast tax incentives and higher yields. Investing in overseas markets through ETFs also reduces the need for hedging, which is mandatory for foreign investments in some markets.

Leveraged and inverse

Before the advent of leveraged and inverse ETFs, insurers hedged with short futures. That entailed rolling over the future contracts, determining the hedge ratio, meeting margin requirements and factoring in the premium/discount on their hedge.

Leveraged and inverse ETFs emerge as an ideal hedging instrument for insurers. "ETFs allow investors to better manage portfolio risks," says Jackie Choy, director of Asia ETF research at Morningstar Investment Management Asia. "The use of futures and options needs to be disclosed in separate books. This is another reason why leveraged and inverse ETFs' hedging capability appeals to institutional investors."