

MARKETING COMMUNICATION

Active ETFs: Basics

FREQUENTLY ASKED QUESTIONS



ODDO BHF
ASSET MANAGEMENT

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What is an active ETF?

ETF stands for Exchange Traded Fund which means that it is a product traded on an exchange regardless of its investment strategy. In short, **the ETF is simply a wrapper and the content itself is independent of the vehicle.**

An **active ETF** is an exchange-traded fund where the portfolio manager actively selects securities with the goal of outperforming a benchmark, unlike passive ETFs that track an index (an active investment strategy in an ETF wrapper)

How do they differ from a mutual fund or passive ETF?

Feature	Mutual Funds (excluding ETFs)	Active ETFs	Passive ETFs
Management Style	Usually active, discretionary selection by portfolio managers according to a determined strategy	Active, discretionary selection by portfolio managers according to a determined strategy	Passive, tracking a specific index
Risk Management	Dynamic risk management	Dynamic risk management	Need to track the index
Fees	Generally higher	Generally lower than mutual funds, but higher than passive ETFs	Generally lower
Minimum investment	Subject to share class minimums	No minimum	No minimum
Liquidity (Frequency of Net Asset Value - NAV)	NAV published according to specified intervals (e.g. daily, weekly, monthly)	Exchange-traded, intraday liquidity (NAV)	Exchange-traded, intraday liquidity (NAV)

What are the key differences between active ETFs and smart beta ETFs?

Management Style: Active ETFs are actively managed by portfolio managers who select and adjust holdings to seek to outperform a benchmark. In contrast, **smart beta ETFs are semi-active strategies to enhance their benchmarks by tilting it towards factors like value and growth, or by changing its weighting scheme.**

Tracking Error: **smart beta ETFs exhibit only a small to moderate tracking error**, as they are still tied to an index, while active ETFs have a higher tracking error due to the discretionary decisions.

Fees: The rules-based approach of **smart beta ETFs requires less human intervention** and, therefore, usually **charges lower fees** than those of active ETFs.

What are the benefits of an active ETF?

Access to Manager Expertise: Investors gain access to insights, experience and decision-making of investment professionals, which can potentially lead to outperformance.

Flexibility: Portfolio managers can actively adjust and select the fund's holdings in real time based on market conditions, enabling them to respond quickly to emerging opportunities or risks.

Cost efficiency: Cost are generally more advantageous than mutual funds due to lower management and distribution fees.

Intraday trading: Active ETFs offer real-time pricing and liquidity. They are traded like stocks.

Transparency: Most active ETFs disclose their holdings daily, which allows an easy monitoring and risk assessment by investors. Daily disclosure to market makers is necessary and allows better pricing and tighter spreads.

Active risk management: Active ETFs provide the advantage of a dynamic risk management, as portfolio managers can adjust the fund's exposure to mitigate the risk compared to passive ETFs which track a designated index.

ESG: Passive ETFs are tracking an underlying index, therefore the ESG integration depends on this underlying index, whereas with the active management of active ETFs or mutual funds, portfolio managers apply and adjust tailored ESG criteria in real time based on controversies or regulatory changes.

Tax advantages: ETFs domiciled in Ireland may offer tax advantages. Investors should consult their tax advisor for further details.

What are the main risks of an active ETF?

Risks of an active ETF are similar to the risks of an active mutual fund and may be exposed to the following risks:

Discretionary management risk: The performance and success of an active ETF depend on the skills and expertise of the portfolio manager. Poor decision-making on their part could lead to underperformance.

Cluster/concentration risk: A portfolio manager might choose to concentrate investments into a smaller number of securities or sectors, which could lead to amplified losses due to reduced diversification.

Liquidity: An active ETF's liquidity primarily depends on its underlying assets. Depending on the assets held by an active ETF, it might face challenges selling these assets in times of distress in the market. Furthermore, market makers are required to facilitate the trading of an ETF's shares. Thus, reduced market maker activity will lead to a reduction of the liquidity of an active ETF.

Other risks may apply, such as equity risk, interest rate risk or credit risk.

Is an active ETF fully transparent?

With regard to active ETFs, depending on their country of incorporation, portfolio holdings may be published either on a daily basis or at defined intervals, provided that certain transparency and clarity requirements are met. The applicable information will be published on the management company's website.

How do active managers make investment decisions?

Active managers make their decisions based on research, forecasts and their own expertise. Active management is guided by the portfolio manager's discretionary decision. The criteria used by active managers may include fundamental, flow, momentum and quantitative analysis to guide their investment decisions.

What is the Total Expense Ratio (TER) and Total Cost of Ownership (TCO) for an active ETF compared to a mutual fund (excluding ETFs)?

The Total Expense Ratio (TER) represents the annual fees associated with managing and operating a fund. The TER of an active ETF tends to be lower than the TER of a mutual fund. However, for an ETF, investors should also consider the Total Cost of Ownership (TCO). The TCO also takes into account some costs that are not covered by the TER, such as the transaction costs at the fund level (for e.g. the bid-ask spread) or swap fees and securities lending income (if applicable). When comparing the TCO, the cost of an active ETF might be close to the cost of a mutual fund.

Are active ETFs more expensive than passive ETFs or mutual funds?

Active ETFs typically carry higher fees than passive ETFs due to the involvement of portfolio managers and active decision-making. Passive ETFs aim to replicate an index and require minimal oversight. However, active ETFs often have lower expense ratios than mutual funds, as they have lower management fees. The related fees may vary from one ETF to another.

Can active ETF pay dividends to investors?

Yes, like traditional ETFs and mutual funds, active ETFs can distribute dividends to investors (distributing share class). As for an accumulating share class, dividends are automatically reinvested into the fund in accordance with its accumulating dividend policy.

Can active ETFs be invested in various asset classes?

Active ETFs are available across a wide range of asset classes, including: equities, fixed income, multi-asset, (liquid) alternatives and thematic strategies.

Can active ETFs be liquidated?

Yes, like a passive ETF or mutual fund (excluding ETF), active ETFs can be liquidated. This may occur in particular when the fund's strategy fails to attract sufficient assets to remain economically viable or when the investment strategy is no longer aligned with the management company's broader product offering.

When an active ETF is liquidated, subscriptions and redemptions of shares on the primary market will be suspended and investors will receive the net asset value (NAV) of their holdings minus any applicable costs as a cash payment.

Can active ETFs be merged?

Yes, an active ETF can be merged, and investors will receive shares in the new ETF in proportion to the shares they held in the old one.

How often are active ETFs rebalanced?

The rebalancing of active ETFs may depend on the manager's strategy and market conditions. Managers are free to adjust holding as often as they see fit, ranging from daily to less frequent changes.

Where can I find reliable information about an active ETF?

Investors can find reliable information about an active ETF on the website of the issuer, the management company and/or the distributor, on financial and data platforms, on brokerage platforms and on the exchange where the fund is listed. This reliable information is contained in particular in the fund's regulatory documentation, approved by the competent regulator. These documents are generally available on the website of the company offering the ETF, on some financial data platforms, some brokerage platforms and on the exchange on which the fund is listed.

How do I track the performance of an active ETF?

The performance of an active ETF is available on the monthly factsheet provided by the issuer, the management company and/or the distributor and can also be tracked online via investment websites. Important updates will be made available on the respective exchange through market announcements.

What is the process of buying an ETF on primary and secondary market? How does the creation and redemption process work?

ETF purchase process:

- **Primary market**
The primary market is only for Authorized Participants (APs), which are usually large financial institutions. They trade directly with the ETF management company to request the issuance or redemption of blocks shares, so-called creation units.
 - Creation: the AP delivers a basket of securities that exactly matches the composition of the ETF (or the equivalent in cash) to the issuer. In exchange, it receives creation units that it can resell on the secondary market.
 - Redemption: the AP returns the creation units to the issuer and receives the basket of underlying assets or cash in exchange.
- **Secondary market**
This is the “traditional” market where investors buy and sell ETF shares among themselves, via a brokerage platform or stock exchange, just like a regular share. The price fluctuates according to supply and demand.

Liquidity risk on the primary market: even if the secondary market for an ETF may appear active, actual liquidity also depends on the ability of the APs to create or redeem shares efficiently. In times of stress (high volatility, illiquid underlying market), it may become more expensive or difficult for them to supply or recover the underlying securities, which may widen price spreads and make trading less smooth.

How does the liquidity of active ETF work?

The main factors of the liquidity of an active ETF are the securities held by the fund. Fundamentally, if an active ETF invests into liquid assets, the latter will be liquid and vice versa.

Primary Market: The creation and redemption process involves exchanging baskets of the ETF’s underlying securities for ETF shares. If the underlying securities are highly liquid the Authorized Participants (APs) can promptly assemble the required baskets for creation. This fluidity in the primary market translates to higher liquidity in the secondary market. Similarly, a deterioration in liquidity in the primary market may lead to a deterioration in liquidity in the secondary market.

Secondary Market: This liquidity is visible through metrics such as trading volume, market depth and the bid-ask spread. High trading volumes and narrow bid-ask spreads frequently signify good liquidity, making it easier and more cost-effective for investors to trade.

Does low AuM mean that an ETF is illiquid?

No, low AuM does not necessarily mean low liquidity. While AuM might be a metric for an ETF’s popularity, it does not directly determine its liquidity. The liquidity of an ETF has two components: the volume of units traded on an exchange and the liquidity of the individual securities in the ETF’s portfolio. ETFs are open-ended, meaning that units can be created or redeemed based on investor’s demand. How easily the Authorized Participants can deliver or sell securities depends on the liquidity of individual securities in the ETF portfolio. If these underlying securities are liquid, so is the ETF. Therefore, ETFs with low AuM can also absorb large investments easily if the investment universe is highly liquid, and vice versa.

What role can an active ETF play in a portfolio?

For investors, active ETFs can serve multiple roles within an allocation: as core holdings with an active tilt, as satellite strategies for specific themes or market segments, or as tactical tools to respond swiftly to changing market conditions.

Investors searching for active strategies but who like the convenience offered by the ETF structure, might appreciate active ETFs. Data shows that investors are increasingly using active ETFs to replace or complement passive strategies.

Which criteria should an investor consider when searching for an active ETF to invest in?

Before investing in an active ETF, it is essential that investors consult the regulatory documents (KID, prospectus), in particular to familiarise themselves with the characteristics of the fund and understand the management strategy, as well as the due diligence procedures applied, the investment horizon and the risk profile. Passive ETF due diligence teams focus on aspects like liquidity, spreads and tax benefits. Active mutual fund due diligence teams focus on the investment strategy, historic results and investment capabilities. As active ETFs combine the features of ETFs and active investment strategies, investors should consider both sides in their analysis.

How long should an investor plan to hold an active ETF?

The recommended holding period is stated in the regulatory documentation. Active ETFs are, in general, planned for a medium-to long term-investment. It will depend on the investment strategy of the active ETF and the risk profile of the investor. However, they offer intraday liquidity and hence can be sold at any time of the trading day, while mutual funds only offer daily trading at best.

Can an investor buy and sell an active ETF whenever he wants?

Active ETFs can be bought and sold at any time during regular market trading hours through a stockbroker, investment platform or via a financial advisor, just like individual stocks.

Are the active ETFs available through a life insurance contract or a savings plan (PEA, PEE, PER, PEA-PME)?

Yes, like most UCITS funds, active ETFs are eligible for life insurance and savings plans (PEA, PEE, PER, PEA-PME, etc.). Their availability depends on the products offered by distributors and insurance companies

Before any subscription, investors are invited to consult the ETF's regulatory documentation and, if necessary, contact their financial intermediary.

ETFs are exposed to a number of risks, including the risk of capital loss.

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