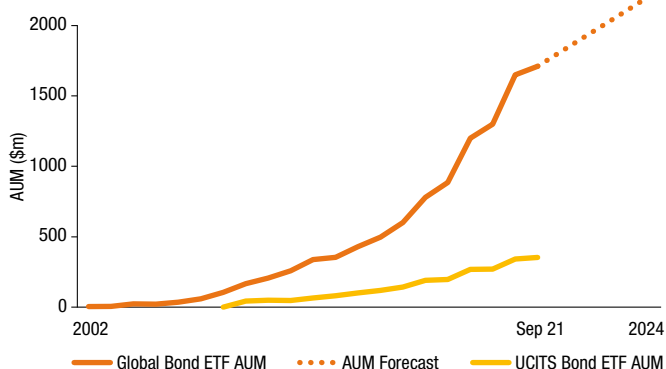


THE MODERNISATION OF THE EUROPEAN BOND MARKET: THE DEVELOPMENT OF THE ETF ECOSYSTEM

The Covid-19 selloff in early 2020 upended financial markets and has had a large effect on how fixed income ETFs function: As liquidity in underlying markets has receded, ETF trading volumes have soared to all-time highs. Investors are shifting towards utilising baskets of bonds (as opposed to single bonds) for investment and risk management purposes amid the volatile climate.

Growth of global fixed income ETF AUM



BlackRock, as of 30/09/2021. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast or guarantee of future results. This information should not be relied upon as investment advice regarding any particular fund, strategy or security. Forward looking estimates may not come to pass. All figures in US\$.

This increasing number of institutional investors incorporating ETFs into their investment framework has necessitated rapid development in the trading ecosystem. Technological advancements associated with the asset class are furthering the modernisation of the European bond market.

We saw how in times of stress, these instruments performed as intended, providing continuous liquid access to key exposures which allowed investment managers to manage their exposures in an efficient manner.

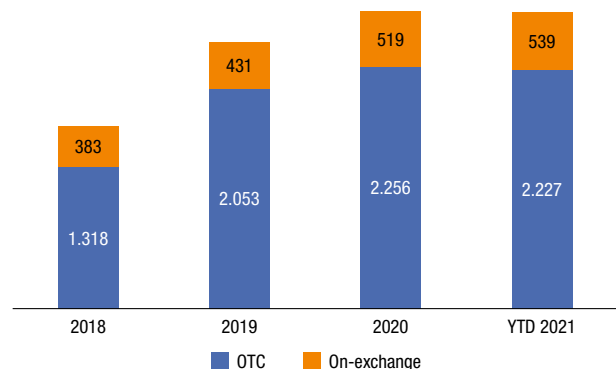
Smadar Shulman, Head of Fixed Income Index EMEA



ETF liquidity and continuous bond market pricing that comes with it has enabled a diverse ecosystem to develop both on the funded and unfunded side, as well as led to advances in price discovery necessary for efficient markets. We continue to see ETFs playing a key role in this ecosystem.

Smadar Shulman, Head of Fixed Income Index EMEA

Longer term growth trend of fixed income UCITS ETF trading volumes (\$ million)



Source: BlackRock, as of 30/09/2021. All figures in US\$.

Critical to this growth has been the increasing electronification of ETF trading, which has led to further automation, easier access and lower execution costs. More and more brokers are providing automatic quotes on ETFs through request-for-quote platforms, accelerating the execution of small and recurring orders. Banks have also been building out their ETF algorithmic trading capabilities, leading to the possibility of layering ETF execution strategies based on pre-programmed instructions. This has the potential to optimise trading by integrating multiple liquidity pools to source the best prices, minimise market



impact and provide a rules-based approach to achieve pre-defined execution targets.

Beyond this, the introduction of MiFID II legislation saw a number of data and analytics companies begin to aggregate secondary trading volumes across listings and trading venues, offering a much clearer picture of total ETF liquidity. The strategy of portfolio trading (in which a counterparty offers a portfolio of multiple line items simultaneously, to be taken all together or not at all, in a single trade) has grown significantly in Europe as technology and pricing capabilities have improved.

An increase in analytical tools has certainly aided this phenomenon: Over the past several years, platforms such as Aladdin and Bloomberg have enabled investors to insert ETFs into their toolkit by allowing them to perform relative-value analysis across index products.

The future of the ETF ecosystem

As the ETF market continues to expand, we can expect to see a more diversified investor base and further utilisation of fixed income ETFs. Developments such as larger lending pools of ETF units will further enhance the liquidity in European-domiciled ETFs, offering investors an additional source of return.

Furthermore, the unit (or ETF share) lending market has benefited from the emergence of a fixed income ETF repo market – an increasing number of banks are pricing and trading fixed income ETFs. This has allowed fixed income investors to improve their performance by trading ETF repos directly with

banks, instead of engaging a securities lending agent (cutting out the middleman, if you will).

As the bond market continues to modernise, so too must the techniques fixed income dealers use to interact with ETF issuers in the primary market. For example, the iShares Bond ETF primary market platform has improved the predictability and transparency of the custom basket process through the development of better interfaces with authorised participants (APs), which allows them to electronically submit custom basket proposals. Algorithms have been developed which help guide APs when selecting their baskets; this is beneficial as it applies a rules- and exposure-based framework to aid in the selection process.

The growing adoption of fixed income ETFs and other index and portfolio-based products, coupled with growth in electronic trading, algorithmic pricing capabilities and dramatic improvements in technology are continuing to revolutionise the way investors access European corporate bond markets. ETFs have proven to be a powerful diversification tool in an environment which has seen more traditional bond instruments struggle. The growth in index vehicles is a recognition of the need for liquidity and transparency. We believe ETFs will continue to play an increasingly integral role for investors looking to access and navigate bond markets.

Source: 'The Modernisation of the of the European bond market: The journey continues', BlackRock, as of 31/12/2021.

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