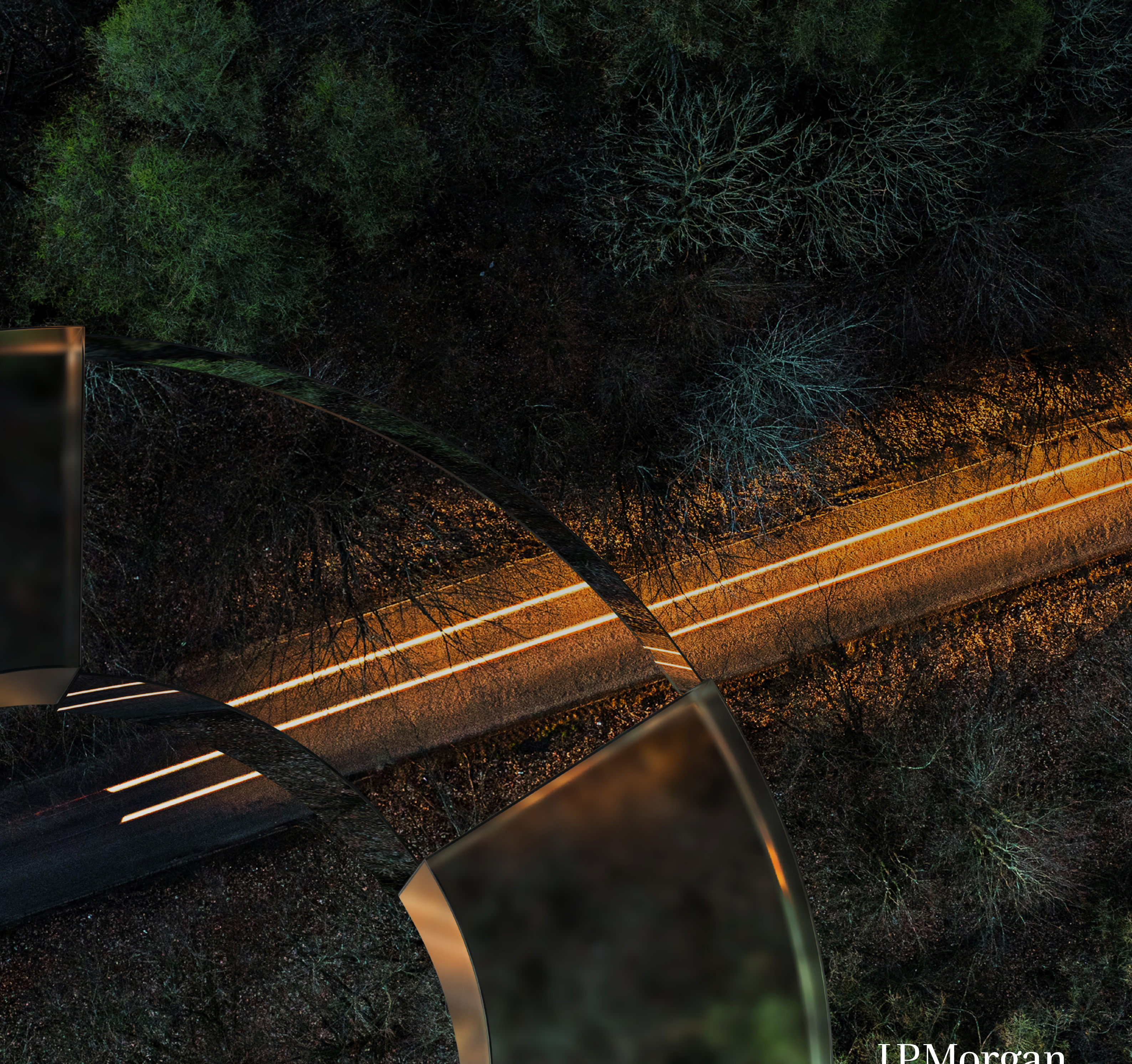
Europe’s institutions are missing out on the active ETF opportunity

European institutional investor perceptions of active ETFs



J.P.Morgan
ASSET MANAGEMENT

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Executive summary

Active ETFs are underused in Europe, with over 70% of large asset owners not currently investing, according to our research.

1. Two clear camps emerge:
   - Early Adopters (27%) and Considerers (73%)
2. Early adopters are using active ETFs for tactical and strategic goals – prioritising cost savings, flexibility and thematic alignment.
3. Considerers face resistance from preference for passive ETFs, knowledge gaps and structural hurdles.
4. Italy, Germany, and France lead on adoption; the UK lags for now.
5. The fixed income frontier and ESG (environmental, social and governance) tipping point are key sub-themes to watch.
6. Broader adoption will require better education and demonstrable performance key to convert wavering considerers.

Source: J.P. Morgan Asset Management, Research in Finance as of January 2025.

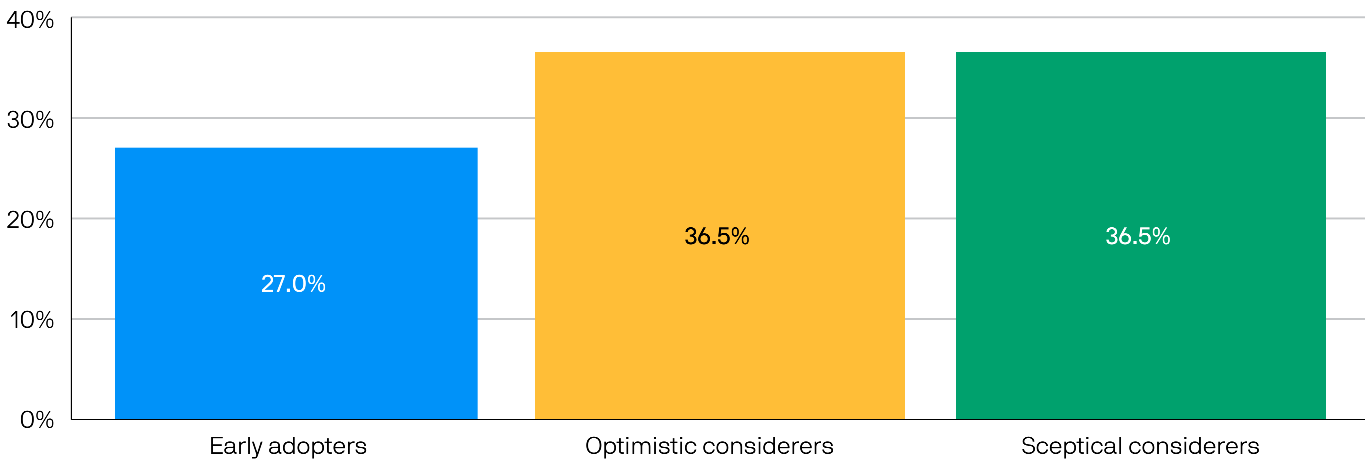
Introduction

Active ETFs offer flexibility and cost-efficiency with the potential to outperform traditional index strategies. Yet according to our latest research, they remain underused by European institutions, with over 70% of the continent's largest asset owners not currently invested in active ETFs at all.

Why the reluctance? Our recent survey of 70 institutional fund selectors across 12 European countries has revealed a sharp divide in views.[1] Around 27% are enthusiastic early adopters, championing active ETFs as tools for cost-saving, risk management and growth. But the remaining 73% – the considerers – are split between cautious optimism and scepticism.

This report explores what's driving active ETF adoption among Europe's institutional investors, the barriers holding some asset owners back, and the trends shaping the market.

Interviewees are evenly split



Source: J.P. Morgan Asset Management, Research in Finance as of January 2025.

1 Explanation of methodology included in appendix on page 15.

Active ETFs: The two camps

The enthusiasts

For the 27% of asset owners who already use active ETFs, the attributes are clear. These early adopters deploy active ETFs both tactically and strategically, particularly to navigate market volatility and align with thematic goals. They view active ETFs as versatile, alpha-focused tools that can replace more expensive active mutual funds.

We use active ETFs to play a different game. We hope that it gives a better-balanced client portfolio.

Dutch consultant, using active ETFs

The considerers

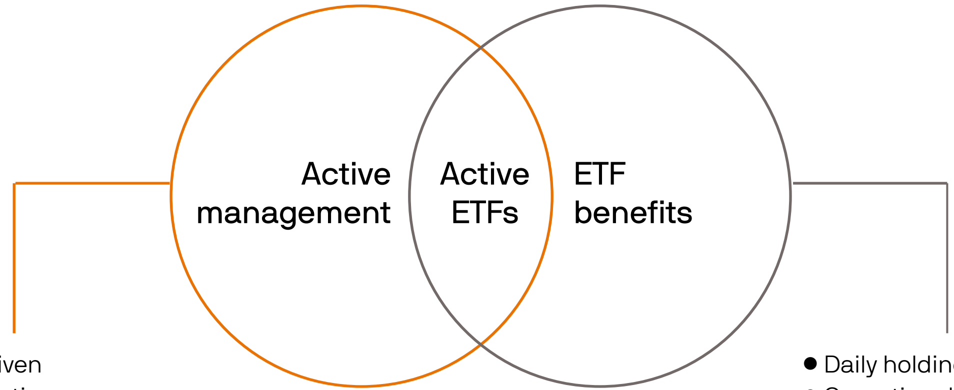
The remaining 73% of respondents are split down the middle:

Optimists: These investors – roughly half of the considerers – see potential in active ETFs, particularly in fixed income, but are waiting for clearer performance data and broader product ranges before they take the plunge.

Sceptics: This group – the other half of the considerers – doubts whether active ETFs justify their costs, citing concerns over complexity, lack of transparency, and unpredictable alpha generation.

For many considerers, confusion about active ETFs creates a trust gap that currently feels too wide to cross. However, perceptions are starting to shift as the track records of early adopters come to light. The active ETF trailblazers are helping to clarify the potential role of active ETFs and their characteristics (see *How early adopters are using active ETFs* below).

Knowledge corner: Active management in an ETF structure



- Research-driven
- Security selection
- Portfolio construction
- Risk management
- Opportunity for outperformance

- Daily holdings transparency
- Operational efficiency
- Access and price discovery
- Low cost for pooled fund
- Flexibility

Source: J.P. Morgan Asset Management. For illustrative purposes only. Information shown is based upon market conditions at the time of the analysis and is subject to change. Not to be construed as Investment recommendation.

How early adopters are using active ETFs

Early adopters consistently highlight active ETFs' ability to combine the best aspects of passive and active management – that is, the cost-effectiveness and transparency of traditional ETFs and the tailored exposures and alpha generation potential of active strategies.

Flexibility

Our panel acknowledged active ETFs offer far more flexibility than passive ETFs and can be used to access more niche investments, or better align to in-house investment guidelines, particularly those related to sustainability. These enthusiasts specifically praised how active ETFs help them seize market opportunities or respond to threats. The ability to avoid certain investments at times of turbulence is a key point of difference.

Cost-effectiveness

Most early adopters also recognise that active ETFs can be more cost-effective than traditional active mutual funds – providing an attractive middle ground between passive ETFs and active mutual funds that bridges a gap in institutional portfolios. Plus, because the fees are lower than for the equivalent traditional active mutual fund, they note it's easier for active ETF managers to deliver returns over and above fees, for longer. For these adopters, active ETFs are a simpler, more cost-effective way to access actively managed strategies – and the managers behind them too.

Diversification

Next up is diversification and using active ETFs to diversify away from traditional passive core building blocks in search of better-balanced portfolios. Early adopters cited active ETFs' effective management of liquidity issues, clear transparency on holdings and adherence to investment approaches as key advantages. This contrasts with the "liquidity paradox" noted previously and highlights a perception gap: early adopters recognise liquidity as a critical tool for navigating market stress and maintaining flexibility, even in strategic allocations, while considerers often overlook this benefit, focusing instead on more immediate cost and performance metrics.

Liquidity

While several investors recognised the liquidity benefits of active ETFs, many asset owners who run conservative, medium-to-long-term strategies don't feel the need to incorporate highly liquid instruments. This creates what some called the "liquidity paradox": ETFs offer significant flexibility, yet even their strongest advocates sometimes don't prioritise this feature.

Knowledge corner: Benefits of daily ETF liquidity for institutional investors

Institutional investors might overlook the broader importance of daily liquidity, even for long-term investors. Efficient pricing and price discovery both benefit from high liquidity, and can provide a crucial edge when entering or exiting positions. Liquidity also boosts portfolio transparency and can support investor confidence during market stress. The flexibility to make tactical adjustments to long-term strategic portfolios is an underappreciated benefit.

Ease of entry and exit

High liquidity ensures that institutional investors can enter or exit positions with minimal market impact. This flexibility is crucial for large trades, as it allows investors to buy or sell significant quantities of an ETF without causing substantial price fluctuations. Additionally the ETF vehicle allows institutional investors to allocate efficiently without having to go through onboarding requirements typical in other fund structures.

Risk management

Liquidity is a key component of risk management. In times of market stress, liquid ETFs can be sold more easily to raise cash or rebalance portfolios, helping to manage risk and maintain desired asset allocations.

Price transparency

Liquid markets provide more accurate and transparent pricing, helping institutional investors to value their holdings and make informed investment decisions.

Cost efficiency

Liquid ETFs typically have tighter bid-ask spreads, which reduces transaction costs. Lower costs are beneficial for institutional investors, as they can improve overall investment returns over time.

Early adopters are broadly enthusiastic about the active ETF product highlighting tactical access, alpha generation and cost savings, with the latter becoming increasingly crucial as fee pressures mount.

> **For institutional investors who want to be benchmarked but generate a little alpha, it's the perfect product**
>
> Swiss consultant, using active ETFs

Key advantages of active ETFs as seen by...

Users of active ETFs	Considerers of active ETFs
Tactical access	Flexibility
Cost-efficiency	Cost-efficiency
Potential to generate alpha	Liquidity

Source: J.P. Morgan Asset Management, Research in Finance as of January 2025.

Why aren't more institutions using active ETFs?

Market preferences and bias

For many respondents, the low cost and simplicity of passive ETFs outweigh the benefits of active management, especially at times of volatility. This preference is deeply entrenched in markets perceived as efficient, such as global equities, where successful stock-picking is seen as too challenging among respondents.

Even the enthusiastic early adopters note that active ETFs carry the same inherent risk of underperformance as their mutual fund counterparts, which some highlighted might feel worse than underperformance from an active mutual fund.

That said, these preferences can shift depending on market conditions. Some oscillate between active and passive strategies. "We went from 80%-90% passive in 2017 to 50% for the next three to four years," said one Italian fund selector. "Today we're back up to 70%-80% again, but it's all about timing and trends."

While relying on passive strategies may feel safe, it carries its own risks, particularly in major indices where a handful of high-performing stocks have driven returns. This preference may now pose risks to portfolios as passive strategies inadvertently magnify uncompensated concentration risks. Active ETFs offer a way to mitigate these kinds of biases, helping investors to diversify more deliberately and better navigate shifts in market dynamics.

Confusion and complexity

Confusion/lack of knowledge remains a significant hurdle. Many considerers struggle to distinguish active ETFs from smart beta or passive ETFs. Some believe they are "lightly active", involving minimal human input, while others assume they function more like traditional active mutual funds.

This lack of clarity undermines confidence and hinders adoption. It can feel hard to explain active ETFs to a board, for example, if the lines between active and passive are too blurred. Greater education of the benefits of active ETFs can help to overcome this hurdle.

Structural and regulatory hurdles

Tax and domicile issues can further complicate matters. Swiss pension funds, for example, prefer local products for tax efficiency, while for others, the treatment of withholding tax for equity-based ETFs can feel like a dealbreaker.

Separately, while active ETFs have potential liquidity benefits, the general lack of interest in intra-day liquidity means active ETFs are being overlooked or just not 'landing on the radar'. These fund selectors aren't as aware of the products already available to them, or which companies are leading the market – because they don't need to be.

Product confusion: What's in a name?

Let's look at the confusion and complexity point more closely. The idea of an active ETF is broadly understood by both current users and considerers. But not all grasp entirely how it works.

Some found it hard to distinguish between an active ETF and a smart beta equivalent, or to explain exactly what the manager of an active ETF does.

In-the-know users categorise active ETFs as investments based on portfolio management, not tied to an index. They recognise the differences between passive, smart beta and active ETFs – with passive tracking indices, smart beta using a refined set of index rules and active having a fund manager making decisions on security selection and index deviations.

But to some, the extent of the manager's involvement was less obvious, believing it was more about selecting which sampling method was used. They see active ETFs more as a human hand at the tiller, rather than being driven by active, insight-based security selection.

The truth lies somewhere in the middle. Both systematic and fundamental, human-led approaches are available – with strategies ranging from relatively benchmark constrained to higher-octane active strategies that are less tied to the benchmark they're trying to beat.

There was a little less certainty among the considerers. Some referred to weightings or factors or noted that the product is still rules-based rather than manager-driven, suggesting the lines between smart beta ETFs and active ETFs are somewhat blurred. Clearly, the industry still has work to do to explain how and why to employ active ETFs in institutional portfolios.

This wide range of expertise and familiarity is also reflected in the mixed uptake of ETFs – both passive and active – by institutions across European countries.

Knowledge corner: ETFs offer exposure to different types of investment strategy

Passive	Strategic beta	Active
• **Objective:** seeks to provide beta exposure to the market • **Methodology:** rules-based, market capitalisation index • **Portfolio construction:** tracks index (less fees); rebalanced systematically	• **Objective:** seeks to optimise risk adjusted returns relative to traditional benchmarks • **Methodology:** rules based, quantitative, non-market cap index • **Portfolio construction:** tracks index (less fees); rebalanced systematically	• **Objective:** seeks to outperform a benchmark • **Methodology**: actively managed, research-driven portfolio • **Portfolio construction:** managed on a discretionary basis, benchmarked to an index

Contrasting fortunes for ETFs in Europe

Looking at the different groups and approaches above, it should be no surprise ETF usage varies widely across Europe. They typically account for 15%-30% of asset owner portfolios in our research, with allocations at their highest in Italy, France and Germany, while UK institutional investors currently lag behind in their ETF adoption.

Momentum for increased allocations is building, however, thanks to cost pressures and more interest and awareness of what ETFs can offer in areas like risk and transition management.

- **Italy and Germany** High ETF adoption rates, with growing interest in active strategies. Sustainability and tactical flexibility are key drivers.
- **France** Widespread use of passive ETFs, but strong curiosity about active solutions. Insurance firms face regulatory challenges under Solvency II.
- **Nordics and Benelux** Conservative but receptive. Fixed income is a major focus, though competition from segregated mandates is fierce.
- **Switzerland** Tax efficiency heavily influences decisions. Active ETFs appeal for fixed income, but local index funds often take precedence.
- **UK** The slowest adopter. Risk-averse pension schemes dominate, and both passive and active ETFs struggle for traction.

Source: J.P. Morgan Asset Management, Research in Finance as of January 2025.

Two sub-themes to watch

#1 The fixed income frontier

While equities dominate active ETF usage today, many of our interviewees see fixed income as the next big opportunity. In post-QE (quantitative easing) markets, bond investors are increasingly wary of passive strategies that overweight heavily indebted issuers due to their market-cap weighting. This inherent bias can lead to portfolios that are disproportionately exposed to lower-quality credit or systemic risks.

Active ETFs, by contrast, are seen to allow for more selective credit exposure, enabling investors to focus on higher-quality issuers, diversify across sectors, and implement nuanced strategies that better align with risk and return objectives. Actively managed funds can adapt to changing market conditions, such as rising interest rates or sector-specific stresses, helping to mitigate some of the pitfalls associated with the passive approach.

Both users and considerers see fixed income as an untapped space. Many are eager for innovations in high-yield bonds, infrastructure debt, and ESG-aligned credit strategies.

Yet, the lack of available fixed income products is a sticking point, especially across the Nordics and Benelux, where appetite for fixed income solutions is growing.

> **ESG is something that could be offered by active ETFs, be it broad green or more narrowly focused.**
>
> Danish foundation, considering active ETFs

#2 A tipping point in ESG

Speaking of ESG, sustainability is no longer optional for many of Europe's asset owners – increasingly, it's mandated.

With regulations like the EU's Sustainable Finance Disclosure Regulation (SFDR) driving change, ESG-aligned investments are at the top of the institutional priority list.

Most of the users we interviewed find active ETFs make it easier to align with specific ESG criteria, without having to compromise on cost or performance. Being able to implement exact exclusion policies or adhere quickly to new regulations while still pursuing alpha targets and keeping costs low make them an attractive alternative to passive ETFs or more expensive mutual fund strategies.

Some enthusiasts cited sustainable active ETFs as being more adaptable, especially when it comes to capturing emerging themes, because re-balancing constraints and index rules can put that kind of tailoring beyond pure indexed strategies.

The quality of data and reporting were important too. The kind of standardised ESG reporting that sustainable active ETFs can offer is harder to achieve with segregated mandates and the outsourcing of ESG monitoring removes a time-consuming burden.

Challenges do remain, however. Many investors worry about greenwashing, questioning whether active ETFs can balance sustainability with performance. Others struggle to find ESG products tailored to their needs.

What's next for active ETFs?

All early adopters expect to maintain or increase their current allocations to active ETFs.

They're optimistic the market will continue to develop, and product ranges will grow, driven by a wider appreciation of active ETFs' ability to meet diverse investment needs in a cost-efficient way.

Some see active ETFs replacing traditional active mutual funds in core regional allocations, while others expect to deploy them as sophisticated, satellite exposures – notably on the thematic side.

What about the considerers? This group believes that active, thematic ETFs (including those covering sustainable themes) could be the gateway to their wider adoption of active ETFs. The combination of active and thematic is a "very sweet spot", a "hit" that's promising, even sought after in certain sectors.

Just under half of our considerers expect to use active ETFs soon, with a Luxembourg insurer for example already conducting a benchmarking study with a view to making active ETFs available to their customers in 2025.

All told, two-thirds of the big asset owners we interviewed expect to soon be investing in active ETFs – probably in specialised sectors or thematic investments such as climate and biodiversity. The rest? Well, more persuasion is needed.

Encouraging wider adoption of active ETFs

For investors considering active ETFs, the key factors influencing take-up include performance and costs. Many are looking for clear, demonstrable evidence of the advantages active ETFs can offer over traditional active mutual funds.

Market participation is another critical signal. Moves by larger, more sophisticated institutions towards active ETFs could provide the reassurance needed to encourage considerers off the sidelines.

The sustainability angle is an additional point of focus. Some panellists raised concerns about whether sustainable active ETFs can deliver consistent performance, especially if opportunities are restricted by exclusions of sectors such as oil. Others raised concerns about transparency and the potential for greenwashing. Some simply haven't found an ETF that meets the requirements of their portfolio.

A handful feel passive ETFs are better suited for long-term strategies, partly because of the perceived limitations of the current active ETF product ranges. However, most considerers are willing to explore active ETFs further, provided the knowledge gap is bridged. To do that, the focus needs to be on understanding investor strategies, demonstrating how active ETFs can fit in their portfolios, and offering more tailored education.

In the UK, adoption is likely to be more gradual than in other markets. As panellists pointed out, uptake will depend even more heavily on communication, accessible education and robust research from asset managers to show the tangible benefits of integrating ETFs into portfolios.

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J.P. Morgan Asset Management's active ETF platform

#1	30+	$37bn+
Largest active UCITS provider	Active ETFs, the largest range anywhere	Assets under management in our active UCITS ETFs

Source: J.P. Morgan Asset Management, Bloomberg as of 30 December 2024.

Research methodology

70 qualitative interviews

Interviews across 12 European countries:
UK, Germany, Italy, France, Switzerland, Belgium, Luxembourg, Netherlands, Denmark, Sweden, Finland and Norway

29x Pension Funds

18x Institutional Consultants

19x Insurance Firms

4x Foundations

19x current active ETF users

51x considering using active ETFs

This research, prepared by Research in Finance, explores institutional investor perceptions of active ETFs across 12 European countries. The study included 70 in-depth, qualitative interviews conducted in September and October 2024 with institutional fund selectors and decisionmakers from pension schemes, insurers, consultancy firms, and foundations. Participants currently invest in, or are considering investing in, active ETFs. Research participants were screened, with those not considering active ETFs not included in the research. Each interview lasted approximately 60 minutes, providing insights into the drivers, barriers, and future potential of active ETFs in Europe.

Source: J.P. Morgan Asset Management, Research in Finance as of January 2025.

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