

ICI: ETFs Proved Resilient During Unprecedented COVID-19 Market Volatility

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New Paper Details How ETF Ecosystem Facilitated Smooth Functioning in Markets and Provided Critical Price Discovery Mechanism for Investors

Washington, DC; October 22, 2020—Despite unprecedented market volatility in March 2020, the structures for creating, redeeming, and trading shares of exchange-traded funds (ETFs)—including ETF issuers, authorized participants (APs), and ETF liquidity providers—proved their resilience, says the Investment Company Institute (ICI) in a new paper on the COVID-19 market crisis, “Experiences of US Exchange-Traded Funds During the COVID-19 Crisis.”

“ETFs and their ecosystem emerged from this real-life ‘stress test’ with distinction,” said Shelly Antoniewicz, ICI senior director of industry and financial analysis. “Throughout this period, APs, market makers, and other liquidity providers remained active and engaged, helping to facilitate high volumes of ETF activity. ETFs also acted as a source of stability and an important source of price discovery in the fixed-income market by providing investors with real-time views on the costs of liquidating the underlying bonds. This evidence should help ease the concerns of policymakers and others about the role ETFs play in our financial system during a crisis.”

The paper draws these conclusions from extensive data, in-depth analysis of ETF trading and flows, and a survey of ICI members to assess the activity of APs during the height of the market turmoil caused by the economic response to the COVID-19 pandemic.

Net Flows of ETFs Were Modest

Despite extreme market volatility, the paper finds that ETFs had modest flows in March. Equity ETFs had total net inflows of \$31 billion, or 1.3 percent of their February assets, and bond ETF outflows totaled \$18 billion or 2.1 percent of their February assets. Net outflows from bond ETFs were concentrated in investment grade bond ETFs, likely reflecting investors’ desires to shore up their cash positions by selling high-quality assets (page 15).

ETF Trading in the Secondary Market Functioned Smoothly

Most ETF trading takes place in the secondary market. ICI’s paper shows that, during the height of market volatility related to COVID-19, investors turned to ETFs to quickly and efficiently transfer and hedge risks (page 3). The paper also demonstrates that registered market makers and other liquidity providers remained active in the secondary market (page 8) and provided competitive two-sided quotes for ETF shares relative to their underlying securities (page 4).

Discounts on Bond ETFs Largely Reflected Price Discovery

During March, bond ETF prices adjusted quickly in the rapidly changing markets and acted as an important source of price discovery for fixed-income markets, explains ICI. The paper contends that the difference between the ETFs’ price and their net asset values (NAVs) reflects the increased liquidity costs in the underlying market. Bond ETF shares are traded on the secondary market and their market prices are continually updated, incorporating market participants’ real-time, evolving views on the values of the underlying bonds held in ETFs’ portfolios, as well as their estimated transaction costs (page 12).

New Data Show APs Increased ETF Primary Market Activity

Policymakers and commentators have speculated that ETFs rely too heavily on a limited number of APs that would stop facilitating creations and redemptions during periods of market stress. ICI conducted a survey to determine how well APs served ICI members from March 9 to 27, 2020—the height of the COVID-19 market turmoil. The results disprove this theory. When compared with a more “normal” period, from March 11 to 19, 2019, the results show that rather than pulling back, more APs entered the market to serve a

significantly higher volume of ETF creations and redemptions for more ETFs in March 2020 than March 2019 (page 17).

Report Overseen by ICI's COVID-19 Working Group

This paper is the second in ICI's series, Report of the COVID-19 Market Impact Working Group. The report is being issued under the auspices of ICI's COVID-19 Market Impact Working Group, whose members include senior industry executives convened by the Executive Committee of ICI's Board of Governors for this purpose. The working group is examining the causes of the market turmoil in early 2020 and the experiences of regulated funds. The report will provide a sound, empirical basis for any future regulatory discussions or other policy responses that could affect regulated funds and their investors. ICI's research, legal, industry operations, and global staff are supporting the working group in drafting the report.

The first paper in the report, "[The Impact of COVID-19 on Economies and Financial Markets](#)," was published October 14.

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