The ETF Report – Magazine for ETF Investors
May 2015

By Lara Crigger

# THE ETF TRAILG

**Six years ago, J. Garrett Stevens, CEO of FaithShares, had just launched his first ETFs. He and his partners sat back, counted their victories, and eagerly waited for investors to bang down the door to buy up the funds.**

**They never did.**

**The rest of the story is all too familiar. Stevens and his partners had spent far more than they anticipated on getting their funds to market, with little left over to make sure investors actually knew the funds existed. As a result, the five FaithShares ETFs, despite solid performance, failed to accrue enough assets to survive. FaithShares shuttered its doors in 2011.**

**But a funny thing happened on the way to dissolution.**

**"People started calling, wanting to know if they could buy our exemptive relief," said Stevens. "Or they wanted to know if we could consult and help them launch their own funds, since we'd already been down that road."**

**That gave Stevens an idea: a white-label service that would shoulder the burden for would-be ETF providers looking to launch their very own funds. Thus was Exchange-Traded Concepts (ETC) born.**

**Founded in 2011, ETC offers an "ETF-In-A-Box" service that slashes the time it takes to launch a passive index ETF to just three months, while shaving as much as 90% off the associated costs of filing.**

**"ETC came out of a very painful time for us," said Stevens. "But it gave us perspective, too. We were able to make lemonade out of lemons."**

## HOW IT WORKS

Launching an ETF is not for the faint of heart—or those with empty coffers. Most funds can take anywhere from one to three years to traverse the necessary regulatory channels to make it to market. Startup costs range from $750,000 to $1 million, estimates Stevens, which includes legal fees, due diligence costs, listing fees, seed funds, the associated audits and so on.

By using the ETF-In-A-Box platform, however, the cost to bring an ETF to launch—soup to nuts—is roughly $100,000. Furthermore, most funds can be launched in just 75 days.

It's possible because ETC already possesses exemptive relief, the most expensive and time-consuming piece of the legal puzzle in launching an ETF. Obtaining exemptive relief can take months—even years—of ping-ponging between lawyers and the SEC, but once in hand, it covers any similar ETFs a firm might launch.

ETC retained its passive exemptive relief from FaithShares, meaning that for most index-based funds, the firm can knock the prelaunch back-and-forth down to a 75-day window. (Active funds, however, require additional approvals, and can take up to six months to process.) ETC also possesses exemptive relief for a range of other funds, including active, fixed income, long/short, 130-30 and fund-of-funds.

"Basically, we can launch any type of fund that clients would like," said Stevens.

Having the pipes and plumbing in place significantly reduces ETF launch time and cost. Legal fees are drastically lower, since counsel and service providers already have the necessary paperwork complete. Plus, ETC's existing trusts—under which many funds are registered—have already performed the required audits. "We've nailed down a pretty good road map, a template that saves us lots of time in drafting documents, and so on," noted Stevens.

The savings can be critical, especially for new ETF providers. "With more ETFs out there, it takes longer and longer for people to find your product. You need the time and capital to get out there and market," said Stevens. "If we'd had a platform like this at FaithShares—where, instead of spending almost $1 million to get going, we could've spent only $100K, then spent the rest on marketing—maybe our products could have lived."

## EXPERTISE

Shepherding a nascent fund through SEC approvals is only part of the ETC package. Stevens and his partners also guide providers through marketing, operation, compliance and distribution of funds, as well as how to handle the critical days post-launch.

"I can tell clients what they should and should not do, because I have the scar tissue to prove it," said Stevens.

ETC rolls up its sleeves to help fledgling providers in a variety of ways, including refining concepts into marketable ideas, making introductions to and soliciting feedback from potential market makers, and acquiring seed capital. Plus, working with ETC nets clients significant discounts from service providers, such as accounting, distribution and legal advice.

"For a first-time ETF issuer, it was good to have someone with ETC's experience in bringing ETFs to market—to learn important success drivers and avoid potential pitfalls," says Mazin Jadallah, CEO of AlphaClone, which launched its $131 million Alternative Alpha ETF (ALFA|D-62) through ETC in 2012.

Travis Briggs, CEO of Robo-Stox, agrees. "Launching a successful ETF takes more than a good investment idea. Like any other business, back-office operations are critically important," he said.

Briggs worked with ETC to launch the Robo-Stox Global Robotics and Automation ETF (ROBO|F-20) in 2013. The fund now has $122 million in assets. "ETC manages much of the back-office operations for ROBO, and it has proven reliable and responsive. Also, through its knowledge of the marketplace and pricing power, ETC could provide better pricing with the highest quality vendors. That's something we couldn't have done as a first-time ETF startup," Briggs noted.

## A RANGE OF CLIENTS

To date, ETC has launched 17 funds for clients, totaling almost $2.5 billion in assets under management.

Its customers range from one- to two-person shops to some of the world's largest money managers. Research firms, index providers and RIAs have all sought ETC's assistance, as well as established international ETF providers such as Source and Horizon, both of whom wanted a larger foothold in the States.

"We're getting more and more interest from foreign ETF providers and money managers," noted ETC's Stevens. "They don't have experience with the U.S. regulatory environment, so they don't know what's needed, or even who to talk to. Working through our platform is a great turnkey solution."

Another growth area, says Stevens, are bespoke funds for RIAs looking for different distribution options for their strategies. Tiedemann Wealth Management, for example, requested an ETF built around a custom index of undervalued stocks of its choosing, into which it could move client assets. Hence the Deep Value ETF (DVP|F-55).

"For them, it's more efficient to make one trade in an ETF than to trade a bunch of smaller client portfolios," Stevens said. "Plus, anybody with $25 can buy one share. It's a whole different distribution avenue."

## LOOKING AHEAD

Things are busy at ETC these days. Six ETFs are scheduled to launch through the second quarter, including its first active ETF. It's also signed three new clients, each of whom intends to launch several funds.

"It's possible we'll double the number of funds traded by the end of this year, and potentially the assets in them as well," noted Stevens.

That success is encouraging, but if clients want to move on, Stevens doesn't mind.

"If clients want to launch their first few products with us, then launch on their own after that, we absolutely understand," he said. "At some point, it does make sense. But ETC is a great way to get started in this business, to hit the ground running." ●

**Investments involve risk. Principal loss is possible.**

**The AlphaClone Alternative Alpha Fund has the same risks as the underlying securities traded on the exchange throughout the day. Redemptions are limited and often commissions are charged on each trade, and ETFs may trade at a premium or discount to their net asset value. The fund can make short sales of securities, which involves the risk that losses in securities may exceed the original amount invested in a security. The fund is non-diversified, meaning it may concentrate its assets in fewer individual holdings than a diversified fund. Therefore, the Fund is more exposed to individual stock volatility than a diversified fund. REITs may be affected by changes in the value of their underlying properties or mortgages or by defaults by their borrowers or tenants. Furthermore, these entities depend upon specialized management skills, have limited diversification and are, therefore, subject to risks inherent in financing a limited number of projects. In addition, the performance of a REIT may be affected by changes in the tax laws or by its failure to qualify for tax-free pass-through of income. Investments in securities of MLPs involve risks that differ from an investment in common stock. Holders of the units of MLPs have more limited control and limited rights to vote on matters affecting the partnership. There are also certain tax risks associated with an investment in units of MLPs. In addition, conflicts of interest may exist between common unit holders, subordinated unit holders and the general partner of a MLP, including a conflict arising as a result of incentive distribution payments. The performance of the fund may diverge from that of the Index. Because the fund employs a representative sampling strategy and may also invest up to 20% of its assets in securities that are not included in the Index, or may overweight or underweight certain components of the Index, it may experience tracking error to a greater extent than a fund that seeks to replicate an index. The fund is not actively managed and may be affected by a general decline in market segments related to the index. The fund invests in securities included in, or representative of securities included in, the index, regardless of their investment merits. Outside the index construction rules, the fund does not take defensive positions under any market conditions, including conditions that are adverse to the performance of the fund. AlphaClone and the fund are in no way affiliated with the hedge funds and/or institutional investors whose public filings are utilized to derive the index's constituents. Public filings may not disclose all an investment manager's positions.**

**For the Global Robotics & Automation Index ETF, International investments may also involve risk from unfavorable fluctuations in currency values, differences in generally accepted accounting principles, and from economic or political instability. Emerging markets involve heightened risks related to the same factors as well as increased volatility and lower trading volume. Narrowly focused investments and investments in smaller companies typically exhibit higher volatility. These risks associated with investments in Robotics and Automation Companies include, but are not limited to, small or limited markets for such securities, changes in business cycles, world economic growth, technological progress, rapid obsolescence, and government regulation. Robotics and Automation Companies, especially smaller, start-up companies, tend to be more volatile than securities of companies that do not rely heavily on technology. Rapid change to technologies that affect a company's products could have a material adverse effect on such company's operating results. Robotics and Automation Companies may rely on a combination of patents, copyrights, trademarks and trade secret laws to establish and protect their proprietary rights in their products and technologies. There can be no assurance that the steps taken by these companies to protect their proprietary rights will be adequate to prevent the misappropriation of their technology or that competitors will not independently develop technologies that are substantially equivalent or superior to such companies' technology. Diversification may not protect against market risk.**

**For the Deep Value ETF, shares are bought and sold at market price (not NAV) and are not individually redeemed from the Fund. Brokerage commissions will reduce returns.**
**Fund shares are bought and sold at market price (not NAV) and are not individually redeemable and will be issued and redeemed at their NAV only through certain authorized broker-dealers in large, specified blocks of shares called creation units and otherwise can be bought and sold only through exchange trading. Creation units are issued and redeemed principally in kind. Shares may trade at a premium or discount to their NAV in the secondary market. Brokerage commissions will reduce returns. The Deep Value ETF is non-diversified, meaning it may**

**concentrate its assets in fewer individual holdings than a diversified fund. Therefore, the Deep Value ETF is more exposed to individual stock volatility than a diversified fund. As with all index funds, the performance of the Deep Value ETF and its Index may differ from each other for a variety of reasons. For example, the Deep Value ETF incurs operating expenses and portfolio transaction costs not incurred by the Index. In addition, the Deep Value ETF may not be fully invested in the securities of the Index at all times or may hold securities not included in the Index. The Index methodology is based on a "value" style of investing, and consequently, the Fund could suffer losses or produce poor results relative to other funds, even in a rising market, if the methodology used by the Index to determine a company's "value" or prospects for exceeding earnings expectations or market conditions is wrong. In addition, "value stocks" can continue to be undervalued by the market for long periods of time.**

Past performance does not guarantee future results.

References to other exchange traded funds should not be interpreted as an offer of these securities.

The AlphaClone Alternative Alpha Fund and the Deep Value ETF are distributed by Quasar Distributors, LLC. Robo-Stox Global Robotics and Automation Index ETF is distributed by SEI Investments Distribution Co. The Advisor to the Funds is Exchange Traded Concepts, LLC.

SEI Investments Distribution Co. and Quasar Distributors, LLC are not affiliated with Exchange Traded Concepts, LLC or any of its affiliates.