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happening with 401(k)s. I understand that there is already some 401(k) work going on, but I think it could increase substantially. From what I understand, that is what really helped mutual funds to take off; so just imagine if you had an option to use ETFs instead of open-end funds.

IU: What is driving the growth of the industry, from your perspective?

Bush: My guess is very simple: 1) the natural characteristics of ETFs—the flexible trading, the tax efficiency, the transparency, the low cost, which always helps performance. I think just the nature or the pure characteristics of the instrument; and 2) there is this trend toward fee-based from a financial adviser's point of view as opposed to more commission-based. I think that's going to help ETFs as well.

IU: Are retail investors becoming more or less important to the industry's growth?

Bush: I would say more. People I meet—typical retail investors—know about mutual funds but not necessarily about ETFs, and that is what makes me think that there's still so much room for ETFs to grow. I think as they become more familiar with ETFs, they will be asking for them more.

IU: How have adviser attitudes toward ETFs shifted in the last couple of years? Do you expect them to evolve further?

Bush: I think they're becoming familiar with them, more comfortable with them, and they're using them more. They're more open to ETFs and willing to use them.

Kim Arthur, CEO, Main Management

Kim Arthur

IU: What do you see as the most important development or event in the ETF industry in the last 12 months?

Kim Arthur (Arthur): The crash of fourth quarter 2008/first quarter 2009 was a seminal event for the ETF industry. At the beginning of 2008, managers had moved so far out on the risk curve that they actually believed that alternatives were zero betas and you could borrow money to put on that exposure and not increase your risk profile. We all know what happened. These zero-beta investments became 100 percent correlated to the market and lost money. With ETFs, the transparency allows you to know what you own at all times. There were no gates [barriers to redemption] put up with ETF strategies, and no unintended capital gains distributed.

IU: Now that the events of the market crisis of 2008 have largely shaken out, what kind of effect did it have on the ETF industry? Was it a positive or negative end result?

Arthur: It was a very positive impact. There were $180 billion of outflows from mutual funds and $180 billion of inflows into ETFs. BlackRock's purchase of BGI is a ringing endorsement of the future growth of ETFs: [Larry Fink, BlackRock's founder and CEO,] has an enviable record of being ahead of the pack and creating enormous value for his shareholders.

IU: What do you think investors should expect to see with regard to the ETF industry over the next year? Next five years?

Arthur: ETFs will continue to gain market share against mutual funds, alternatives, etc. The 401(k) space is teed up to be the next battle front against the mutual fund industry. iShares has partnered with SunGard to expand the number of [third-party agreements that provide] ETF-based 401(k) solutions to 2,000. This is big. When you couple this with professional management of ETF solutions for plans and unbundling of pricing, ETFs are poised to grow dramatically in this space.

> **"This industry is exploding due to three simple things: liquidity, transparency and diversification." —Kim Arthur, Main Management**

IU: What is driving the growth of the industry, from your perspective?

Arthur: This industry is exploding due to three simple things: liquidity, transparency and diversification. As a bonus, you get low-cost and tax-aware [strategies] thrown in.

IU: Are retail investors becoming more or less important to the industry's growth?

Arthur: Retail will continue to have a major impact as mutual fund flows go into ETF solutions and as 401(k) plans open up to ETF solutions, but the institutions have the ability to hockey-stick the growth of ETFs in the near term. Five years ago, institutions were reluctant to use ETF managers because of the embedded fees and the perception that they were only beta plays. There is a growing realization that, since sector, country and style rotation has more alpha generation than individual stock selection, ETFs are a great product to help with these strategies. Additionally, the efficiencies that ETFs bring to trading are enormous. The cost to trade all names in the Russell 2000 is 13 times more expensive than the ETF. The same can be said for credit ETFs.

IU: How have adviser attitudes toward ETFs shifted in the last couple of years? Do you expect them to evolve further?

Arthur: Many advisers viewed ETF strategies as a passive strategy, as institutions did. (And similar to institutions, advisers have realized how ETFs can be used to implement alpha-generation strategies and have come to see the benefits they carry.) With over 800 products and a pipeline growing every day, however, these strategies require deep plumbing analysis and a sharp eye to avoid the pitfalls that many of the ETFs face when they are stress-tested in the real-world markets.