

Does Cash Redemption Amplify the Outflows of ETFs?

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Summary

The growing reliance on exchange-traded funds (ETFs), especially those that can be redeemed in cash (i.e., cash-redeemable ETFs), has raised concerns about their resilience to a market downturn. This study finds that abrupt redemptions from these cash-redeemable ETFs may occur during a market downturn. In particular, an initial redemption shock to ETFs with a low cash buffer level could lead to a downward spiral in fund performance and outflow, which could expand a downturn to the broader financial market. Given the widespread existence of cash-redeemable ETFs in Europe and emerging market economies, our results point to the potential financial vulnerability of these regions, if these ETFs are redeemed in a large scale. In regions where cash-redeemable ETFs are popular because of taxation regimes or asset liquidity, regulators should carefully scrutinise relevant policies and balance the pros and cons of this ETF redemption mechanism in terms of overall financial stability.