**A spirit of innovation drove the creation of ETFs in Canada: today, it inspires new offerings**

From the debut of the world’s original ETF in 1990 to the launch of the world’s first crypto-currency ETFs in 2021, the development of Canadian exchange-traded funds has been spurred by an orientation to innovation.

Of significance to the CETFA, the ongoing emergence of new product has generated a robust shelf of ETFs for Financial Advisors and their clients. Choice is abundant and the breadth of offerings is noteworthy. A supportive, flexible regulatory environment has allowed core and niche thematic solutions that can address a complete range of investment goals and priorities to flourish. And a responsive industry has positioned itself to seize opportunity and answer demand by introducing diverse options for investors on a continual basis. For 2021, as National Bank Financial Management reported, 202 ETFs were launched, breaking all previous records; the total number of ETFs was 1,177.

**The breadth of Canadian ETFs can satisfy virtually any client portfolio**

I want to explore what underlies this emphasis on innovation and its impact. My goal is to broaden awareness among advisors about what Canadian ETFs offer and how they can contribute to durable and customizable portfolios for their clients – as well as more efficient and satisfying professional practices. A key takeaway for you is that the range of ETFs available in Canada can satisfy virtually any of your clients’ portfolio requirements. And more are in the product development pipeline. So, there’s absolutely *no* need for cross-border shopping and incurring the tax consequences accompanying non-domestic funds.

A resource produced by the CETFA supported writing this column. If you’re unfamiliar with our Guide to the Canadian ETF Industry – A Road Map (at cetfa.ca), it’s worth reading. The Guide traces the origins of ETFs to the presence of Toronto Index Participation Units (TIPS) on the TSX in March 1990, “which validated the ETF concept.” It then describes the next phase of technical and marketplace progress in the United States and investor adoption of ETFs around the world. But, as it confirms, Canada “punches above its weight” when it comes to ETF innovation and new product creation.

In 2000, the world’s first bond ETF became available in Canada. As [Investment Executive](https://www.investmentexecutive.com/news/products/record-breaking-year-for-canadian-etfs/) reported in January 2018, for 2017, “the industry welcomed a record 11 new providers, and witnessed the launch of 169 new products – another record.” New launches that year included cannabis ETFs and the launch of cryptocurrency ETFs was first explored. In 2019, Canadian investors could buy their first ETFs offering exposure to high-interest deposit accounts and to the esports industry, liquid alternative ETFs, cannabis-related ETFs, and six funds that offer exposure to blockchain and distributed ledger technologies. Growing demand prompted the launch of 65 ESG funds in Canada by the end of June 2021, more than in all of 2020, and (based on media reports) we believe the appetite for introducing more is not exhausted.

Last year, National Bank Financial Management reports, “several new themes emerged in Canada that were previously unavailable, such as semiconductor, metaverse, space exploration, psychedelics, lithium & battery technology, etc.”

To be clear, we are *not* claiming that ETF innovation has occurred or is occurring exclusively in Canada. A long list of product firsts in the United States and internationally is well documented. By way of example, as ETFGI Founder and Managing Partner Deborah Fuhr explained in an article we published online last September, although the European market represents only 16% of overall ETF AUM worldwide, it is the “global hotspot” for ESG ETFs, with 290 products and $US 154 billion in AUM. However, Canadian producers are active on the ESG ETF front: As NBC Financial Markets reported last December, ESG ETFs doubled to 100 in 2021 from about 50 in 2020 and the variety of ESG product types is “also blossoming.”

**Canada’s ETF industry is nimble, responsive and focuses on novel solutions**

Given the relatively small size of the Canadian market – especially when compared with our southern neighbour and advanced economies in Europe – the extent and pace of innovation in the Canadian ETF market is striking. Ironically, the small size of Canada’s ETF industry (in a global context) has worked in its favour because it is also nimble and focused primarily on two main centres of expertise, Deborah Fuhr told us last year on a videocall from the U.K. And an accelerating list of product firsts supports the claim that our domestic investment industry is well primed to introduce novel solutions that respond to anticipated or actual demand.

However, we believe there is more to be said about the ETF innovation story. To get a broader sense of what motivated and shaped novel Canadian ETF product development, the CETFA consulted an informed source. Asked what had propelled growth and innovation in the Canadian ETF industry, Carlos Cardone, senior managing director at Investor Economics, shared an overview of pivotal macro trends and milestones.

Canadian ETF companies began by introducing products and product categories that were easy to find in multiple segments in retail and institutional practices, he said. And initially, this meant index-tracking offerings that were largely “vanilla.” So, about a decade ago, the fund industry was either entirely passive or entirely active.

However, Canadian ETF companies soon saw an opportunity to introduce active management into passive products by offering strategic beta (or “demi-active”) funds. These were not necessarily unprecedented solutions but were well received by Canadian financial advisors, even as the adoption of actively managed ETFs lagged in the U.S. And since its early days, the Canadian ETF product pipeline has been creative in launching new products with innovative styles, strategies and classes, (e.g., crypto-asset ETFs), that were generally not available in the mutual fund industry, Carlos said.

As financial advisory practices evolved and matured, ETF companies responded by introducing new options to track specific sectors and sleeves to deliver pinpoint exposure (e.g., to semiconductor companies). And as these niche ETF products became more widely available, advisors have increasingly switched from selecting and managing portfolios of individual equities and bonds for their clients.

**A need for efficient practice management solutions has spurred ETF niche innovation**

Canadian advisors’ want lower-cost practice management alternatives and efficient access to niche asset classes. And ETFs have made it much more feasible for advisors to implement such strategies for their clients. Certain ETF product development teams have also been nimble in looking for new opportunities that could address potentially unmet needs among advisors, Carlos stated. They’ve engaged with industry members considering developing inhouse solutions to identify where an ETF alternative could be offered.

Aided by rapid, diverse and appealing product introductions, the substitution of ETFs for mutual funds among self-directed investors happened so quickly it’s “remarkable,” Carlos observed. And institutional investors have also taken advantage of ETFs’ flexibility. This includes repackaging them for retail sales, seeking more exposure to specialized markets and/or classes of investment, and/or as a transitional vehicle while waiting to move the money into something else.

The story of ETF innovation in Canada is rich (no pun intended) and thriving as a new year gets underway. While I will avoid making detailed predictions, you may confidently assume that novel ETF solutions are likely to emerge over the course of 2022 and that their creation will be informed by advisor and investor demand. Against all previous experience, they will provide new financial tools to help you build your practice and meet the unique investment needs of your clients.

Pat Dunwoody