Nordic ETF Trends 2018

Supplement | Distributed with Nordic Fund Selection Journal #05, 2018

Photo: Agnes Tell

tell
MEDIA GROUP

PREPARING FOR THE NEXT GROWTH PHASE...

Welcome to the third annual Nordic ETF Trends supplement. Just as in previous years, we have strived to gain insight from investors as well as product providers and for the latter we travelled to London earlier this fall to host a roundtable discussion with some of the biggest names in the industry. Representatives from BlackRock/iShares, Invesco, J.P. Morgan Asset Management and Vanguard debated, among other things, the key drivers of the industry such as the growth of fee-based advisory, the growing importance of fixed income ETFs and the potential for active ETFs. A summary of the roundtable discussion starts on page 12.

ETFs are still very much an institutional product in the Nordic region but the next growth phase is likely to come from the wealth segment as regulation will be pushing the industry towards fee-based advice structures, which in turn will need cost-efficient building blocks. On pages 22–23 we take a look at ETFs and ESG and insight on how Finnish investors use ETFs can be found on pages 26–27.

Niklas Tell
Tell Media Group

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ETF NEWS

New VP at Lyxor's ETF Nordics team

MARIA VON MATÉRN *Photo: Håkan Målbäck*

Maria von Matérn has joined Lyxor Asset Management's ETF Nordics team as its new vice president. She joins Europe's second-largest provider of exchange traded funds from Alfred Berg where she used to work as a sales manager since 2016. She started her career at the Stockholm-headquartered Finnish asset manager FIM where she got her first job in 2008, while finishing her degree at Hanken Svenska handelshögskolan in Helsinki. Maria von Matérn is based at Lyxor's Stockholm office with Carl-Christian Höeg, director of the ETF Nordics at the firm.

SSGA looking for new head of Nordics for SPDR ETFs

State Street Global Advisors is currently looking for a new head of Nordics for its SPDR ETFs with the brief to lead, manage and develop the SPDR ETF business in the Nordic region across all channels. The person will be taking over the role from Marcus Miholich who was recently promoted to head of capital markets EMEA & APAC. The Nordic role was created a year ago when Marcus Miholich was recruited from Haitong Securities where he was head of delta one, ETF and cash equity trading. He has also held senior positions at Bank of America/Merrill Lynch and J.P. Morgan.

J.P. Morgan AM appoints ETF specialist

TOBIAS NILSSON

Earlier this year, J.P. Morgan Asset Management announced it had appointed Tobias Nilsson as an ETF specialist to be based in the company's Stockholm office. Tobias Nilsson joins from Wisdom Tree where he was responsible for leading business development and client coverage in the Nordic countries. He has previously also worked at State Street Global Advisors.

"I am excited to be joining an experienced ETF team to deliver a comprehensive range of J.P. Morgan strategies via the ETF vehicle, be it the best of active, strategic beta or market-cap. I look forward to working with Nordic investors, widely regarded as sophisticated and responsible, as I help to build the company's ETF footprint in the region," Tobias Nilsson says.

First ETF from Nordea Markets

In September, Nordea Markets announced the launch of its first ETF (Nordea SmartBeta Eurozone Equity UCITS ETF). The product will be based on the Nasdaq Nordea SmartBeta Multifactor ESG Eurozone Index, which track stocks from the Eurozone that have a high dividend yield, low beta and positive development vs the market. "Nordea Markets has a clear ambition to create investment strategies that are simple, transparent and cost efficient and to offer these to the public. We are therefore very happy to introduce the first Nordea IndexGo-ETF", said Carl Christenson, Head of ETFs & Index Solutions at Nordea.

Danish Darwin up and running with ETF portfolios

LARS BERTRAM

Over the past couple of years, Lars Bertram, CEO at BankInvest, has been working hard to guarantee that the Danish fund company stays on top of the competition. Last year, the company revealed it was developing a robo-advisory service called "Darwin", which was launched on the first of February this year. According to Lars Bertram, BankInvest aims to be a one-stop-shop for its owner banks and that Darwin is an integral part of that scenario.

"After its launch, Darwin will be used by 10 Danish banks including Jyske Bank and Sydbank. It is a new business area that we are building to help our owner banks," he said in an earlier interview with FBNW, adding that it is a solution to help the banks with the challenge that comes with Mifid II. "The Danish market is a bit special. If you buy international funds you will be taxed differently from when you invest in Danish funds. We will therefore create a Danish wrapper to ensure that investors don't have to do anything different with regards to tax authorities," he said and explained that the balanced funds it creates will invest in external ETFs.

WisdomTree tapping business opportunities in the Nordic region

Earlier this year, WisdomTree Investments announced that it had completed its previously announced acquisition of ETF Securities. Jonathan Steinberg, WisdomTree CEO and president, said: "The completion of the acquisition brings together two undeniable forces in the industry, strongly positioning WisdomTree as a differentiated and diversified ETP provider that can thrive globally."

Following the introduction of two new ETFs to Nordic investors this summer, Frank Spiteri, head of European distribution, said that the Nordic region was very important to the firm. "We find there is a vast institutional interest for high quality, innovative ETFs and that retail investors are learning and appreciating ETFs to a greater extent," he said, adding that following the firm's acquisition of ETF Securities it now has a strong platform in Europe.

J.P. Morgan launches active ETFs

In October, J.P.Morgan Asset Management announced the launch of three fully transparent active equity ETFs:

- JPM Europe Research Enhanced Index Equity (ESG)
- JPM US Research Enhanced Index Equity (ESG)
- JPM Global Research Enhanced Index Equity (ESG)

Bryon Lake, head of international ETFs said: "We are delighted to be delivering the first-of-their-kind active equity ESG ETFs. This is the type of innovation our clients and the industry have been looking for. These ETFs seek to incorporate the best of both active and passive management and can play a versatile role in portfolios, including as a cost-effective core exposure to certain equity markets or as an asset allocation tool."

// THE GROWTH OF ETFs IN EUROPE

According to ETFGI, a research and consultancy firm focused on the ETF industry, assets invested in ETFs (Exchange Traded Funds) and ETPs (Exchange Traded Products) reached USD 835 billion at the end of August. That is an increase by close to USD 100 billion since August last year.

ETFs IN NUMBERS:
Number of ETFs/ETPs in Europe: 2 324 (up from 2 285 last year)
Number of listings: 7 893 (up from 7 215 last year)
Total assets: USD 835 billion (up from 734 billion last year)
Number of providers: 67 (up from 60 last year)

Source: etfgi.com

Most Nordic selection teams still focused on active products

The growth of ETFs is undeniable. However, indications from an on-going survey among Nordic selectors, reveal that a majority of selection teams are not yet doing ETF selection.

Text: Niklas Tell

The addition of ETFs to the agendas of Nordic fund selection teams has not taken off in similar fashion as the investment vehicle itself, although many believe that fund selectors could add value to the investment process. In our ETF roundtable, which can be found on pages 12- 19, Andreas Zingg, head of ETF sales specialists Europe at Vanguard Asset Management spoke in favour of having more fund selectors doing ETF selection by stating: "If you look at US equities, there are three broad indices with some 40 to 50 ETFs tracking them and the main differentiating factor is the price. In fixed income, for example in USD corporate bonds, you have seven ETFs tracking seven different benchmarks. That's where you really have to dig into the details to understand the differences and where I think a fund selector can really add value. It's not that one ETF is better than the other but rather which ETF fits into the asset allocation."

Bryon Lake, head of international ETFs at J.P. Morgan Asset Management, added: "It used to be that when you came to a client, you were directed to different parts of the business if you came with an ETF or an active strategy. What we see more and more is that clients now do the selection and due diligence on the asset class level rather than on the product or wrap level."

Indications from an on-going survey among Nordic selectors, however, reveal that a majority of selection teams are not yet doing ETF selection. Some 63 per cent say that they are currently not doing ETF selection and are not likely to include them in their coverage over the next 12 months. They are, however, confident in their abilities to take on ETF selection with 86 per cent saying they would not need to add new expertise to the team if they were to include ETFs in their coverage.

Jonas Thulin, head of asset management at Erik Penser Bank in Sweden, who have been using ETFs since 2014 says that they use ETFs for both tactical and strategic work. "This process has run for several years and we are now switching from hedge funds to ETFs as ETFs have made a remarkable development in this area," he says.

When asked about the main differences between selecting active managers and ETFs he stresses that they use the same process. "When looking into an ETF you have to do your homework, just as with a fund. Liquidity, underlying strategy, how big it is and so forth," he says and adds; "What we appreciate is the transparency. We can dig as far down as we like. All the information is there. For a fund you are depending on a prospect that sometimes can be more or less transparent."

63%

Some 63 per cent of respondents to our survey say they are currently not doing ETF selection and are not likely to include them in their coverage over the next 12 months.

(Based on answers from eight selectors in Denmark, Finland, Norway and Sweden).

86%

Some 86 per cent of respondents to our survey say they would not need to add new expertise if they were to include ETFs in their coverage.

(Based on answers from eight selectors in Denmark, Finland, Norway and Sweden).

Q&A WITH MUSSIE KIDANE

Earlier this year Nordic Fund Selection Journal did an interview with Mussie Kidane, the global head of fund and manager selection at Pictet Wealth Management, where he highlighted the advent and eminence of ETFs as a massive change for the industry. He also explained that the team recently established a comprehensive, robust and proprietary assessment process for passive funds (ETFs), akin to what they do for active funds. "The process has been live and effective for some time now," he said. We decided to follow up to learn more about their use of ETFs and how they are selected.

MUSSIE KIDANE, PICTET WEALTH MANAGEMENT

HOW ARE YOU CURRENTLY USING ETF'S AT PICTET?
"We use passive strategies, including ETFs, mainly to express tactical asset allocation decisions. These decisions generally are time sensitive and the investment horizon tends to be shorter. We also use passive strategies in our strategic allocation in areas where alpha is rare and/or inconsistent. The US large cap equity space is a typical example."

FOR HOW LONG HAVE YOU BEEN USING ETFS?
"We have been using passive strategies for a long time, although the scope of our exposure to such strategies has increased since the financial crisis."

WHAT ARE THE MAIN DIFFERENCES BETWEEN SELECTING ACTIVE MANAGERS AND ETFS?
"I would say the operational due diligence on the passive side is quite comprehensive. We investigate the quality and depth of expertise of the provider, the importance of the index choice, the replication methodology and the operational details therein, and finally, the cost of replication both explicit and implicit. For active managers, we focus more on establishing whether a manager has an edge in creating excess returns, and whether that edge is structural and sustainable."

DOES IT REQUIRE NEW OR OTHER COMPETENCIES FROM THE SELECTION TEAM?
"I would say it requires dedicated and suitable resources. The passive world is a fast moving one and, as such, requires devoted resources with the right skill set."

WHAT HAVE BEEN THE MOST IMPORTANT/SIGNIFICANT PRODUCT DEVELOPMENT TRENDS OVER THE LAST YEAR WHEN IT COMES TO ETFS?
"There's a shift from synthetic replication into physical replication, which many investors are more comfortable with. The expansion into more and more asset classes and exotic investments is also something we have observed. However, the most compelling development for investors is the pressure on the fund's fees. Investors can now access broad market exposure for few basis point, at least in terms of headline explicit fees."

ESG INTEGRATION IS A GROWING TREND AMONG INVESTORS AND FUND SELECTORS IN THE NORDIC REGION. HOW ARE ETFS MAKING OPTIONS AVAILABLE FOR RESPONSIBLE INVESTING?
"I think the ESG trend is here to stay, and of course, ETF providers are already proposing ESG compliant products. However, investors do not have a unique approach to ESG consideration. As such, the one-size-fits-all type of solutions that we currently observe may not be right for all investors. I do think that as a commonly accepted ESG best practice is established, ETF providers will come up with valuable solutions."

WHAT DO YOU SEE AS THE MAIN CHALLENGES WHEN INVESTING IN ETFS?
"I think ETFs do make sense in the equity space, especially in mature equity markets. However, I am sceptical, not to say outright gloomy, on the fixed income space, especially in credit. First of all, investors know, or should know, that in credit markets avoiding the torpedoes is more important than selecting winners, given the return asymmetry therein. Thus, conceptually speaking, buying junk wholesale simply because it is in the index is a losing proposition in the long run. As credit indices are heavily loaded with highly indebted companies, buying the market is hazardous to say the least. Secondly, the mismatch between the instant liquidity offered at the ETF level and the unremittingly dwindling liquidity at the underlying securities level is concerning. Simply because the foreseeable meltdown hasn't yet happened doesn't mean that it won't ever happen. The liquidity gate may not be as wide as some assume, so beware if and when investors rush for the exit door."

ETFs are more liquid than you think

Author: Andreas Zingg

Investors who are ruling out exchange-traded funds (ETFs) because of liquidity and trading concerns could be limiting their investment options.

WHERE DO ETFS GET THEIR LIQUIDITY?

Many investors think that an ETF's liquidity is best gauged by its average daily trading volume (ADV). But the reality is more complex. ETFs get most of their liquidity from sources other than their trading activity on the stock exchange.

EXCHANGE LIQUIDITY

ADV measures the most visible source of ETF liquidity – the trading activity of buyers and sellers in the secondary market that takes place on an exchange. As the illustration shows, there are more layers to ETF liquidity.

In Europe, many ETFs trade on more than one exchange. So your on-screen view may display an ETF's trading volume on your local exchange but not show its volume on others such as the London Stock Exchange or the Deutsche Börse.

If you're a typical investor, your on-screen view will show an ETF's highest bid and lowest ask, but you won't be able to see all the quotes in an ETF's order book. These quotes are another source of liquidity because they represent additional prices at which ETF shares can be traded.

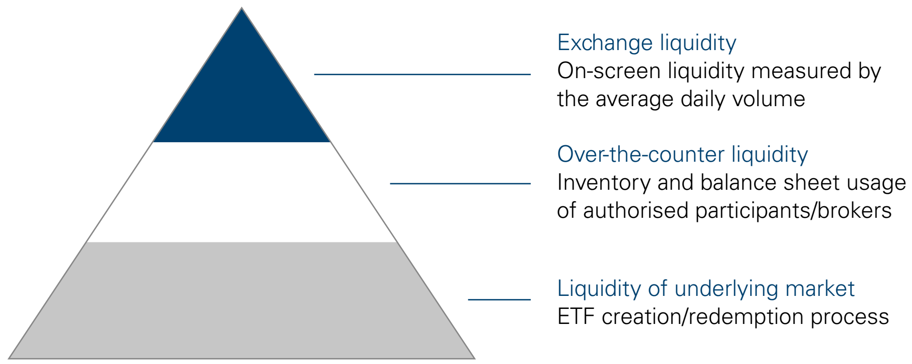
OVER-THE-COUNTER LIQUIDITY

In the same way, trading that takes place off exchanges is not always reflected in the volume data provided. This over-the-counter (OTC) liquidity is another important source. It accounts for around two-thirds of ETF trading in Europe.

LIQUIDITY FROM UNDERLYING SECURITIES

The key to ETF liquidity lies in ETFs' open-ended structure. Unlike single stocks, which have a fixed supply of shares, new ETF shares can be created and existing shares redeemed based on investor demand. This unique process allows ETFs to access the liquidity of their underlying securities. The underlying market is the largest source of ETF liquidity by far. The result is that investors can often trade ETFs in amounts that far exceed an ETF's ADV, without significantly affecting the ETF's price.

When assessing ETF trades, look beyond the on-screen metrics. Professional investors can speak with their trading desk, brokers or the ETF provider's capital markets desk. They can give the up-to-date liquidity picture and the likely costs involved in trading, which keeps your options open when implementing portfolio strategies.



Source: Vanguard

LEARN MORE ABOUT EXCHANGE-TRADED FUNDS AT OUR ETF KNOWLEDGE CENTRE AT GLOBAL.VANGUARD.COM

Investment Risk Information

The value of investments, and the income from them, may fall or rise and investors may get back less than they invested. Past performance is not a reliable indicator of future results.

MATTI TAMMI – ISHARES BY BLACKROCK, BRYON LAKE – J.P. MORGAN ASSET MANAGEMENT, NIKLAS TELL – TELL MEDIA GROUP, CAROLINE LIINANKI – TELL MEDIA GROUP, ABDALLAH MUHAMMAD – INVESCO, ANDREAS ZINGG – VANGUARD ASSET MANAGEMENT.

Many drivers behind the continued growth for ETFs

On September 6, **Tell Media Group** hosted the third annual ETF roundtable together with representatives from **BlackRock/iShares**, **Invesco**, **J.P. Morgan Asset Management** and **Vanguard**. Nordic Fund Selection Journal editor Caroline Liinanki and Tell Media Group founder Niklas Tell moderated the discussion.

Text: **Niklas Tell** Photo: **Christer Salling**

The discussion, which was held at Grange St. Paul's Hotel in London, started with Niklas Tell asking about the most important product development trends since the last roundtable a year ago.

MATTI TAMMI: "If I look at what has happened in the Nordic markets, we've seen over the last year how ETFs have evolved as a financial instrument. Investors are increasingly using ETFs as replacements for other delta one products and especially for equity futures but we're also seeing this more and more on the fixed income side. This is, of course, mostly on the institutional side, which is the big segment in the Nordic region. I think it's very encouraging to see ETFs evolving in this way and that they can be used as an alternative to futures. Why is that? Obviously ETFs are larger, spreads are tighter and they're cost efficient and liquid. But there's also an operational perspective, which matters for some investors. It's not only about costs but also the operational simplicity of ETFs."

ANDREAS ZINGG: "Matti actually started last year with the exact same point and this has actually accelerated this year. Several investors continued to use futures and took on credit and duration risk to achieve a cash return above Libor rates but now this strategy seems too risky. So we see a big shift out of futures and into ETFs and it's an even stronger trend this year compared to last year. If we look at new products, this year some 90 per cent of the flows went into already existing products and only 10 per cent went to new products. In terms of product innovation, I don't think we've seen any revolutionary new things coming. That said, we've had new providers coming in and a lot of them have launched fixed income products, which is a good thing. I think we need more competition on the fixed income side."

ABDALLAH MUHAMMAD: "I wasn't here last year but I agree with you, Andreas, that a lot of investors have had challenges in fixed income and we see a lot of new products being launched in that area. If we look at clients beyond the biggest institutions, we see a bigger demand for hedged products. Asset managers that are investing in ETFs don't want to see returns distorted by currency movements and when we launch fixed income ETFs, we tend to launch multi-currency versions."

BRYON LAKE: "In addition to what has already been said, I would just highlight that the overall trend with investors embracing the ETF wrapper to get exposure to the market continues. I think that's partly about awareness – knowing that it exists – but also understanding the flexibility and how it can be used."

ANDREAS ZINGG: "We've also seen a very positive development with fees coming down. We talked about it last year and I made a statement that I didn't think that fees had come down a lot over the last three years. Since we met last time, fees have actually come down as much as in the three previous years. That's a very good development and a trend that has accelerated."

BRYON LAKE: "I think that's good for consumers and I think we all support that as an industry trend. Where I want to be cautious is that investors should not use fees as their only due diligence check. Too often I hear investors saying that they take all ETFs, sort them by the fee column and buy the thing at the top. I think it's important to take the discussion further to make sure investors look at things in the right order and then fees should not be the first consideration. That said, the ETF wrapper is a very efficient technology and that makes it possible for us to pass along that to investors through lower fees. We've moved from 'buyer beware' to 'supplier beware' and what I mean by that is that in a transparent world driven by the internet, the investors now have as much information as everyone else. They can search and find whatever they need so suppliers must make sure that they're doing the right things by investors."

MATTI TAMMI: "I agree. Pricing is and will be very competitive because of transparency. I'd also like to continue on the product development discussion. The usage of ETFs today is more and more about asset allocation and solutions rather than just as single building blocks. In addition, we see factor ETFs playing a growing role as it gives investors the ability to tilt their portfolios."

NIKLAS TELL: "ARE YOU TALKING ABOUT TILTING THE OVERALL PORTFOLIO USING ETFS OR TILTING THE ETF PORTFOLIO?"

MATTI TAMMI: "It can be both. I recently met with a client who looked at their overall portfolio, consisting of both active strategies and ETFs, and the client asked how they could use factor ETFs to fine-tune their exposures and to manage risk. That means a lot, especially in this environment."

ABDALLAH MUHAMMAD: "I totally agree with that but I'd like to focus on the fee aspect again. I think a lot of the fee discussion has been on fees coming down on the big benchmark ETFs where we now have fees of 0 to 5 basis points as it has become commoditised. Then we have ETFs that provide more unique exposures, such as factor ETFs, where fees can be 50 to 100 basis points. These fees will, of course, also come down as more providers come into that market."

ANDREAS ZINGG: "We have the same pricing approach, even if we're the first to come to the market with a new ETF. We have cost-based pricing and we wouldn't charge a premium fee just because we're the first with a specific exposure."

NIKLAS TELL: "WHEN WE TALKED ABOUT FEES LAST YEAR, WE TOUCHED ON THE QUESTION OF INDEX PROVIDERS AND WHAT YOU HAVE TO PAY IN ORDER TO USE A SPECIFIC INDEX. IS THAT A CONTINUED DISCUSSION, THAT YOU MIGHT CREATE YOUR OWN BENCHMARK BECAUSE BRAND-BENCHMARKS CHARGE TOO MUCH?"

ANDREAS ZINGG: "It has happened. Some providers have launched their own indices and some use indices that are free. It's a trend. We will see if index providers continue to charge a flat fee, regardless of how big the industry gets, or if they will contribute to lowering the fees to investors. Things are happening - maybe not for flagship indices yet but certainly at the periphery of the market. That debate will continue and I think the index providers need to be involved. What's important for investors is that fees continue to come down."

BRYON LAKE: "I think it's very important that we make a distinction between ETF, passive and index. I think it's important to state that an ETF is a wrapper. It's a technology and a delivery mechanism that helps investors get exposure to the market. It's true that often the investment engine put inside the ETF is an index but it's increasingly

BRYON LAKE
J.P. Morgan Asset Management
Head of international ETFs at J.P. Morgan Asset Management. He previously worked at Invesco PowerShares between 2005 and 2017, most recently as head of EMEA.

ABDALLAH MUHAMMAD
Invesco
Head of Nordic ETF business development at Invesco. He joined Invesco from Source, which was acquired by Invesco in 2017.

true that we will have active strategies being delivered through the ETF wrapper. I know that you haven't asked the question yet but when looking at the things we see coming at the horizon, I think active capabilities is something to take into account. You can take music as an analogy. We still listen to the same types of music as before but rather than doing it on a vinyl, cassette or CD, we stream it through Spotify. I think the ETF has done the same thing for the asset management industry."

NIKLAS TELL: SO WHAT ABOUT ACTIVE ETFS? HOW DOES IT WORK AND WHAT ABOUT TRANSPARENCY?

MATTI TAMMI: "The question of transparency is interesting. Do you want to show the portfolio of an active strategy?"

ABDALLAH MUHAMMAD: "I think it depends on the strategy. It's easier in fixed income as it's such a huge universe and it's easier if it's a systematic strategy. I don't think a fund manager would be happy to give away his or her positions if they're running a high active share fund."

BRYON LAKE: "Let's introduce some definitions here. So we have market-cap weighted indices and factor or 'smart-beta' indices. Both are systematic and without human discretion and that's passive to me. As soon as we introduce human discretion to change the portfolio, we have active."

ANDREAS ZINGG: "That's the Bryon Lake definition - active if you deviate from the benchmark. What you say is that only fundamental strategies are active. I think that a systematic approach where you use a rule-based model can also be active. Our factor ETFs, for example, are active. I think where I struggle is on transparency."

BRYON LAKE: "I never said it wouldn't be transparent."

ANDREAS ZINGG: "If you have portfolio managers that create transparency, then I have no problem with these strategies. But if you have non-transparent ETFs, you destroy the fundamental value of ETFs."

BRYON LAKE: "Currently, you can't offer a non-transparent ETF. So as long as you follow existing regulation and if you have a portfolio manager that doesn't feel they are giving away too much market information by producing their portfolio composition ahead of the day, you can absolutely deliver even high tracking-error active strategies. That's actually being done right now. The question is how far out on that spectrum we can go."

MATTI TAMMI: "If you think about this from an investor perspective, there's a blurring of lines between active and passive. We see, for example, a huge trend in the growth of thematic ETF strategies, which is an active story. It remains, however, as an indexed structure within a rule-based framework. In our range, we have an equal-weighted global selection of stocks that fit into a megatrend. It's an indexed implementation but the story and the thinking behind it is very active."

ABDALLAH MUHAMMAD: "I agree. I think we have to get away from the pure active versus passive debate because we can all see the development with factor ETFs and also rule-based active strategies. The development is moving along but I think within the equity space, we're not there yet where portfolio managers are happy to reveal their portfolios at the beginning of the day. I think we will get that a bit quicker in fixed income. In five years, I don't think we will have this traditional active versus passive debate thanks to the developments that we're currently seeing."

BRYON LAKE: "Just one last comment on this. Look at the development of mobile phones. It was revolutionary when they came as you could make phone calls wherever you were. Today, we use the mobile phone for so many other things aside from making phone calls. It was this revolutionary technology that came and today we use it for something completely different from what it originally was meant to provide. I think the same is true for the ETF and it's important to constantly challenge and innovate. The ETF wrapper is brilliant. Passive investing is not going away and active is not going away. But what we're seeing is this evolution of technology and how investors are using it."

ANDREAS ZINGG: "I agree that the ETF is a brilliant wrapper. If we look at the traditional distribution of active strategies, we see that kick-backs were important. The interest of the distributor and the end client were not aligned. We now have new regulation in place to take care of that but active products are still dependent on distributors to get the product to the end client. If you put it in an ETF, everyone has access to it. That's the beauty of the product."

BRYON LAKE: "I think it's a little unfair to paint the entire active industry as being based on kick-backs. If we take a step back, in order to trade a security 100 years ago you probably paid 1000 dollars per ticket and today you go onto a website and pay seven dollars. Technology has changed that. Some of the mutual fund strategies were distributed in the best wrapper that was available. You point to regulation, which is very important especially in Europe and it changes the way a lot of investors and distributors run their business. A big part of that is the limitation of retrocession and the ETF wrapper, because of how it's structured and traded, fits this new reality. It's similar to the US a decade ago when we saw a big shift away from advisory to more discretionary-oriented businesses and asset allocators, both on the retail and institutional side, started to adopt ETFs as the tool of choice to build better portfolios."

MATTI TAMMI: "I agree and if we look at our region, I think it's still early days but things are starting to happen. The traditional model is changing and we will see a lot happening over the next few years. Just the transparency on fees, when clients at the end of the year will see what they are actually paying for their traditional set up, will give a big boost to ETFs. It will drive fee-based advice where ETFs will be a natural component."

CAROLINE LIINANKI: "WHAT ABOUT THE DEVELOPMENT IN THE NORDIC REGION WHEN IT COMES TO ETF USERS? LAST YEAR, MATTI, YOU SAID THAT IT WAS SPLIT 80/20 BETWEEN INSTITUTIONAL INVESTORS AND RETAIL."

MATTI TAMMI: "Even though the institutional business will continue to grow, there's no doubt that the real growth over the next five years will come from the wealth segment. Given what's happening with the regulatory framework, or rather the impact of the regulation that has been implemented, we will see a move to fee-based advice structures. We're seeing it already. That will change the business models and

MATTI TAMMI
iShares by Blackrock
Head of the ETF and index investments business in the Nordic and Baltic region. He joined BlackRock in 2011 from London-based hedge fund and independent research boutique Blue Oak Capital.

ANDREAS ZINGG
Vanguard
Head of ETF sales specialists Europe at Vanguard Asset Management. He joined from BlackRock where he was head of iShares sales for the Middle East & Africa.

with that new set up, they will need cost-efficient building blocks. That's a big growth opportunity for the ETF industry in the Nordic region."

ABDALLAH MUHAMMAD: "That's absolutely the sweet spot. If I compare the conversations I have with wealth managers today to those 18 months ago or even pre-Mifid, it's very different. There's a lot more interest and discussions on how they can use ETFs in their own solutions. The fee pressure has been there for a while but Mifid II has certainly accelerated that trend."

MATTI TAMMI: "I think 'solution' is an important word here. In the old world, it was all about telling a story about an individual active strategy and a star manager. Today, it's also a story about asset allocation and in that sense, the ETF becomes part of an active solution."

CAROLINE LIINANKI: "ARE INVESTORS STILL USING ETFS MAINLY FOR TACTICAL ALLOCATIONS?"

MATTI TAMMI: "They're being used more and more for strategic allocation as well. Some investors value the liquidity of the ETF, even for a strategic allocation, as they might need to get out fast of a given exposure."

ABDALLAH MUHAMMAD: "Today the ETF also work as an introduction when investors are looking to take on exposure to an asset class or to a specific factor."

ANDREAS ZINGG: "We do see a lot of ETFs today in the core of a lot of portfolios."

NIKLAS TELL: "LOOKING AT THE NORDIC REGION, HOW DO YOU VIEW THE VERTICAL INTEGRATION AT A LOT OF THE IMPORTANT PLAYERS WHERE MANY BIG DISTRIBUTORS ALSO HAVE AN ASSET MANAGER AND AN INSURANCE COMPANY? WILL THERE BE TRANSPARENCY AND OPEN ARCHITECTURE?"

MATTI TAMMI: "I would say those conversations are very constructive. It's early days but I think it's moving in the right direction. It's both about transparency but also about the client enhancement requirement in the regulation. They will need to open up and allow external managers."

ABDALLAH MUHAMMAD: "If you look at multi-asset funds provided by some of the bigger names in the Nordic region and compare their top ten holdings today and a year ago, you will see a lot more external funds there."

NIKLAS TELL: "MATTI, YOU MENTIONED EARLIER THE CHANGE IN THE WEALTH INDUSTRY AND THAT WE HAVE MOVED FROM TELLING A STORY ABOUT THE STAR MANAGER TO TALKING ABOUT ALLOCATION. DOES THE INDUSTRY NEED TO BE BETTER AT TELLING THE ALLOCATION STORY IN ORDER FOR RETAIL INVESTORS TO EMBRACE ETFS BECAUSE IT HAS BEEN A LOT ABOUT HAVING FUND SELECTORS THAT WILL FIND THE BEST MANAGERS?"

ANDREAS ZINGG: "The importance of asset allocation is, of course, not new but historically, the advisory business didn't have the technology to consult clients individually in an asset allocation way. It was also very much driven by incentives so people pushed individual products. But thanks to regulation, that's now going away."

ABDALLAH MUHAMMAD: "It's not an active versus passive debate but investors will, of course, ask themselves if they should try to beat the US market rather than buying a very cheap S&P500 ETF. But maybe you will pay a little extra if you can find a very good Japanese equities manager, for example. That decision is also part of the asset allocation process."

BRYON LAKE: "There's also another shift that is playing into what we're discussing. The early adopters of ETFs were actually individual equity owners that were picking stocks but found that maybe they didn't have all the information they needed to decide whether they should buy Yahoo or Google. So they bought the tech sector ETF to get exposure to the sector but without the idiosyncratic risk of individual companies. Also, what we've all alluded to but haven't said explicitly yet is that this trade hasn't happened on the fixed income side yet. We don't have investors yet that are replacing individual bonds with a bond ETF and I actually think that bonds delivered in an ETF wrap is a killer app. It will become bigger than equities. If you look at the traditional fund industry in Europe, two-thirds are in fixed income mutual funds and one-third is in equities. The ETF industry is the opposite of that."

NIKLAS TELL: SO WE HAVE INVESTORS THAT AVOID INDIVIDUAL STOCKS AND INSTEAD BUY ETFS OR USED TO BUY MUTUAL FUNDS TO GET DIVERSIFICATION. THEN WE HAD SO MANY MUTUAL FUNDS THAT WE NEEDED FUND SELECTORS. DO YOU SEE THE SAME DEVELOPMENT IN THE ETF INDUSTRY? DO WE NEED MORE ETF SELECTORS?

ANDREAS ZINGG: "If you look at US equities, there are three broad indices and you have some 40 to 50 ETFs tracking those and the main differentiating factor is the price. In fixed income, for example in USD corporate bonds, you have seven ETFs tracking seven different benchmarks. There you really have to dig into the details to understand the differences and here I think a fund selector can really add value. It's not that one ETF is better than the other but rather which ETF fits into the asset allocation."

BRYON LAKE: "It used to be that when you came to a client, you were directed to different parts of the business if you came with an ETF or an active strategy. What we see more and more is that clients now do the selection and due diligence on the asset class level rather than on the product or wrap level."

ANDREAS ZINGG: "On the equity side, I think selectors that are used to looking at active strategies will handle the ETF due diligence just fine. However, I do think you need some specific technical knowledge to do due diligence on fixed income ETFs."

CAROLINE LIINANKI: "IS THAT KNOWLEDGE OUT THERE?"

ABDALLAH MUHAMMAD: "From a fund selector perspective, it's more about finding the right type of ETF for a certain fixed income exposure. When it comes to the trading aspect, it's an ongoing educational discussion that we have with our clients. I would also like to highlight capital market teams, which are increasingly important in this educational process and to make sure clients have the best possible experience."

ROUNDTABLE – LONDON

ANDREAS ZINGG: "I would argue that the cost of trading and the liquidity of different fixed income ETFs are crucial aspects in the selection process and the selectors must have the knowledge to evaluate this. Trading fixed income is complex and we see in the market some providers that work off excel sheets and others that have great technology integrated in the portfolio management system – and the latter offer much more attractive transaction costs."

BRYON LAKE: "I don't think that ETF trading is that complex that our investors and due diligence teams can't do that - particularly when our capital market teams are there to service them. The reason I say that is that I don't want investors to be scared away from trading ETFs because of complexity. There are some moving pieces that people should be aware of but it's essentially like trading a stock. Yes, people need to be aware of how to evaluate liquidity but it's not something they can't do."

ANDREAS ZINGG: "But this is the reason why the adoption of fixed income ETFs is still relatively low. Traditionally, you have had equity desks that traded fixed income ETFs like stocks. Today, that has changed and you have fixed income desks trading fixed income ETFs.

BRYON LAKE: "I think what we need to do is speak to investors and say that 'this is what you need to consider when it comes to the ETF wrapper: the way it's constructed, how it trades and how to do the due diligence on the investment engine'. Those are the conversations we need to have."

"I would argue that the cost of trading and the liquidity of different fixed income ETFs are crucial aspects in the selection process"

– Andreas Zingg, Vanguard

CAROLINE LIINANKI: "WHAT WOULD YOU HIGHLIGHT AS THE BIGGEST CHALLENGES FOR THE ETF INDUSTRY IN GENERAL RIGHT NOW?"

ANDREAS ZINGG: "I think it's the product proliferation. Some 65 per cent of ETFs in Europe are below USD 100 million (EUR 87 million). There are some new ETFs among those and then it's natural that they're small but there are also a lot of old, complex and expensive ETFs out there that haven't attracted assets. They still have the label ETF and that's to some extent hurting the industry. ETFs should be transparent, simple and relatively cost-efficient. There are too many products out there that don't tick those boxes. We also see ETFs being launched in niche areas where the underlying market isn't very liquid and if such an ETF gets into trouble, it will hurt the whole industry."

MATTI TAMMI: "I agree and I think there's still a lot of education to be done about the whole exchange-traded product marketplace - both by us but also by regulators and others. I was very pleased to see the Danish regulator the other day announcing that private investors can use UCITs ETFs. That's a quality stamp right there."

ABDALLAH MUHAMMAD: "I also think that educating investors on total cost of ownership is an important aspect. Even if they know exactly what they trade, if the cost of trading is expensive and they don't take all of this into account, it will not be a good overall experience for them."

BRYON LAKE: "I would just add is that the one thing we lack here in Europe is a consolidated tape. The ETFs trade well, they are liquid and spreads are tight but investors still don't appreciate how much and how well ETFs trade. Because we have a fragmented marketplace, investors don't see the full picture and having a consolidated tape of all trading would be so beneficial."

NIKLAS TELL: "MATTI, YOU JUST MENTIONED THE DANISH REGULATOR PUTTING A STAMP OF APPROVAL ON UCIT ETFS BUT THERE HAVE BEEN A LOT OF DISCUSSIONS GLOBALLY ABOUT REGULATORS BEING WORRIED ABOUT THE GROWTH OF ETFS. WHERE ARE WE IN THAT DISCUSSION?"

BRYON LAKE: "There was a story in the Financial Times recently saying that after all of this attention from regulators, the conclusion has been that they are fine. Yes, ETFs have grown rapidly and yes, there has been a lot of attention in media. And yes, regulators have taken time to look into the ETF vehicle and they have concluded that it's fine."

ANDREAS ZINGG: "I think it's great that the regulators came to the industry and asked all these questions. One of the questions - and that was a fair and good question - was how much of the trading in underlying securities was done by passive vehicles. According to our own research, more than 90 per cent of the trading is done by actively managed funds so the information gathering and efficiency of the market is still intact. Now that the regulators have done this extensive research on the ETF industry, it would be interesting to see a similar exercise on the active side as well. What about securities lending and transparency in active funds?"

NIKLAS TELL: "WHAT ABOUT ESG INTEGRATION? IS IT MORE ABOUT HOW YOU ACT AS AN ACTIVE OWNER OR IS IT ALSO ABOUT THE PRODUCTS THEMSELVES?"

ANDREAS ZINGG: "I think it's both about how we act as owners but also about taking the ESG requirements of our clients into account. In the Nordic market, this is still more an institutional discussion but the wealth management industry is catching up. If we talk about exclusions, it's a challenge as each client has a slightly different exclusion list."

ABDALLAH MUHAMMAD: "I think clients in general are pragmatic and they don't expect a perfect product. Both institutional investors and wealth managers and multi-asset managers are increasing the pressure on asset managers to provide SRI-approved products. Going forward, many will not be able to invest in products that are not approved according to SRI or ESG criteria and then they must find the best possible fit – even if it's not perfect."

MATTI TAMMI: "There's no doubt that the Nordic region in many ways is leading the ESG agenda but there are still differences between the individual countries. That's, of course, a challenge for us as we have to try to create ETFs that fit as many investors as possible and at the same time provide liquid and cost-efficient products."

ANDREAS ZINGG: "We have done research on active ESG strategies in the US and the results are promising. It's different when you have an analyst who can dive deep into companies and connect the dots compared to trying to filter information systematically for an ETF."

NIKLAS TELL: ARE ACTIVE ETFS ARE THE WAY FORWARD WHEN IT COMES TO ESG?"

BRYON LAKE: "If you print that as the headline, I wouldn't complain."

ANDREAS ZINGG: "I think it depends on the type of client. Many institutional investors would like an exposure close to a benchmark but one that takes ESG criteria into account. We can then make exclusions and optimise back to make sure the exposure comes as close to the original as possible."

MATTI TAMMI: "Yes, we see a lot of demand for that and that's something we could potentially deliver."

NIKLAS TELL: "IF WE LOOK AHEAD, WHAT DO YOU SEE ON THE HORIZON?"

BRYON LAKE: "The global ETF industry today is some USD 5 trillion and it has doubled every five-year period. My estimate is that we will be at USD 30 trillion in 2030."

MATTI TAMMI: "We see continued growth as well and we have an estimate of USD 12 trillion by 2023. We've talked about the key drivers already: it's about cost-efficiency, the increased focus on asset allocation, the growth of fee-based advisory and the growth of fixed income ETFs."

BRYON LAKE: "I think we can add the growth of active ETFs to that list as well."

The ESG challenges of ETF investing

Nordic investors share their views on if and how to use ETFs and still be compliant with internal ESG policies.

By: **Caroline Liinanki**

"When you go for passive investments, you need to rely on somebody else's perception or analysis of ESG of those underlying companies"

– Hanna Kaskela, Varma

How do you ensure that your ETF exposures are compliant with your overall ESG policy? That is a highly relevant question for investors wanting to apply the same ESG standards across the total portfolio but perhaps a question that hasn't been sufficiently addressed.

Using some of the mainstream ETFs can either lead to breaches of an investors' responsible investment guidelines by gaining exposure to unwanted companies or sectors or simply fail to adhere to the same standards of ESG integration that the investor would apply to the bulk of the portfolio.

In general, integrating ESG into passive investments has been a challenge for many institutional investors. Sweden's Kåpan Pensioner is one institutional investor having struggled with how to become a more responsible and sustainable investor while continuing to invest passively in global equity markets. "We have a few actively managed funds as well but with the bulk of the exposure, we feel comfortable in getting that through passive management. It's a simple and cheap implementation in order to get a broad market exposure," its chief investment officer Marie Giertz previously told Nordic Fund Selection Journal.

However, finding a suitable ESG index for global equities turned out to be a lengthier and more difficult process than what the pension fund originally foresaw. The pension fund also tried to avoid vehicles with some kind of active ESG overlay. "There are a lot of fund companies that are offering ESG funds or indices that are constructed based on their own ESG view but then you have to pay extra for something that you might not be completely comfortable with and that may not correspond fully with your own view," Marie Giertz said at the time.

In the end, Kåpan Pensioner opted for using the MSCI ESG Universal index as the benchmark for part of its passive global equity portfolio and appointed a manager to run the strategy.

The Swedish pension fund AP1 has also faced similar issues with the passive part of its emerging market equity portfolio, which the pension fund has tried to steer in a more sustainable direction.

"Our biggest problem has been with our passive book where we've had to think hard about how to improve the sustainability profile," Tina Rönnholm, portfolio manager, external management at AP1, previously told Nordic Fund Selection Journal. "Over the years, we've used our voting rights via external managers, engaged with companies through the AP funds' Ethical Council and given the managers a short exclusion list to follow. But for years, we've wondered whether that really is all that can be done with passive investments and ESG."

In the search for better options, the pension fund spent two years looking at hundreds of products and talking to a lot of managers. In May, AP1 seeded a new sustainable emerging market equity fund run by Blackrock that looks to combine data-driven returns with sustainability insights - an investment that AP1 views as part of the solution to this challenge. However, the work continues.

Within the index-fund space, due to the more long-term, strategic and often larger exposures, institutional investors can implement more tailor-made solutions and spend more time and resources on finding the ideal exposure and product. However, the same would be difficult for ETFs, which usually are more short-term in nature. For those exposures, investors are not only reliant on that there are ESG products available but also that those are equally good as their mainstream equivalents.

While product development over the years has taken off when it comes to ESG-compliant ETFs, they are still largely missing from many investors ETF portfolios. Part of this reason may have to do with investors having focused most of their ESG attention on other parts of the portfolios and other vehicles but investors also cite a lack of liquidity and higher costs as some of the obstacles for taking on ESG vehicles.

About two years ago, the Finnish pension company Varma introduced a new climate change policy. As part of the policy, the pension company plans to reduce the carbon footprint of its listed equity investments by 25 per cent, its listed corporate bond investments by 15 per cent and of its real estate investments by 15 per cent by 2020. In order the reach the target, the pension company has been turning to engagement, exclusions as well as trying to identify the winners benefitting from climate change.

"We're looking for ETFs that comply with our ESG policy – that's our target," says Hanna Kaskela, director for responsible investments at Varma. "We've seen that there are some ESG or low carbon ETFs but liquidity has been a problem. So it's not the product offering that has been a problem but rather liquidity. But lately we've seen that this has been improving." She adds that the same exclusions that Varma applies to its direct portfolio is also what the pension company is looking for in the ETF space.

While Varma declined to comment on its current holdings and whether the portfolio currently holds any ESG-focused ETFs, the pension company did not have any ETFs with an ESG tilt at the end of 2017, according to its latest annual report.

Hanna Kaskela notes, however, that the main focus so far at Varma when it comes to its climate change policy has been on the actively managed part of its portfolio.

"For the active portfolio management, you can use all the data points and reports available and select ESG compliant or climate change compliant companies. That's the luxury in the active portfolio. But when you go for passive investments, you need to rely on somebody else's perception or analysis of ESG of those underlying companies," she comments.

Furthermore, Hanna Kaskela also points to the fact that different investors have different views regarding ESG and emphasising different aspects, which is one reason why assets not necessarily are driven into one type of product but spread across a range of vehicles. This, in turn, may contribute to the lack of liquidity.

In an article in Financial Times in May, Deborah Fuhr, co-founder of the London-based consultancy ETFGI, said "the variety of ESG-focused ETFs now available meant that investors needed to look carefully at their underlying construction before making any commitment." She commented in the article: "There is no clear definition of what constitutes an ESG ETF and that has been a source of confusion for investors."

At Denmark's MP Pension, its chief investment officer Anders Schelde notes that the pension fund doesn't currently have any exposures through ETFs but doesn't exclude that they could be used for more tactical views. While he points out that some potential issues with ETFs relate to transparency and counter-party risk that you may not be aware of, he also recognises that it would be problematic from an ESG point of view.

"If you go down the route of passive exposures, then you cannot implement your responsible investment policy for part of the portfolio," Anders Schelde says. "And you have to be able to live with that. For us, that would be something we would have to think very seriously about."

He continues: "We want to be completely honest and transparent and say things the way they are. As I see it, it may not be against our policy to invest in an ETF that potentially own some companies that we've excluded. But we would be required to be totally open and transparent about it and not try to hide it away."

He adds, however, that while doing so might not be in breach of the responsible investment policy as such, he doesn't see this happening in practice. ●

Factoring in the full potential of your portfolio

Multi-factor ETFs offer a one-stop solution but choice still matters

Mention ETFs to most investors and they'll probably think of simple, low cost index trackers While those "core building blocks" are still important, investors are increasingly turning to ETFs for more innovative strategies, both strategically and tactically. Factor ETFs are a great example.

If you are unfamiliar with them, factors are characteristics that help explain a group of stocks' performances relative to the broad market. For example, academic studies have shown how value stocks tend to outperform over the long term, and this has been proven by historical data. Stocks with quality, small size, low beta and momentum characteristics have also outperformed.

If you're looking for performance and don't mind holding on through the ups and downs, an easy option would be to simply pick a factor and invest in an ETF that gives you exposure to it. While we know that past performance is not a guide to future returns, history suggests you would have been better off with such a single factor investment over the long term than if you had invested in the wider market.

Multi-factor approach
An alternative option would be to diversify across factors. A mixture of single factor ETFs may sound ideal but this approach tends to deliver lower factor exposure than using one ETF that does it all for you. Multi-factor ETFs offer a one-stop solution but choice still matters as they vary in terms of the number of factors targeted and how they allocate to each one.

When thinking about the number of factors to include, and which ones, it is worth considering the inter-relations between them. Some are closely correlated, while value and momentum tend to move in opposite directions. The way in which an ETF accounts for these relationships - or if it does - could have a sizable impact on the fund's performance, in absolute and risk-adjusted terms.

Below is a comparison of the indices used by some of the largest multi-factor ETFs listed in Europe. They all provide exposure to European equities, but really begin to diverge from there.

You can see that A and C both outperformed the MSCI Europe index in each of the 12-month periods over the past five years, but the disparity of returns across the various strategies is remarkable. Over the longer term, A and C outperformed with an equivalent annualised return, but the inclusion of the Low Beta factor in strategy A enabled it to do so with lower volatility and a higher Sharpe Ratio.

If you are considering adding a multi-factor ETF to your portfolio, think about your objective and choose a strategy that makes sense. You can find more information at **etf.invesco.com** or alternatively get in touch with us directly. Please note that products may not be available in all jurisdictions.

A multiple of approaches, a multiple of results

	Strategy A	Strategy B	Strategy C	Strategy D
Factors	Quality, Value, Momentum, Low beta, Small size	Quality, Value, Momentum, Low beta, Small size	Quality, Value, Momentum, Small size	Quality, Value, Momentum, Low volatility
Approach	Stocks scored on factor exposure with factors weighted to take into account factor volatility and correlations. Strict country and sector limits	Top-down, equally weighting exposure to five factor sub-indices	Stocks scored on factor exposure with factors equally weighted, and broad country and sector limits	Stocks scored for exposure to each factor, and weighted by set percentages for each factor
Rebalance frequency	Every 8 business days	Monthly	Semi-annually	Semi-annually

Performance comparison[1]

Percent (%)	MSCI Europe	A	B	C	D
1yr to end Aug-14	17.4	20.4	19.1	22.3	21.4
1yr to end Aug-15	-8.3	-3.5	-5.3	-1.3	-7.3
1yr to end Aug-16	-3.0	-0.9	-2.8	-1.1	-2.2
1yr to end Aug-17	19.1	21.6	18.0	21.0	17.6
1yr to end Aug-18	2.3	6.4	5.1	6.0	-0.3
10yr annualised return	3.1	6.5	3.3	6.5	4.1
10yr Sharpe Ratio	0.13	0.30	0.14	0.28	0.19

[1] Source: Bloomberg, in USD, performance is of the reference index used by each of the ETFs

Investment Risks
Investment strategies involve numerous risks. Investors should note that the price of your investment may go down as well as up. As a result, you may not get back the amount of capital you invest.

INVESTOR PROFILES

Insight from Finnish ETF investors

Compared to their Nordic peers, Finnish investors have for some time been at the forefront of ETF investing. We spoke with some of them to see how they use ETFs in their portfolios and what they see as the biggest changes at the ETF front over the past year.

Text: **Janina Sibelius**

JUKKA VÄHÄPESOLA
head of equities at Elo

Elo pension insurance company, with some EUR 23 billion in assets under management, uses ETFs mainly in its equities portfolio. Jukka Vähäpesola, head of equities at the third largest pension player on the Finnish market, says the pension company has "a meaningful and important" part of its EUR 9.2 billion equities portfolio invested in ETFs. There, ETFs are mainly used in strategic asset allocation, but some are also used for tactical allocations. "In equities we've been increasing our exposure in index investments, including ETFs, together with direct holdings while decreasing our active fund holdings," Jukka Vähäpesola says. Elo also uses ETFs in its equity portfolio to gain new type of exposures, especially on factors. Jukka Vähäpesola notes that factor ETFs are playing an increasingly important role, especially in the US market.

Like most of the Nordic pension companies, Elo has a stringent focus on ESG, which, Jukka Vähäpesola says, has so far made it difficult to find enough suitable ETF opportunities. "ESG focused ETFs are a somewhat underdeveloped part of the market," he says, adding that the product offering is too narrow and the liquidity is not there yet.

Elsewhere, Elo uses ETFs on the fixed income side, although it has a very limited exposure. According to Jukka Vähäpesola, this is mainly due to the high fees. Asked whether the pension company had considered using ETFs as a replacement for other instruments, he replies: "We are always looking for alternatives."

For Elo, the preferred way to invest in ETFs is to work with different providers depending on the exposure the pension company is looking for. Jukka Vähäpesola says, the insurer is always trying to find "the most efficient and suitable products" for its use.

TOMMI KOKKARINEN
head of fixed income and equities at OP Financial Group, asset management

The Finnish financial group OP's asset management arm has also ramped up its use of ETFs. Tommi Kokkarinen, head of fixed income and equities at OP's asset management arm, says that the use of the investment vehicle is only going to grow in the future. In addition to traditional equity exposure, OP also uses ETFs to gain factor exposure. In the fixed income space, he says ETFs are currently used in the government bond portfolio.

Tommi Kokkarinen explains that some the main challenges the team, which manages some EUR 78 billion in assets, faces when looking at suitable investment opportunities are the variety of liquidity and size of ETFs currently on offer. In addition, he says that so far the investment team has not been able to find enough suitable investment opportunities to invest in ETFs in the group's current ESG framework. "But it will definitely be a very relevant area in future," he adds.

> "Construction of trackable indices has become easier and more sophisticated. Hence, ETFs are not merely passive vehicles but also tools by which different risk segments can be captured"
>
> *– Carolus Reincke, Mandatum Life*

CAROLUS REINCKE
head of multi-asset solutions at Mandatum Life

Carolus Reincke, head of multi-asset solutions at the Finnish financial services company Mandatum Life, says that ETFs are used as a normal part of the company's investment toolbox both strategically and tactically, although the company prefers to use active managers who can "demonstrate robustness in the investment process and outperformance potential". He adds, however, that especially in highly efficient markets ETFs are an attractive option on a net of fees basis.

In addition to traditional equity exposure, Carolus Reincke says the investment team at Mandatum Life also uses factor ETFs and ETFs that focus on different ESG risks, to mention a few, to gain new types of exposures. On the fixed income side, ETFs are used on highly efficient markets and for ESG tilting purposes.

Instead of a preferred partnership model, Mandatum Life prefers products that offer competitive pricing and liquidity. When asked about the main challenges faced by investors when venturing out to ETFs, Carolus Reincke says: "Liquidity and spreads are challenges in segmented ETFs, for instance ESG filtered products." He also notes that it is still hard to find ETFs that would comply with the team's ESG framework. "Existing products are young, small in size and clearly more expensive than respective products without ESG filters," he says, agreeing with his peers that the demand for ETFs that focus on different aspects of ESG is growing rapidly.

Another challenge the team has been looking at is overcrowding. Carolus Reincke notes that "it can be seen as a risk in larger markets such as the US high yield fixed income-space".

However, he notes that there has been a lot of development in the ETF space over the past year: "Construction of trackable indices has become easier and more sophisticated. Hence, ETFs are not merely passive vehicles but also tools by which different risk segments can be captured."

// SOME OF THE MAIN CHANGES OVER THE PAST YEAR IN THE FIELD OF ETFS ACCORDING TO FINNISH INVESTORS:

- Lowered management fees
- Construction of trackable indices has become easier and more sophisticated
- At the ESG front the investors say they've noticed that ETF providers have started using their shareholder rights more actively

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