Nordic ETF Trends 2019

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tell
MEDIA GROUP

REPEATING THE SAME OLD INVESTMENT HABITS?

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DISCUSSING THE KEY DRIVERS OF THE INDUSTRY

Welcome to the fourth annual Nordic ETF Trends supplement. Just as in previous years, we have been looking to gain insight from investors as well as product providers and this year we have got both in our roundtable discussion, which was hosted in Stockholm in mid-September. In addition to representatives from the ETF providers BlackRock/iShares, Franklin Templeton Investments, Invesco, JPMorgan Asset Management, UBS and Vanguard, we also had two ETF investors joining the discussion. They debated, among other things, the key drivers of the industry, the growing importance of fixed income ETFs and, of course, ESG. A summary of the roundtable discussion starts on page 12.

There is still a belief that the next growth phase of the industry will come from the wealth segment and there are even suggestions that we could be seeing more asset managers developing a retail proposition and go directly to clients rather than relying on distributors. As of today, however, ETFs are still very much an institutional product in the Nordic region. Some are even developing bespoke solutions, as discussed on pages 8 to 9.

Niklas Tell
Tell Media Group

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NEWS

Bespoke ETF solutions in demand among ESG-conscious Nordic investors

As the demand for more bespoke solutions in the ETF space grows, the Finnish pension companies **Ilmarinen** and **Varma** are spearheading the development with several new ESG ETFs launched only this year.

By: **Janina Sibelius**

Cost-consciousness and disappointing active management returns have sparked many investors to move from the active space into more passive investments. However, with the change of strategy they have been faced with a new challenge: finding index tracking products that would fulfil the criteria of their growing ESG demands.

Two large Finnish players, Ilmarinen and Varma, have tackled the problem by partnering up with managers able to deliver bespoke solutions that fit their portfolios. Between them, the duo has thrusted several billions of euros into ESG-compliant ETFs this year alone.

The largest allocation so far was made by Ilmarinen, which manages a EUR 47.8 billion investment portfolio. The Finnish heavyweight allocated EUR 750 million to BlackRock's iShares ESG MSCI USA Leaders ETF-fund in May this year. The listing of the new bespoke equity ETF to the New York Bourse was one of the largest in US history.

Anna Hyrske, head of ESG at Ilmarinen, says the decision to develop the ETF in co-operation with BlackRock came from the pension company's struggle to find passive strategies that suited its portfolio. "We were looking for passive products that better suited our strategy and were also ESG compliant. We wanted products that had a small tracking error and competitive pricing," Anna Hyrske says.

The announcement of the new fund by BlackRock came after the world's largest asset manager decided earlier this year to start disclosing the exposure of 253 of its 318 EMEA ETFs to so-called "sin stocks", such as tobacco producers and weapons makers. It also said it will make public how the funds score on environmental, social and governance principles.

"We are very pleased to see ESG-compliant products being developed on the passive side as well," Anna Hyrske notes. She says being part of the development process of the iShares ESG MSCI USA Leaders ETF was "an interesting and useful" learning experience for the pension company and that Ilmarinen would be interested in doing similar exercises in the future as well. "Investments in cost-effective ESG index funds is an important part of portfolio diversification for us," she says.

Earlier this year, Ilmarinen also allocated EUR 700 million to another solution it had developed in collaboration with the DWS Group. The Xtrackers MSCI USA ESG Leaders Equity ETF (USSG) launched at the New York Bourse in March this year and is an expansion of the Xtrackers suite of ESG ETFs, which also includes a US and an emerging market ETF. This time, the listing was the largest seen so far in the New York Bourse.

Fiona Bassett, global co-head of passive asset management and global co-head of product at the DWS Group, said in a statement that the latest release in the asset manager's ESG offering provided investors with the opportunity to get exposure to the US market while ensuring investment in companies with the highest ESG performance at a highly competitive price.

"Our aim is to be the partner of choice for our clients and to develop and provide solutions that allow them to fulfil their financial objectives in a way that is aligned with their core values," she said in a statement released by the firm.

In addition to BlackRock's and DWS Group's ETFs that both provide exposure to large- and medium cap US companies with high ESG performance relative to their sector peers, Ilmarinen has also been part of a development of an ETF, which focuses on the European market.

Another Finnish player, the EUR 46.5 billion Varma, revealed early this autumn it had invested EUR 200 million in L&G Europe Equity (responsible exclusions) bespoke ETF fund launched by Legal & General Investment Management in co-operation with the index manager Foxberry. Like its peer Ilmarinen, Varma also opted for the development of a bespoke solution in the absence of suitable products in the market.

"We couldn't find an investment product that would have fulfilled our ESG criteria so we decided to develop one ourselves in co-operation with LGIM and Foxberry," says Timo Sallinen, senior vice-president for investments at Varma. When selecting partners to team up with, the decision boiled down to three factors: know-how, costs and flexibility, of which the latter comprises "a genuine willingness to serve the investor". He further adds: "Developing more responsible index funds is one of the key elements in the development of responsible investments globally and [index funds] are really in need of that change."

According to Timo Sallinen, Varma will use the ETF to minimise its exposure to carbon emissions. The fund, which follows the Stoxx600 index and charges a total expense ratio of 0.16 per cent, excludes tobacco companies, weapon manufacturers, companies that derive most of their revenues from coal as well as companies that pollute excessively or use/hold large reserves of fossil fuels. It also looks to minimise exposure to those companies that are likely to face longer-term issues such as more stringent regulation, consumer boycotts or environmental hazards.

"We need options when looking at exclusions. We believe that in order to enhance responsible investment, investors need to co-operate with different players in the field. Many investors don't have the internal resources to make adequate analysis on different methods of exclusion," he said.

What makes the L&G Europe Equity (responsible exclusions) ETF fund exceptional, is the way it is run by its sustainable advisory committee, which includes Foxberry advisors Tomas Franzén and Gustaf Hagerud, who previously worked at the Swedish pension funds AP2 and AP3. The committee will use a collaborative approach to allow for investors and interested parties the chance to review summary findings and contribute insights and suggestions to the process.

"Investor expectations and awareness of new issues are constantly evolving and this has highlighted a need for integrating a dynamic investor and expert-led approach to help navigate through the changing landscape. By bringing experts together to collectively evaluate companies, their actions and behaviours on an on-going basis, this ETF is designed to provide the investment community with a dynamic and transparent exclusion approach for their market cap index investment but also provides them with the ability to provide suggestions and contribute to the committee's thought leadership," Howie Li, head of ETFs at LGIM, said in a statement.

When asked about the challenges that come with ESG integration in passive investments, Timo Sallinen says: "ESG products are not yet popular enough or the parameters for exclusions differ too much. In other words, standardised products are still missing from that space. However, having said that, there is an increasing emphasis on governance issues and I believe with time the parameters [for exclusions] will start to become more unified. Getting enough information and data is not always easy. Co-operation is therefore crucial so we can bring even better and more popular funds to the market. There are always those initial investors that will need to take the bull by the horns and lead the way."

However, the enthusiasm to add passive products in their portfolios did not result in increased passive exposure to neither of the Finnish investors. "The investments to these [three] funds did not increase our passive exposure. Instead, we switched from passive products that we felt were no longer suitable to our strategy to passive products that we deemed more suitable," Anna Hyrske explains.

Timo Sallinen agrees. "We replaced some of the more traditional index investments with ESG- compliant products," he comments.

ESG shortcomings among ETFs & establishing an expert panel

By: **Caroline Liinanki**

The new ETF, managed by LGIM, is based on the Foxberry Sustainability Consensus EU index, which has been developed by the London-based index provider. Nordic Fund Selection Journal finds out more from David Sahlin, chairman and director of Foxberry, as well as the former Swedish AP fund employees Gustaf Hagerud and Tomas Franzén, who currently work as senior advisors at Foxberry. Together with representatives from LGIM and Varma, Gustaf Hagerud and Tomas Franzén form the new ETF's sustainability committee.

WHAT ARE SOME OF THE SHORTCOMINGS WITH EXISTING ESG ETFS?

DAVID SAHLIN: "Many products in the market have fixed exclusion methodologies that may be relevant at a particular point in time but may also quickly become outdated. These methodologies have been embedded into investment strategies over the years but are often static or constrained only to certain industries and capture the perspective at a single point in time. Investor expectations, awareness and insights of new issues are constantly evolving and this has highlighted a need for integrating a dynamic investor and expert-led approach to help navigate through the changing landscape."

IN WHICH WAY DOES THIS ETF DIFFER FROM THE CROWD AND WHAT HAVE BEEN SOME OF THE KEY CONSIDERATIONS WHEN CONSTRUCTING THE INDEX?

GUSTAF HAGERUD: "What stands out in this index is the engagement of an expert panel - the sustainability committee. This ensures that the index approach to exclusions is dynamic and able to evolve with the fast-changing investment and social landscape. The approach taken by the committee aims to bring a reference point to the investment community by engaging with investors."

IS HAVING A SUSTAINABILITY COMMITTEE FOR AN ETF QUITE UNUSUAL AND WHY DO YOU NEED THAT?

TOMAS FRANZÉN: "We believe this approach is unique. Investors have the benefit of having access to an exclusion list that gets updated and where potential exclusions on industries or companies can be discussed in a timely manner, without having to review the whole index methodology. The sustainability committee meets on a quarterly basis but a member can request for an ad-hoc meeting when necessary in order to engage discussions around exclusions. To encourage and build on consensus in the investment community, the committee is taking a collaborative approach that allows investors and interested parties the chance to review summary findings and contribute insights and suggestions to the process."

How to choose a bond ETF

Growing awareness of the benefits of fixed income exchange-traded funds (ETFs) has led to rapid expansion of the market in recent years. In Europe alone, there were 373 fixed income ETFs with more than $202 bn in assets at the end of June 2019. This is up from 250 fixed income ETFs with over $117 bn in assets at the end of 2016 [1].

With so many options, how can investors select the right one? Answering these four questions should help.

1 Which index to track?

Select a bond ETF that tracks a benchmark which reflects the true opportunity set and matches your risk appetite. Bond indices are not straightforward. The bond universe is much broader than is the case with equities, and yet despite this, the availability of some bond issues may be limited.

The index methodology, which should be easy to access and clear, should explain how bonds are chosen to represent the particular asset class or market. The inclusion criteria typically drives the number of constituents. They are likely to focus on a particular region or country, types of bond and usually include a minimum issuance size and maturity requirement. The constituents, in turn, drive the risk, return and yield characteristics of the index.

Choose a strategy that is aligned to your investment objectives. It is also a good idea to track an index with a proven track record, one that has demonstrated consistency not just in its construction but also in its exposure over time.

2 How does the ETF invest its assets?

Index-tracking ETFs invest in two ways, either physically or synthetically. Physical ETFs generally aim to hold all, or as is often the case with bonds, a representative sample, of the underlying securities that make up the index. Physical replication is reasonably straightforward to understand, which may explain its increasing popularity[2].

Synthetic ETFs use derivatives contracts. These contracts are agreements between the ETF and a counterparty (usually an investment bank) and generally involve collateral, margin calls and exposure to counterparty risk. These additional requirements and additional sources of risk may partly explain why synthetic ETFs have become less popular, as does the general lack of transparency when compared to the physical approach.

To select the right bond ETF for you, look for the ones that explain clearly how your money is invested.

3 Who is the ETF provider?

Choose a provider with scale and experience. Building well-diversified bond portfolios requires an ETF provider to have sufficient scale to assemble and manage large portfolios, and the experience to mirror the index's risk characteristics in the portfolio. For broad global and regional indices that include thousands of bonds, the asset manager's ability to source and trade the index constituents (or bonds with similar characteristics) is critically important.

4 How much does it cost?

In a world of low yields, costs matter a lot. This is especially true for bond markets, where in recent years yields have been below their historical averages[3] and costs erode a larger share of returns than they have in the past.

Selecting a low-cost fixed income ETF in this environment makes sense. All else being equal, lower costs mean investors keep more of their returns. This translates into higher net returns and better performance over the long term.

[1] Source: Morningstar

[2] AUM for physical ETFs in Europe surpassed that for synthetic ETFs in 2013 and has continued to grow, while synthetic ETF AUM has declined. Source: ETFGI June 2019.

[3] Roughly a quarter of global debt is negative yielding. Source: FT, Negative rates: investors go through looking glass to sub-zero yields, 13 August 2019.

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Vanguard

Fixed income ETFs, ESG and approaching end investors directly

On September 12, **Tell Media Group** gathered **BlackRock/iShares**, **Franklin Templeton**, **Invesco**, **JPMorgan Asset Management**, **UBS Asset Management** and **Vanguard** as well as investors from **Erik Penser Bank** and **Coeli** to discuss the development of the ETF industry. Tell Media Group founder Niklas Tell moderated the discussion.

By: Niklas Tell Photo: Christer Salling

The discussion, which was held at Nobis Hotel in Stockholm, started with Niklas Tell asking about the most important product development and other interesting trends since the roundtable a year ago.

MATTI TAMMI: "I think there are two key trends that are worth highlighting. The first is the growth of fixed income ETFs which has really taken off since the fourth quarter last year. There are many reasons behind this and one important reason is the growth of multi asset allocation portfolios using ETFs as building blocks. The other trend is, of course, ESG, which we also discussed last year. We foresee that there will be some USD 400 billion in ESG ETFs by 2028 and a lot of that will be driven by the Nordic region."

TOBIAS NILSSON: "We absolutely agree on the increasing importance of ESG. In fixed income, ETFs have already brought liquidity and operational efficiency in how clients trade that market but looking at the active mutual space, it still has huge potential. So, bringing more actively managed funds to the ETF space is one area of product development and last year we really saw active fixed income ETFs take off in the US and here in Europe."

ANDREAS ZINGG: "I would agree with Matti. It's really fixed income and ESG and now we're also starting to see price cuts in fixed income ETFs. There has been very little competition in this area but now we see more providers offering fixed income ETFs, so clients have a wide variety of providers and exposures to choose from."

JASON XAVIER: "We've launched products in both of these areas, so I would absolutely agree. For instance, our Franklin Green Bond UCITS ETF is a great example of an amalgamation of both of these themes. We've seen some USD 60 billion moving into ETFs in Europe this year and out of that, USD 40 billion went into fixed income."

ABDALLAH MUHAMMAD: "It's not only more competition and better pricing. I also agree with Matti that it's about portfolio construction and the fact that they need the fixed income building block. This is the first year that we've seen fixed income net new assets overtake equities in Europe."

FLORIAN CISANA: "I wasn't at this roundtable last year so it's difficult for me to make a statement on what has changed. That said, we push ESG, which is natural for us as one of the biggest provider of ESG ETFs in Europe. In fixed income, we've launched four ETFs in emerging market debt, a fixed income sub-asset class where we're seeing a lot of demand from investors."

NIKLAS TELL: "FROM AN INVESTOR POINT OF VIEW – HOW ARE YOU CURRENTLY USING ETFS AND ARE THESE NEW ADDITIONS INTERESTING OR IS THERE SOMETHING ELSE THAT YOU LOOK FOR?"

JONAS THULIN: "We use a lot of ETFs and the lowest proportion in any of our portfolios is probably some 75 per cent ETFs. The highest is 100 per cent. On the equity side, we screen some 4000 ETFs every day in order to optimise our portfolios. I'm just amazed by the inventiveness from the industry and you can pretty much express any view you have with ETFs today. Where we use the least ETFs is on the fixed income side so it's great that there are more products becoming available in that space."

NIKLAS TELL: "LOOKING BACK, HAVE YOU CHANGED HOW YOU USE ETFS IN THE PORTFOLIOS?"

JONAS THULIN: "Well, I only started two years ago. The objective or strategy back then was to create portfolios based on ETFs as that's how the bank wanted to position itself."

ERIK LUNDKVIST: "I think you selected Jonas and me because we do things very differently. We use ETFs as an add-on and for theme-based investments, for cost reasons and for ESG reasons. We also use ETFs when we're in between active managers. I'm pleased to hear that there are more things happening on the fixed income side because that's very much needed. Also, when it comes to fixed income ETFs, for us they must be currency hedged."

MATTI TAMMI: "We actually launched five SEK hedged fixed income ETFs last week, so that might be of interest. We see an increasing demand to invest in the global bond markets in a currency-hedged manner and the ETF structure simplifies that allocation due to better liquidity compared to investments in individual bonds."

JONAS THULIN: "We like SEK hedged fixed income ETFs as well but for me it's more about how the hedge is done and what the costs are. We all know how expensive it can be and I want to know how cheap you can make it. Are you willing to take some risk on your own books for example? That's a discussion I would like to see in 2020."

NIKLAS TELL: NOW YOU'VE ALREADY PARTLY ANSWERED MY NEXT QUESTION, WHICH IS WHAT NEW PRODUCTS YOU WOULD LIKE TO SEE. IS THERE ANYTHING ELSE?

JONAS THULIN: "Providing ETFs on basic existing indexes is something we already have and I think the more interesting development will be who has the most attractive investment thesis and who will be able to bring that, at the right time, to the market as an ETF."

ABDALLAH MUHAMMAD: "We see that clients are receptive to new innovative ideas if it makes sense and if you're able to explain them correctly. It does, however, take content

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and education to make sure investors fully understand what we're trying to achieve with a specific exposure. This is one reason for us launching what we call alternative fixed income ETFs, giving clients exposure to preferred shares, variable rate preferred shares and additional tier 1s (AT1s). AT1s have been one of our fixed income success stories this year and the ETF has just under 400 million in AUM now."

JASON XAVIER: "Also, it's not only about what exposures that are missing from the ETF industry. For us, it's very much about looking at the broader investment landscape to understand where capabilities are absent and therefore, the ETF wrapper is often a suitable vehicle for fulfilment as we can be nimble and quick to market."

TOBIAS NILSSON: "Being active with your passive has been a huge theme and focusing on the asset allocation, which you can express tactically today with regional or sector ETFs. The other area of ETF development is, of course, thematic products. These are more long term as a diversified approach to areas we know will be important for the future economy but where we're uncertain of which specific stocks will be successful."

ANDREAS ZINGG: "When talking about trends and innovation, I think it's interesting to note that in 2019, 60 per cent of the flows went to products that were launched in 2017 or later. That makes me optimistic. Clients don't need a three-year track-record when investing in ETFs. They trust the ETF structure. Another result of this trend is that clients are increasingly seeding new products, which is a fantastic development."

NIKLAS TELL: "I ASSUME THAT MUST BE A BIG DIFFERENCE FROM ACTIVE PRODUCTS, WHERE YOU AS SELECTORS WOULD TYPICALLY LIKE TO SEE A LONGER TRACK-RECORD.

JONAS THULIN: "We always start with the portfolio and every holding must compete for its place. We do need a track-record and the duration of that track-record can vary depending on the exposure. Sometimes a one-month track-record is enough and other times we would need six months. Then it comes down to the due diligence where we look at some 50 different variables to fully understand what we would be holding."

TOBIAS NILSSON: "I think it would depend on the product and it would be difficult for us to launch active ETFs without having the capabilities or track-record on the active side."

NIKLAS TELL: "MANY OF YOU HAVE TALKED ABOUT THE NEED TO INFORM AND EDUCATE INVESTORS, ESPECIALLY ON NEW EXPOSURES. COMBINED WITH THE FACT THAT THERE'S PRICE PRESSURE ON ETFS, DO INVESTORS HAVE REALISTIC EXPECTATIONS WHEN IT COMES TO THE CONTENT AND SERVICE THEY CAN EXPECT GIVEN WHAT THEY PAY?

ABDALLAH MUHAMMAD: "This is still a content and education-driven business and we will do that job regardless whether it's an ETF where we charge 5 basis points or 35 basis points. Clients can expect the same access and level of service regardless of fees."

ANDREAS ZINGG: "The average fee of ETFs in Europe is still at 26 basis points. There is enough margin to provide service, information and education to clients. Also, the knowledge level has increased massively and you probably won't need to provide much service around an S&P500 ETF today. However, with new products, there's a need for more information and education and that's also where we think we can add more value."

NIKLAS TELL: "WHAT KIND OF INFORMATION AND SERVICE WOULD YOU LIKE TO SEE OR ARE YOU HAPPY WITH NOT BEING APPROACHED TOO MUCH?"

JONAS THULIN: "For us it's a pure quant-driven methodology so it's all about specific ETFs competing their way into the portfolio at each point in time. We might be missing out on something but we find the data we need in databases."

NIKLAS TELL: "BUT YOU ALSO ASKED FOR MORE BESPOKE ETFS COMING TO MARKET IN A TIMELY FASHION AND I ASSUME THAT WOULD REQUIRE MORE OF A DISCUSSION."

JONAS THULIN: "What would be very interesting is to see more of a direct link between the research and conclusions presented by strategists at these big asset managers and the products on offer. I understand that can be very difficult at big organisations but that would be high on my wish list."

ERIK LUNDKVIST: "Often when we use ETFs it's for very specific and niche exposures and then it's very useful to get niche research as well. I still need to do my own research but that external input could be very valuable."

FLORIAN CISANA: "In terms of services, we see a need for education, especially around sustainable investments. That is also nice from a sales perspective as this gives us the opportunity to learn about our client - how they think and what's important to them."

MATTI TAMMI: "I think we can all agree that there's still a lot of room for continued growth in the ETF industry and yes, on average prices will come down and therefore it's a scale business. We also see that investors are moving away from single fund selection towards portfolio construction and asset allocation solutions and ETFs will play a big role in these portfolios. At BlackRock, our portfolio analysis and solutions group provide added services to clients around consulting on portfolio construction, such as optimising portfolios on costs or ESG metrics, for example."

JONAS THULIN: "As both Florian and Matti mentioned ESG, I think I need to amend my previous answer and thank everyone around the table. On the ESG side, we've been very dependent on the ETF providers because the transparency we get here is far better than what we get from actively managed funds. When it comes to ESG, we're keen listeners to what you have to say."

JASON XAVIER: "Coming back to fee levels and service, I think it's important to point out that service is service regardless of product and you're paying a fee for the capability exposure and its potential return. This ultimately highlights the efficiency of the ETF product."

JONAS THULIN: "I really have to agree with that. When I took over the portfolios, we had some nine hedge funds and none are left. They have been outcompeted by actively or passively managed, but very niched, ETFs that we can use to express what we want to do. As a result, local hedge funds have a tough time showing us numbers that are competitive enough and cost is obviously a huge factor."

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FLORIAN CISANA: "When we talk about costs, we should look at the entire value proposition of an ETF. There are elements, such as index costs and cost of trading where I see improvements in the industry. We see a trend where some asset managers are building in-house indices as an alternative to buying off the shelf indices from index providers, which can make a difference in costs. We're also seeing huge improvements in the efficiency of trading, such as directed basked trading, which reduces the overall roundtrip costs for clients."

ANDREAS ZINGG: "That's a very good point. We've made a lot of investments, especially on the fixed income side, to make sure that the creation/redemption activities of our authorised participants is more integrated in our portfolio management systems, which is bringing the overall costs of trading down, even if it's not visible in the stated total expense ratio."

TOBIAS NILSSON: "In relation to support and service, with innovation and greater choice I think there's a greater need for us around the table to support and highlight why one alternative would be more suitable to their investment outcome. Regular portfolio reviews and commentaries are, of course, high-level services but especially when it comes to more innovative products, I think that's appreciated by clients.

NIKLAS TELL: "JONAS, YOU PRAISED THE ESG TRANSPARENCY FROM ETF PROVIDERS. HOWEVER, WHEN WE TALK TO INSTITUTIONAL INVESTORS AND FUND SELECTORS ACROSS THE REGION, IT'S ALL ABOUT THE IMPORTANCE OF ASSET MANAGERS INTEGRATING ESG FACTORS INTO THE INVESTMENT PROCESS. HOW DO YOU DO THAT IN ETFS?"

FLORIAN CISANA: "I would say that there are two main elements to this. The first is what you do as an asset manager from a stewardship perspective, regardless if it's active or passive, and I think this is not fully understood by everyone. It's about what you believe in as an asset manager and how you engage with the companies you hold in your portfolios. We exercise our voting rights on almost all our holdings regardless if the holding sits in an ETF or in an active fund. Similarly, we select our engagement priorities across both active and passive holdings. Then, when it comes to the ETF, the integration of ESG issues depends on the index that the ETF will be tracking. Here, I think we can do more as an industry in really understanding how the investors would like to implement their ESG policies, which range from exclusions to focusing on best-in-class companies."

ANDREAS ZINGG: "What Florian mentions about stewardship is really important. When we invest in a company through an index fund or an ETF, we do that based on the assumption that we will hold it forever. Sustainability is a long-term thing and you can create value and make a change by engaging with those firms. As an industry, I think we can become even more transparent and open with regards to our stewardship efforts. We must explain not only what we do but also what different things mean to us."

TOBIAS NILSSON: "I think you're absolutely right. Clients want to know what we have done in terms of proxy voting in the companies that we own. Also, even if you're in a different position as an active manager compared to a passive house when you engage with a company, it's very powerful to integrate your engagement efforts to create change or transparency on ESG across your active and passive holdings."

MATTI TAMMI: "I think it could be argued that engagement is even more important on the passive side as indexing typically implies long-term ownership of companies."

ABDALLAH MUHAMMAD: "We take engagement and active ownership very seriously whether the assets are passive or active. I think it's a communication gap and we need to make sure that investors understand that we do engage with the companies we hold also in ETFs and not only what we hold through active funds."

FLORIAN CISANA: "What we also see is that investors are keen to understand our views and our approach to stewardship across strategies as they, of course, don't want to invest in an ETF that takes a completely different view on the ESG performance of companies compared to other portfolios. Going forward, I think we will see more conversations and more cooperation with clients in this area."

NIKLAS TELL: "ROBO-ADVISORS IS A TOPIC THAT WE'VE HAD IN THESE ROUNDTABLES FOR SOME TIME NOW. ARE THESE PLAYERS BECOMING NOTICEABLE IN FLOWS?"

ANDREAS ZINGG: "It's growing but from a low level. A study from some three years ago asked investors across the Nordic region if they would invest with a fully digital wealth solution. Half of the respondents said yes but only a fraction of those actually invested. I personally believe it's a question of trust but also the ability to have the option for face-to-face interaction. More than 90 per cent of these clients want at least the option to have a personal meeting and most robo-advisors in Europe and in this region don't have the scale to offer that."

NIKLAS TELL: "EARLY ON, IT WAS MAINLY START-UPS BUT NOW WE'VE SEEN THAT BIG NORDIC BANKS ALSO OFFER THIS."

JASON XAVIER: "But you have to ask who you're pitching robo-advisors to. Right now, it's targeting a demographic that has not grown up in a digital world. For me, while it's slow burn right now, it really will be about the next generation. They will embrace the technology."

TOBIAS NILSSON: "As an industry, we often look at the US for clues about where the industry is moving but it's a very different market. There's one ticker-tape, retail take-up of ETFs is much bigger compared to Europe and the use of robo-advisors is also bigger. That said, even if it's not big right now, it's a channel that we want to nurture for future growth and on-screen liquidity."

ANDREAS ZINGG: "Robo-advice in the US is a success because Vanguard is a success. We have a trusted brand and we offer face-to-face communication and it works. To your point about established players offering robo-advice, you have to ask what their incentive is to push that service when they have other advisory services with higher margins."

MATTI TAMMI: "You're right that we've seen the large banks and distributors in the region launching digital wealth services and they have the client loyalty and trust that Andreas was talking about. However, it's not really impacting flows yet but it's part of the transformation of the wealth business as we move to a fee-based model of advice where the use of technology plays an important role."

ROUNDTABLE – STOCKHOLM

ROUNDTABLE – STOCKHOLM

JONAS THULIN
Erik Penser Bank
Head of asset management at Erik Penser Bank. Before taking on his current role in 2017, he was head of asset allocation at Nordea Wealth Management.

ERIK LUNDKVIST
Coeli
Chief investment officer and partner at Coeli. He has worked at the firm since 2004 when he joined as an analyst. Before taking on the chief investment officer role, he was a senior portfolio manager.

NIKLAS TELL: "CAN WE BLAME THE SLOW TAKE-UP OF ROBO-ADVICE ON HOW MIFID II WAS IMPLEMENTED AND THE FACT THAT DISTRIBUTORS CAN STILL KEEP RETROCESSIONS IF THEY PROVIDE THE CORRESPONDING VALUE TO THE END CLIENT?"

ANDREAS ZINGG: "I don't think so as we see the same trend also in markets where Mifid II was implemented more strictly and even in markets where retrocessions are banned completely. That said, I would have liked to see an outright ban across markets to ensure that incentives are completely aligned. Right now, I think the take-up of robo-advice comes down to the factors I outlined earlier. However, as Jason said, it will probably be different when the new generation grows up."

JONAS THULIN: "I have a different take on this and I do think there's partly an issue with regulation. We did some research together with the Royal Institute of Technology here in Stockholm where we looked at the math used by these platforms and we were not impressed. We found that platforms are typically very limited, which is a Mifid II issue, and 90 per cent of platforms are based on models where they optimise back-testing, which introduces you to risks."

ANDREAS ZINGG: "But is that really important? I don't think that the big task for robo-advisors is to introduce models to beat the market, which we know is very challenging. The most important task is to guide the client through the advice process. It's to make sure that the client is in the right risk profile and has the right asset allocation to achieve his or her goals and to avoid pro-cyclical behaviour. We did a study in the US and found that clients who follow these behavioural biases destroy 3 per cent of value per year. That's massive."

NIKLAS TELL: "IF I UNDERSTAND EVERYONE CORRECTLY, WHILE YOU DO SEE LONG-TERM OPPORTUNITIES WITH ROBO-ADVISORS, IT'S STILL VERY MUCH ABOUT PROVIDING ETFS TO PROFESSIONAL INVESTORS IN THE NORDIC REGION?"

ABDALLAH MUHAMMAD: "You have to look at the bigger picture. It's a market that hasn't grown as much as we would have liked but we still very much appreciate that they have a role to play. We want to position ourselves not only as a product provider but also as a trusted advisor with these robo-advisors and bigger distribution platforms."

MATTI TAMMI: "You see the fee-based model everywhere else in the world and that's opening up for ETFs to grow. We're seeing how some of the players in the region are slowly and incrementally building some parts of their wealth offering purely on a fee-based model. That's creating openings for us."

ANDREAS ZINGG: "I personally believe that more and more asset managers will develop a retail proposition and approach end-investors directly. I'm from Switzerland and we have the same challenge as the Nordics and that's the fact that we're comparatively small countries. Larger asset managers that are thinking along these lines will go for the bigger markets first but I'm optimistic for smaller markets as well because once you have a retail proposition in place, you can replicate it fairly quickly. Maybe the asset managers will be the robo-advisors of the future if the market is not changing. The cost of advice globally has not come down in contrast to product prices. Asset managers might step in here if it's not happening with existing providers."

FLORIAN CISANA: "Also, robo-advice is a very wide term and I think we need to be more specific with what we mean. That said, these newcomers do good things and one of the benefits they have is that they can build things from scratch, compared to existing investment managers that typically sit on legacy systems. I personally think we, the investment managers, can learn a lot from the new approaches robo-advisors choose."

MATTI TAMMI: "I think that many of these new providers will end up as business-to-business providers. They lack the trust and they don't have access to the wide distribution of banks, but they could provide the innovative technology and solutions they have built to established distributors."

JONAS THULIN: "One topic that I'm surprised that no one has mentioned is regulation. If you look at what's available to European retail clients, I wouldn't use ETFs. We run two different portfolios for comparative reasons – one with UCITS ETFs and one with US ETFs – and there's a noticeable difference. Across our portfolios, I would say that some 70 per cent of the ETFs we use are US ETFs just because they're so much better."

ANDREAS ZINGG: "It would, of course, be a dream to have one vehicle that could be traded globally. That said, I don't think your comparison is fair because you're comparing a very mature market with a developing market when it comes to ETFs. Also, the US is one market with one currency and that's very much the opposite of what we have in Europe."

FLORIAN CISANA: "For some markets within EMEA, I actually see a trend where larger institutions are shifting from US domiciled ETFs into European domiciled ETFs. For me, this proofs that European ETFs can be competitive in pricing and trading."

ERIK LUNDKVIST: "If we're talking about end clients buying ETFs off the shelf, I don't think the big issue is whether the ETF costs 3 or 7 basis points but rather the fact that you pay 50 basis points or more in transaction and currency exchange fees for a foreign listed ETF on an open platform."

NIKLAS TELL: "WE'RE APPROACHING THE END OF THE DISCUSSION AND I'M KEEN TO HEAR WHAT EMERGING TRENDS YOU'RE SEEING."

JASON XAVIER: "As the range of investment products and capabilities continues to expand, we notice the role of portfolio construction in all ETF discussions. In the current market environment, we have, for instance, helped many clients identify the rationale for replacing parts of their exposure with specific quantitative-based, smart beta ETFs to give better protection to the downside while keeping the exposure to the market. We expect this trend to continue as more and more clients appreciate the underlying factors driving their returns. The flexibility to implement these decisions from both a core, tactical or as a liquidity buffer has attracted many to the ETF wrapper and we expect this trend to continue."

ANDREAS ZINGG: "As mentioned before, I strongly believe that we will see asset managers developing a retail proposition. The Nordic region will not be the first market but it will happen."

JONAS THULIN: "I would like to come back to regulation. It would be great if there was a platform in Sweden that would take the product responsibility for the product, which would mean you don't have to list the product. It takes us five seconds to do that in our bank. It's easy but it's a question of business model, which can be sensitive. I think someone will come along and I know that there are players looking into how you can bring ETFs to retail in order to compete with existing platforms. It will be interesting to see if someone succeeds."

Responsible investing is becoming a core strategy

With US$30.7 trillion in assets held in responsible investment funds[1], investors around the world clearly want the companies in which they invest to do more than just make profits. Asset managers and institutional investors are driven by regulatory pressure and the desire to reduce portfolio risk, while a more general trend is seen in people – especially the influential millennials – wanting to align their investments with their own principles.

The good news is there are now funds to suit most needs, if the investors understand what they are trying to achieve. Is it (a) primarily to meet certain ethical criteria, with performance a secondary consideration, or (b) first and foremost to achieve financial objectives but in a responsible way?

Strategies fit for purpose
Investment managers have responded to the demand by creating a wide variety of products with different approaches for incorporating environmental, social and corporate governance (ESG) considerations. Some funds simply filter out companies with poor ESG credentials or that are involved in unacceptable business practices, while others focus on companies with attractive ESG profiles. You can also find funds that combine these negative and positive screening techniques.

The evolution of responsible investing has been boosted by the increased quality and availability of ESG-related data issued by publicly traded companies. Index providers can use the data to score companies based on their current ESG profile and, in the case of MSCI, can even factor in whether that profile is improving – what they call "ESG Momentum". Research from MSCI suggests a possible connection between ESG momentum and share price performance.

Suitable to the core
We believe that ESG could become more integral to the valuation and selection of securities, as analysts look to uncover potential risks and opportunities. At the same time, ESG is gaining genuine importance with the management teams of companies as they address shareholder concerns. Tackling these issues is no longer a "nice to have" but is now a critical part of corporate strategy.

ESG is also increasingly important in investment strategies. Ethical funds were once considered niche products for a minority of investors who were willing to sacrifice performance. Now, ESG funds are in the mainstream, with some suitable for core holdings in diversified portfolios. Investors looking for core exposure should look at the risk profiles, correlation and tracking error of the ESG funds they are considering compared to the existing core holdings they could replace.

US$30.7tn

Assets held in responsible investment funds[1]

Why ETFs for ESG?
Historically, most investors have gained ESG exposure through actively managed mutual funds, but demand has been increasing for low cost, passive exposure. We believe it is important for funds to exercise their proxy voting rights, whether the fund is active or passive. With passive ETFs, this can be accomplished by investing physically in the holdings of the chosen ESG index. ETFs have several other attractive features, including the ability to trade throughout the day, transparency with holdings published daily and typically low costs. After all, investing ethically shouldn't cost the earth.

Investment risks: The value of investments, and any income from them, will fluctuate. This may partly be the result of changes in exchange rates. Investors may not get back the full amount invested.

[1] Source: Global Sustainable Investment Alliance, Global Sustainable Investment Review 2018. Data as of January 2018

New sustainable ETFs from UBS Asset Management

UBS Asset Management has, together with STOXX, MSCI and J.P. Morgan, launched a series of three ETFs that expand the core benchmark ESG series of products that integrate sustainability into their methodologies.

UBS ETF (LU) EURO STOXX 50 ESG UCITS ETF

A product that enables investors to receive similar performance characteristics to the standard EURO STOXX 50 exposure but with an ESG approach added to it. Ten per cent of the lowest ESG-scored companies are excluded, (in total 5 securities), and are replaced by better-scoring sector peers from the wider STOXX universe. It also omits non-UN Global Compact Principle compliant companies and tobacco producers, controversial weapon producers, and those involved in thermal coal.

UBS ETF (LU) MSCI CHINA ESG UNIVERSAL UCITS ETF

A product that physically replicates the MSCI China ESG Universal Index, which favours companies with a robust and an improving ESG profile. From within the eligible universe (MSCI China), companies that are ESG and/or controversy unrated are excluded, as are those touched by controversy. Involvement in controversial weapons leads to exclusion, as is the case in most ESG-centric exposures.

UBS ETF (LU) J.P. MORGAN USD EM IG ESG DIVERSIFIED BOND UCITS ETF

A product that offers a sustainability filtered selection of sovereign and corporate emerging market USD debt. The investment approach behind the index is entirely rules-based, transparent and efficient in its implementation. With the improvement in credit quality of the underlying assets comes the increasing appeal of this ETF for investors with minimum credit rating requirements, such as insurance companies and pension funds that often have restrictions to only invest into investment grade exposures. ●

Innovative yield curve ETFs from Lyxor

Lyxor has launched a range of yield curve ETFs with four new listings across Europe. Each of the four new ETFs – the first of their kind in Europe – is designed to help investors express their views on expected changes in the shape of the US Treasury and German Bund yield curves, two key benchmarks for interest rates.

The Lyxor US Curve Steepening 2-10 UCITS ETF, allows investors to potentially profit from an increase in the yield differential between 2Y and 10Y US Treasuries, known as a steepening of the yield curve, within a simple and transparent ETF vehicle. Lyxor's other new ETFs allow investors to express the opposing view – that the 2-10Y portion of the US Treasury yield curve will flatten, via the Lyxor US Curve Flattening 2-10 UCITS ETF. There are equivalent exposures to the 2-10Y portion of the German Bund yield curve via the Lyxor EUR Curve Steepening 2-10 UCITS ETF and the Lyxor EUR Curve Flattening 2-10 UCITS ETF. All four ETFs come with an annual management fee (total expense ratio) of 0.30 per cent. ●

BlackRock introduces five SEK hedged bond ETFs

BlackRock has introduced five new SEK hedged iShares for credit exposures. "Swedish investors have for a long time experienced a volatile and downward trend for the Swedish Krona. In average this has improved returns of unhedged international exposure but also added currency risks that allocators and investors must manage. The new SEK hedged credit iShares mitigates the impact of that currency risk and protects portfolio's international credit exposure from currency fluctuations. This will be particularly of value for Swedish investors in a scenario of a strengthening Swedish Krona," says Matti Tammi, Nordic head of iShares ETF and index investment at BlackRock.

- iShares € High Yield Corp Bond UCITS ETF SEK Hedged (Acc)
- iShares $ Corp Bond UCITS ETF SEK Hedged (Acc)
- iShares Core € Corp Bond UCITS ETF SEK Hedged (Acc)
- iShares $ High Yield Corp Bond UCITS ETF SEK Hedged (Acc)
- iShares Core Global Aggregate Bond UCITS ETF SEK Hedged (Acc)

"The demand from private and institutional investors for opportunities to invest in the global bond markets in a currency-hedged manner is growing and the ETF structure simplifies that allocation due to better liquidity compared to investments in individual bonds," says Matti Tammi. ●

SPDR has launched the first ESG ETF based on STOXX Europe 600

The SPDR STOXX Europe 600 ESG Screened UCITS ETF aims to eliminate exposure to controversial weapons, tobacco and thermal coal, and companies that do not comply with United Nations Global Compact (UNGC) principles, and has a 'Fast Exit' feature to react quickly to breaking ESG controversies. ●

First ESG ETF to surpass EUR 1 billion in Europe

In July, a European exchange traded fund focused on ESG investing passed the EUR 1 billion mark of assets under management for the first time. Launched in 2011, UBS Asset Management's UBS ETF (LU) MSCI World Socially Responsible UCITS ETF exceeded EUR 1.23 billion in July 2019.

The ETF physically tracks the MSCI World Socially Responsible 5 per cent issuer capped TRN index, which includes companies that represent the top quartile on ESG criteria, according to the index's methodology. With a total expense ratio of 0.25 per cent, the fund gives access to the shares of companies in 23 countries and applies a 5 per cent cap on any one issuer, assuring a varied basket of stocks that offers sound diversification potential for portfolios.

Florian Cisana, head passive & ETF specialist sales strategic markets EMEA at UBS Asset Management, commented: "This milestone represents a further confirmation of our commitment to meet the increasingly sophisticated needs of investors. We want to continue to stay at the forefront in developing innovative products and solutions for our clients, helping them to align their investments and ESG goals." ●

EURO STOXX 50 ESG UCITS ETF

UBS ETF On Track Research

Invest in top Eurozone companies through a core equity benchmark, filtered by ESG criteria for enhanced sustainability.

UBS ETF (LU) EURO STOXX 50 ESG UCITS ETF – Going green with Eurozone blue-chip equities

- The EURO STOXX 50 is one of the most renowned benchmark indices for investors in Eurozone equities with Euro 31.3bn[1] ETF assets tracking it globally.
- The 10% lowest ESG-scoring companies are filtered out to tilt the index towards more sustainable companies.
- In addition, the EURO STOXX 50 ESG index filters out companies with revenue exposure to controversial weapons manufacturers, tobacco, thermal coal and those that do not comply with the United Nations Global Compact (UNGC) principles.
- The EURO STOXX 50 ESG targets comparable performance to the standard EURO STOXX 50 index.
- To bring the number of constituents and sector exposure back in line with the standard EURO STOXX 50 index, the excluded companies are replaced with higher ESG-scoring companies from the same ICB Supersector.
- The EURO STOXX 50 ESG can be seen as a 'core replacement'. It is designed to maintain the characteristics of the EURO STOXX 50 while also meeting relevant and meaningful ESG criteria.
- All funds and share classes are UCITS V compliant. Share classes are available with and without currency hedging.

Core equity, ESG in mind

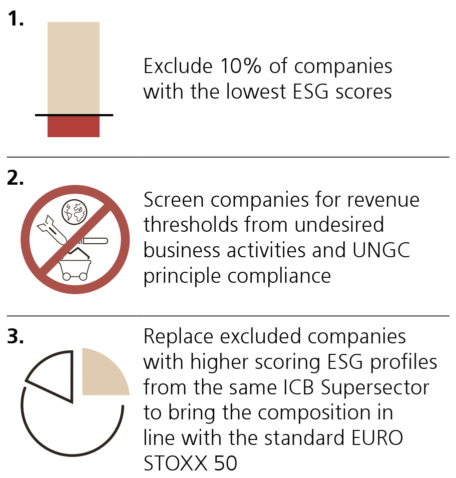
As investors become increasingly aware of the impact of their investment choices, they are increasingly looking for sustainable versions of their core benchmarks. The goal of such sustainable core benchmarks is to provide a similar risk-return profile as the non-screened version while significantly improving the sustainability footprint.

Taking the next step

After the successful launch of the UBS ETF (IE) S&P 500 ESG UCITS ETF, which catered for the need for a sustainable U.S. core equity solution, the next logical step was to make additional markets investible by creating sustainable versions of their core indices. The EURO STOXX 50 is the single largest Eurozone benchmark for ETFs globally with around Euro 31.3bn[1] assets tracking it and a track record of over 20 years.

[1] Source: Morningstar. Data as of June 2019.

Figure 1: Summary of ESG screening methodology



Source: STOXX, UBS Asset Management.
Data as of August 2019.

Sustainability filtering – a three stage process

The EURO STOXX 50 ESG index employs a comprehensive three stage process for screening companies for sustainability:

In the first step, from the 50 constituents the five companies (10% of constituents) with the lowest ESG scores are excluded.

In the second step, companies are screened for exceeding revenue thresholds from undesired business activities such as the production and sale of controversial weapons (>0%), or voting rights in such companies (>10%), revenue from tobacco production (>0%) or thermal coal extraction and power generation (>25%). The screening also assesses companies' compliance with the UNGC principles' four pillars: human rights, labor, environment and anti-corruption. Companies that fail to comply with any of the screening criteria are excluded from the index (Figure 2).

Step three involves new inclusions to fill the allocation space left by the first two exclusion phases. Replacements are sourced from the universe within the same sector, where the replacement company has a higher ESG score than the one it. Simple yet robust process for the creation of a new-generation ESG index.

Figure 2: Excluded companies and reasons

Company	Weight	Exclusion criteria
AIRBUS	2.93%	Controversial weapons
SAFRAN	1.94%	Bottom 10%
VOLKSWAGEN	1.09%	Bottom 10% & Controversial weapons
VIVENDI	1.00%	Bottom 10%
FRESENIUS	0.74%	Bottom 10%
UNIBAIL-RODAMCO-WESTFIELD	0.67%	Bottom 10%

Source: STOXX, UBS Asset Management.
Data as of August 2019.

Risk, return and sector neutrality

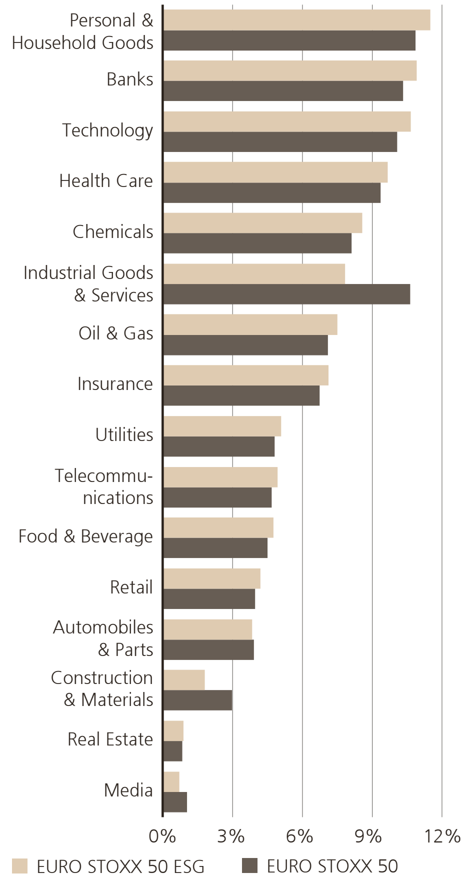
Applying sustainability filtering leaves the index at less than 50 companies. For each company excluded, an additional company that meets the sustainable requirement is selected from the same ICB Supersector, in order to bring back the constituents to 50 (Figure 3). The result is an index that has shown very similar risk and return characteristics to the standard index in long term back tests (Figure 4).

The case for sustainable core Eurozone equity

Investors in Eurozone equity often choose the EURO STOXX 50 benchmark as it tracks the blue-chip Eurozone equity market. The new ESG screened version of this core portfolio component allows investors to make sure that they are compliant with certain ESG requirements, such as adherence to UNGC principles and avoidance of undesired revenue exposure to business activities like controversial weapons manufacturing and sales.

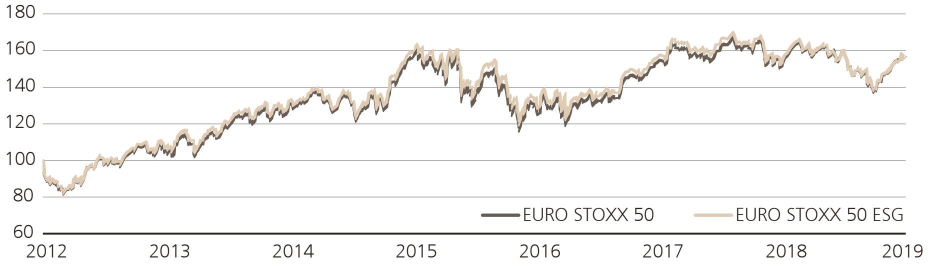
The EURO STOXX 50 ESG presents an all-new core benchmark in that it maintains the characteristics of the established and renowned core-equity index while meeting relevant and increasingly important ESG criteria.

Figure 3: ICB Supersector index allocation



Source: STOXX, UBS Asset Management.
Data as of July 2019.

Figure 4: Long-term index performance
Both indices Total Return Net. Indexed to 100 as of 31 July 2012.



Source: STOXX, Bloomberg, UBS Asset Management. Data as of July 2019.

Past performance is not a reliable indicator of future results.

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UBS

Focus on European statistics

2 351 Number of ETFs/ ETPs in Europe

68 Number of providers

30 Number of exchanges

Source: ETFGI, data as of end of August 2019.

ETFGI, an independent research and consultancy firm covering trends in the global ETF/ETP ecosystem, has reported that ETFs and ETPs listed in Europe suffered net outflows of USD 7.86 billion in August, bringing year-to-date net inflows to USD 54.89 billion. Assets invested in the European ETF/ETP industry have decreased by 2.2 per cent, from USD 910.34 billion at the end of July to USD 890.21 billion.

Franklin Templeton registers 14 ETFs for Nordic investors

Franklin Templeton has registered 14 ETFs from its Franklin LibertyShares range in Denmark, Finland and Sweden. These 14 ETFs span across a full spectrum of actively managed suite of fixed income ETFs, passive and smart beta products. Caroline Baron, head of ETF sales EMEA, Franklin Templeton said: "In 2016, we began executing upon a multi-year strategy to create a world class ETF business, building an experienced ETF team and leveraging the deep expertise and resources of Franklin Templeton. Following successful launches of our Franklin LibertyShares ETF platform in US, Canada, Mexico, UK, Germany, Italy, Switzerland and Austria, we are delighted to register our 14 ETFs in Denmark, Finland and Sweden. We see this as a natural step in the expansion of our European ETF platform".

Mats Eltoft, head of distribution Nordics for Franklin Templeton, added: "We are excited about the registration of the full Franklin LibertyQ UCITS ETF range and aim to provide investors in Denmark, Finland, and Sweden with the flexibility to construct diversified portfolios across active, smart beta and passive strategies. We believe these strategies co-exist well, each fulfilling a different role within an overall diversified portfolio. While our focus continues to be on traditional active management, we recognise the growing demand for other investment solutions and vehicles, coming from various client types. This full suite of ETFs provides access to beta solutions at a low cost for Danish, Finnish and Swedish investors."

Bloomberg helps UBS to enhance ETF portfolio management

In early October, Bloomberg announced that UBS Asset Management had adopted its basket service (BSKT) for exchange-traded funds.

BSKT enables authorised participants to use Bloomberg data and analytics to deliver baskets of bonds to ETFs for creation and redemption of fund shares. Utilising BSKT, UBS Asset Management can scale its fixed income ETF business, consolidate interactions into a single interface and manage interactions on BSKT's electronic workflows. "BSKT is a step towards a more flexible, straightforward ETF basket creation that generates cost and efficiency benefits," said Matthias Dettwiler, managing director and head of index fixed income at UBS Asset Management. He added: "As a major ETF provider in Europe, we are keen to stay on top of innovation that improves our customisation, reduces our time to market and further enhances our client focus."

Consolidation in the ETF industry

Consolidation in the wider asset management industry has been ongoing for some time, with both large and small deals such as Aberdeen merging with Standard Life and Janus joining forces with Henderson. This trend may now be coming to the ETF sector as well, with Bloomberg reporting in August that Societe Generale is considering options for its Lyxor asset management business. Lyxor managed about EUR 151 billion of assets at the end of July, with almost half

in exchange traded funds.

The news was also picked up in a recent newsletter from Philip Kalus, managing partner at Accelerando associates, where he states that the news on SocGen considering to sell Lyxor AM sparked more speculation on movements in the European ETF space. "Lyxor is an attractive acquisition target. The firm is not only one of the leading providers in the European ETF space, but is also renowned for its alternative business. This should be very attractive to more mainstream asset managers aiming to enhance their propositions and respective reach," he said.

GSAM launches European ETF business

On September 26, Goldman Sachs Asset Management (GSAM) announced the launch of its European ETF business and its first product listing.

The first ETF is the Goldman Sachs ActiveBeta U.S. Large Cap Equity UCITS ETF, which is a European version of its flagship ETF in the US market. With more than USD 6,5 billion in assets under management, it is currently the largest multi-factor equity ETF in the world. The European version of the ETF has been listed on the London Stock Exchange and will, according to a press release, be listed on several exchanges across Europe in the near future.

The press release also states that GSAM is planning to launch a range of ETFs providing access to a number of markets, asset classes and investment styles over the next six months. Nick Phillips, head of the international retail client business at GSAM, said: "Our global clients are demanding more choice in their portfolios and we are excited to complement our existing fund range with ETFs that we believe can help simplify portfolio construction and contribute to superior risk-adjusted returns. The funds will be relevant to both retail and institutional clients. This is a significant addition to our international product offering and we are tremendously excited to enter the fast-growing European ETF market."

Peter Thompson, head of GSAM's European ETF business, added: "GSAM ETFs will be smart, simple and accessible. The suite of products we plan to launch in the coming months will enable our clients to build diversified global portfolios using a mix of active and passive investment styles. We are focused on building this business for the long-term and believe we can provide superior choice and performance to our clients through this product range."

GSAM began offering ETFs in the US in September 2015 and it currently has 19 ETFs in the US, with some USD 14 billion in assets under management.

FIXED INCOME: ACTIVELY MANAGING TODAY'S GREEN BOND OPPORTUNITIES

In this article we examine the process for green bond labelling and certification and its implication for index investors. Passive green bond funds are bound by eligibility rules. Each index has its own labelling requirement. We strongly believe that a well-balanced green bond portfolio should have a wider remit, to include unlabelled debt of companies which can be crucial to the growth of the low-carbon economy. From an investment point of view, there are significant opportunities in this space.

WHAT DEFINES A GREEN BOND?

Green bonds first appeared in 2008 with an issue from the World Bank. Since then, growing concerns about greenhouse gas (GHG) emissions and climate change have prompted a surge both in the popularity of environmental, social and governance (ESG) mandates, as well as issuance to finance climate-related expenditures. Green bonds are a key tool in the attempt to decarbonise the global economy and are set to see continued rapid growth.

The **definition of what should qualify as a green bond is complex**, given the absence of a legally binding system. The International Capital Markets Association does maintain a framework, originally established in 2014 and referred to as the Green Bond Principles (GBP). Although these are voluntary, it is worth looking at the key components in order to understand what is seen as green financing:

1. **Use of Proceeds (UOP).** This needs to be adequately defined in the bond prospectus. In standard bonds, the UOP is often a simple "General Corporate Purposes." To be considered as green, at a minimum, the UOP should clearly indicate the projects financed or refinanced by the proceeds, why these projects are environmentally beneficial and their effectiveness in meeting the issuers decarbonisation goals.
2. **Process for Project Evaluation.** This includes a description of the issuer's sustainability objectives, its process for determining the eligibility of a project as green and the process for managing environmental and social risks.
3. **Management of Proceeds.** Proceeds from green issuance need to be virtually (but not legally) segregated and linked to the green projects in a credible way.
4. **Reporting.** The issuer should regularly provide up-to-date information on the progress of the projects detailed in the UOP. This can be an internal or externally certified process and allows the formal labelling of an instrument as a Green Bond.

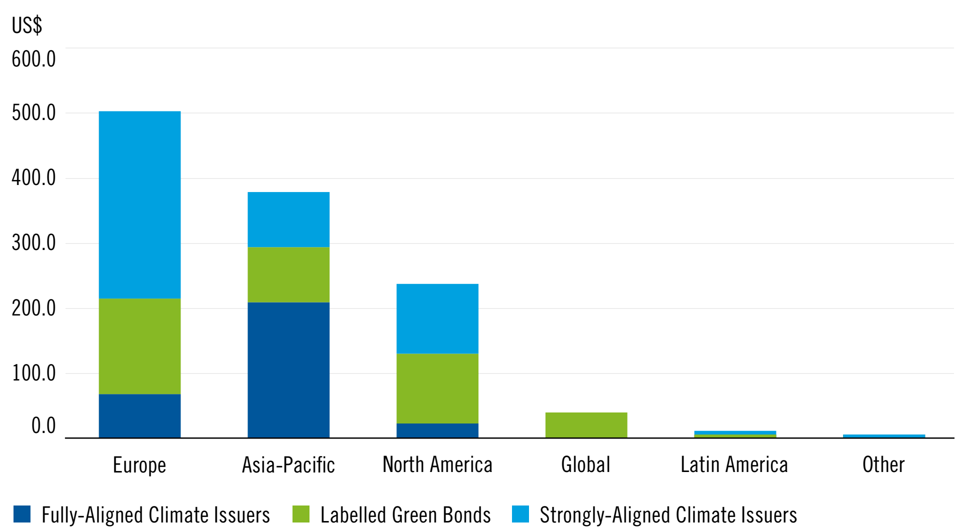
The Climate Bond Initiative (CBI) has added its own independent Climate Bond Standard certification scheme to help reduce due diligence requirements for investors, which is also entirely voluntary.

The GBPs and CBI certification system were originally designed to provide a framework for companies that were not strategically climate aligned but who wished to demonstrate to investors that certain issuance from them was green. Bonds from "green pure-plays"—companies whose revenues are 100% from green activities—were almost non-existent at the time, something that has changed significantly.

EUROPE HAS BEEN THE LARGEST SOURCE OF GREEN BOND ISSUANCE

Climate-Aligned Bond Issuance by Geography

January 2008 through June 2018



Source: Climate Bonds Initiative, Bonds and Climate Change: The State of the Market 2018, September 2018. For illustrative purposes only.

Examples of **green pure-plays** include companies producing solar panels, wind turbines or electric vehicle charging infrastructure. Such companies are part of the drive towards a decarbonised future and in our view their debt should be considered as being aligned with environmentally sustainable investment goals, even if they do not seek a formal label. **Crucially, only a third of the climate aligned bonds identified by the CBI are labelled as green bonds.**[1] In addition, some companies may have projects that meet GBP criteria, are certified and index compliant, but these businesses may still be in industries that are an anathema to ESG investors.

Indices, and by extension passive green bond funds, are bound by eligibility rules. Each index has its own labelling requirement, either through alignment or broad alignment with the GBP or CBI criteria. We believe that active management can add value in such relatively new area as it can tap into opportunities like unlabelled debt of companies, which are crucial to the growth of the low-carbon economy. Something that a traditional index may not consider.

Beyond the label (or lack of), an active manager will primarily consider the fundamental credit profile of the issuer (bottom-up approach) ensuring that he picks companies that are fundamentally healthy and meeting his requirements. That analysis will then be allied to a top-down review of the environmental sustainability of that company's business model. Active Managers can work also with an issuer and influence the way a company's debt is structured.

We believe lower volatility could develop into green bonds permanently trading tighter to the issuer's yield curve, particularly for longer maturities. Lower volatility could also create opportunities for active managers to switch into bonds at longer maturities, with consequently higher spreads, without having an unacceptable impact on potential short-term volatility.

Academic research[2] has demonstrated statistically significant links between environmental events and valuation, with recent studies based on companies within the S&P 500 supporting the theory that **there is a positive relationship between environmental performance and valuation**. Wider studies have also backed the theory that stronger governance and shareholder engagement are linked to higher valuations.

A HOLISTIC APPROACH TO GREEN BONDS

In our opinion, when it comes to Green Bonds, there are merits in constantly benchmarking the value of each bond against its peers and to profit from moving into issues that offer relative value, versus following an index or holding bonds to maturity.

Franklin Templeton's European fixed income research team looks at green bonds holistically: we establish a baseline level of environmental impact reporting with all issuers held in any portfolio, regardless of whether the issue is labelled green. As a major global fixed income investor, we are well-positioned to engage with the management of companies on an ongoing basis around both ESG commitments and the underlying credibility of its business plans. The team assesses these issues and issuers based on the extent to which:

1. **The issuer can pay the interest and coupon on the bond as it falls due;**
2. **They support the transition to a low-carbon future;**
3. **They have an appropriate governance structure;**
4. **The operational processes and practices that make up the company's environmental management systems are adequate.**

Our active approach to investing in green bonds allows our portfolio managers to apply discretion while still investing in bonds that provide environmental benefits. We believe this approach can also deliver superior risk-adjusted returns for investors in an area of the market which is still in its infancy.

Gail Counihan
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Franklin Templeton Fixed Income

Read the full research briefing on
franklintempletonnordic.com/greenbond

1. Climate Bond Initiative Annual Report 2018.
2. Konar and Cohen, 2001; Guenster et al., 2011; Derwall et al., 2005; Gompers et al., 2003; Konar, Bailly and Cohen, 2000.

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