35 years of ETFs: The evolution of a Canadian innovation

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In 2021, we published an article to celebrate the 30-year anniversary of the launch of the first exchange-traded fund (ETF) in Canada. At that time, the global economy was at a vulnerable point, navigating the uncertainty which came with the COVID-19 pandemic. ETFs played an important role in the overall stability and resilience of the Canadian markets, providing transparency, price discovery and liquidity to investors seeking some certainty.

Fast-forward to 2025, now 35 years have gone by since the listing of TIPS, the Toronto 35 Index Participation Units, on the Toronto Stock Exchange. We are again at a critical juncture, with geopolitical events triggering uncertainty and increasingly volatile financial markets, which provides us with an opportunity to look back at some key trends in the Canadian ETF market over the last 5 years that may also shape future developments.

First, some key statistics about the Canadian ETF market since our last update[1]:

- Since 2020, ETF net assets have grown 102% from C$257 billion to C$518 billion in 2025.
- There has been a 46% jump in the number of ETFs listed on Canadian exchanges, highlighting increased investor demand for coverage across various asset classes, sectors and product types.
- Net ETF sales have increased by 81% since 2020, with this sales growth being attributable to both institutional and retail investor demand.

Below we outline three key trends we have observed over the last 5 years in our experience advising clients in the industry, along with some of our expectations as the market continues to develop.

Trend 1: Growing demand for active management

Historically, ETFs have been primarily structured as passive investment vehicles to provide broad exposure to an index. Recently, a greater emphasis has been placed on actively managed ETFs, managed by professional portfolio managers with the goal of outperforming a benchmark.

While passive ETFs still attracted the majority of investor capital in 2024, the overwhelming majority of new Canadian ETFs offered were actively managed,[2] and actively managed funds accounted for 42% of inflows in 2024.[3] Despite only representing 31% of assets under management (AUM) in the Canadian ETF market, actively managed ETFs continue to be an important growing trend.[4]

The growth of the number of and AUM attributable to actively managed ETFs suggests investors are interested in opportunities to outperform the market and may be willing to pay the higher management fees that typically accompany actively managed funds in order to do so. This growth has also been driven over the past several years by an increase in the supply and demand of thematic ETFs as investors seek to position their portfolios to capitalize on emerging trends and industries.

Increased regulatory scrutiny accompanied the increased demand for actively managed products. As product differentiation evolves, fund managers will want to ensure continuing adherence to their fiduciary obligations, including by ensuring transparency in disclosure of a fund's holdings and investment strategies, as they continue to offer innovative actively managed products.

Trend 2: The rise of alternative ETFs

In 2019, the Canadian Securities Administrators (the CSA) adopted amendments to National Instrument 81-102 *Investment Funds* (NI 81-102) through which the regulators provided greater access to alternative investment strategies to the retail market. An "alternative mutual fund" is defined under NI 81-102 as a mutual fund, other than a precious metals fund, that has adopted fundamental investment objectives that permit it to invested in physical commodities or specified derivatives, to borrow cash or engage in short selling in a manner not permitted for other mutual funds under NI 81-102.

Crypto ETFs

The Canadian market has been at the forefront of cryptocurrency regulation, led by efforts from various authorities, culminating in the approval and launch of the first bitcoin closed-end fund in April 2020 and subsequently the first bitcoin ETFs in 2021. The popularity and market demand for bitcoin ETFs was immediately evident with nearly C$600 million in AUM and C$1 billion in trading volume over the first 3 days after listing.[5] In an attempt to provide guidance and certainty around these new products, the CSA issued Staff Notice 81-336 Guidance on Crypto Asset Investment Funds That Are Reporting Issuers (Staff Notice 81-336) which classified all existing crypto ETFs as alternative mutual funds. Since then, the Canadian market for crypto ETFs has grown substantially, and certain managers have undertaken to release more complex offerings, such as leveraged crypto funds.

Like other alternative asset classes, liquidity is a primary concern amongst regulators, particularly within an uncertain economic climate. In fact, shortly after the launch of the first crypto funds, investors looking to reduce the risk exposure of their portfolios began to make significant redemptions in two bitcoin ETFs. Despite this, the fund managers were able to maintain sufficient liquidity to meet redemption requirements without the need to borrow additional funds.

In response to the quick adoption of these funds, and subsequent volatility experienced in both Canada and the U.S. after the failure of FTX Trading Ltd., the Ontario Securities Commission (the OSC) began to make inquiries into these redemptions and the market, with particular attention on the ownership, segregation and custodial structure of the assets being held and offered. These inquiries resulted in detailed guidance being set out in Staff Notice 81-336 regarding the assets, asset markets, custodial relationships, and staking standards that would be expected of an investment fund manager that intends to launch a crypto ETF. The CSA found that notwithstanding the rapid redemptions made in the Canadian market, the crypto markets for bitcoin and ether contained sufficient liquidity and could sustain volatility without causing operational disruptions.

Recent geopolitical developments have also created a headwind in the crypto ETF market. Leading up to the U.S. election, between September and October 2024, new inflows for Canadian crypto-ETFs grew 8.8%, to C$5.68 billion.[6] In the U.S., fueled by the establishment of a domestic strategic cryptocurrency reserve, bitcoin ETFs have been the fastest growing ETF class in history. In both markets, this hyper-growth has led other crypto-based funds to be formed, such as spot bitcoin, Ethereum-tracking and crypto index ETFs.

Canadian securities regulators have placed major emphasis on guidelines for platforms that facilitate cryptocurrency transactions. Specifically, the CSA is seeking to amend NI 81-102 to explicitly integrate public investment funds that invest in crypto assets into the existing alternative mutual fund framework, including by expanding the definition of “alternative mutual fund” to explicitly include them. Coupled with the measures outlined in Staff Notice 81-336 to ensure sufficient liquidity, stability and general investor protection, further amendments to the regulatory regime have the potential to further clarify what is becoming a fast growing market.

Of note, it would be encouraging to see Canadian securities regulators coordinate their efforts with Canadian tax regulators, particularly given the recent request for comment from the Department of Finance (Canada) on whether crypto-backed assets are appropriate as qualified investments for registered savings plans.[7]

Single stock ETFs

Since 2022, there has also been immense growth in the prevalence of single stock ETFs in both Canada and the U.S., with investment fund managers finding novel ways to provide access to some of the most in demand securities in the market. These ETFs, formed to provide investors with access to alternative strategies to generate greater returns on individual listed securities, such as option writing, leverage through cash borrowing and short-selling, have begun to garner popularity. From a Canadian perspective, just like traditional ETFs, these securities have the potential of opening up avenues for Canadian investors to access the largest U.S.-listed public companies without needing to purchase on a U.S. exchange.

An important note regarding single stock ETFs, however, is that not all are considered alternative ETFs since that determination is dependent on the investment strategies undertaken by the ETF.

The first to the market in Canada was a suite of ETFs that utilize a covered call strategy and moderate leverage to generate income for investors, while maintaining the capital upside of the underlying security. The objectives of these ETFs are to generate consistent income, while utilizing call options to create upside potential. Since then, there have been numerous other single stock ETFs launched to track issuers both domestically and in the U.S. These ETFs have received exemptive relief from the concentration restrictions under NI 81-102 to permit investing in a single issuer in excess of the prescribed investment restrictions, showing the willingness of Canadian securities regulators to be innovative.

Other than brief commentary by the OSC[8] and Nova Scotia Securities Commission,[9] Canadian regulators have been relatively quiet on single stock ETFs. However, there has been significant commentary south of the border. From a market standpoint, there is real concern about whether sufficient liquidity and stability exists to ensure proper investor protection. As with other ETFs, single-stock ETFs must be rebalanced on a daily basis, and regulators have warned that such rebalancing could lead to the ETF value diverging from that of the underlying security. Such movements in fund value could be particularly noticeable in volatile market conditions.

Furthermore, from an investor perspective, transparency and understandability of these products, and the technical mechanics behind deriving a return, may be blurred. While on the surface an ETF “tracking” a prominent equity security may seem relatively transparent, introducing leverage has the potential to magnify an already inherently risky investment. U.S. securities regulators have flagged that such products may put an advisor’s fiduciary obligation in recommending such products to the test if the speculative mechanisms implemented through leverage and other financial means could lead to adverse consequences.[10]

Trend 3: “Retail-izing ” private assets

We foresee the continuing development in Canada of the trend of attempting to offer ETFs that seek to invest a significant portion of their portfolios in private assets. In February of 2025, after State Street Corp. and Apollo Global Management Inc. jointly applied for approval, the first private credit ETF began trading on the New York Stock Exchange. The fund, according to U.S. securities law, may only hold 15% of its assets in illiquid securities, such as private credit. However, its managers contend that based on its liquidity structure, the fund may actually hold up to 35% in this asset class.[11] Despite some pushback, this launch was followed by other asset managers in the U.S. submitting applications for other “private asset ETFs”. Given the intense public coverage, and the possible risk-reward opportunities funds like this would create, we anticipate that it will be an important evolving trend in 2025 and beyond.

The demand for exposure to private assets is robust. The inherent high-risk high-reward structure creates opportunities for investors and managers alike by offering a wide variety of otherwise inaccessible asset classes managed by institutional professionals, including private credit, private equity, venture capital and infrastructure. Recent studies have shown that annual yields on direct lending hovered around 11%, while high-yield bonds and leveraged loans returned 6.8% and 5%, respectively. If the market for fixed income ETFs, representing nearly 30% of AUM in Canada, is an indication of investors’ desire for yield, increased rates-of-return over traditional asset classes could justify some of the inherent risks associated with private asset investments.

There are fundamental concerns relating to private asset funds, however, with the most pertinent being the potential for liquidity mismatch. Private asset ETFs are effectively illiquid assets in a liquid wrapper. There is a fundamental asymmetry between the exchange-traded asset created and sold to investors, and the underlying illiquid private asset. The immediate consequences of such an imbalance could result in issues with intraday trading and unintended pricing discounts in times of volatility, where supply of the assets increase without a reciprocal and immediate increase in demand. In such cases, fund managers may face difficulties in maintaining true pricing that reflects the actual value of the underlying assets, particularly when it is not based on the typical “proxy basket”. We do, however, note the private credit market is expected to exceed US$3.5 trillion by 2028,[12] leading participants to believe that there may well be sufficient liquidity to create a robust market in certain areas of the private asset space.

While the first private debt ETF was recently introduced in the U.S., it was immediately met with strong regulatory criticism by the U.S. Securities and Exchange Commission, the body that approved it, pointing to concerns about the fund’s liquidity and compliance with valuation rules.[13] This immediate pushback means that there remains a crucial question of which regulatory hurdles must and can be cleared. If these funds were to be launched in Canada, Canadian regulators will need to work through ensuring effective investor protection when determining whether to ease, or completely remove, the 15% cap placed on the proportion of illiquid assets a fund may hold under section 2.4 of NI 81-102.

An eye towards the future

The last 35 years have demonstrated that the Canadian ETF market remains resilient in the face of market uncertainty. An important trend for participants to watch over the coming years is the speed at which innovation is moving to meet investor demand in the context of an evolving legal and regulatory environment. We also anticipate the release of the CSA’s findings from its review of ETFs in Canada at some point this year which could play a significant role in shaping future developments in the Canadian ETF market.

Footnotes

[1] The Investment Funds Institute of Canada, *2024 Investment Funds Report* (Toronto: The Investment Funds Institute of Canada, 2024).

[2] Gillian Livingston, “Why asset managers continue to focus on active ETFs”, *The Globe and Mail* (October 27, 2024).

[3]> Andres Rincon, “Canada’s 2024 ETF Recap: A Year for the Record Books”, *TD Securities* (January 16, 2025).

[4] Supra note ii.

[5] Andres Rincon, “Bitcoin ETFs: A look back at a historic launch”, *TD Securities* (March 8, 2021).

[6] Vikram Barhat, "Can I Buy a Spot Bitcoin ETF in Canada as Trump's Crypto Push Reignites Rally?", *Morningstar* (January 23, 2025).

[7] This question was asked as part of the Qualified Investment consultation launched by the Department of Finance in 2024.

[8] "OSC Staff Notice 81-734, Summary Report for Investment Fund and Structured Product Issuers", *Ontario Securities Commission* (September 13, 2023).

[9] "What are single-stock ETFs", *Nova Scotia Securities Commission* (May 10, 2023).

[10] Commissioner Caroline A Crenshaw, "Statement on Single-Stock ETFs", *U.S. Securities and Exchange Commission* (July 11, 2022).

[11] Suzanne McGee, "U.S. regulators, in usual move, raise concerns about new private credit ETF", *Reuters* (February 18, 2025).

[12] Amanda Lynam & Dominique Bly, "Private Debt: The multi-faceted growth drivers", *Blackrock* (September 6, 2024).

[13] Of note, with the exit of SEC Chairman Gary Gensler, it is expected that the SEC under the new U.S. administration will have different priorities, which may influence this segment of the ETF industry.

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