

ETFs in the spotlight: The CSA review exchange-traded funds

October 05, 2023

In August 2023, the [Canadian Securities Administrators \(CSA\)](#) announced that they will be engaging in a review of exchange-traded funds (ETFs). The review—which is set to conclude before the end of 2023—will assess whether the current regulations applicable to ETFs remain appropriate. The CSA will determine whether consultations and/or regulatory changes are needed to enhance the current regulatory framework by focusing on how existing regulations interact with the unique features of ETFs, including:

- Secondary market trading;
- The creation/redemption mechanism and the corresponding role played by authorized dealers; and
- The arbitrage mechanism that acts to keep the market price of an ETF close to the underlying value of its portfolio.

In this article, we analyze international recommendations and best practices in the ETF space, informed by BLG's industry insights, to discuss what we see as potential areas of interest for the CSA's ETF review.

ETFs have become a popular investment vehicle, offering investors the opportunity to combine intraday liquidity on the secondary market with diversified exposure to a variety of assets classes and investment strategies. Canada is responsible for launching the world's first ETF over three decades ago, and ETFs have since experienced a rapid proliferation in investor demand and product offerings. Today, ETFs make up approximately 15 per cent of public investment fund assets in Canada.¹ The CSA suggest that ETFs' share of public investment fund assets will continue to grow, and that an appropriately tailored regulatory framework will foster competition and facilitate more investment choices for investors.

The CSA review will consider whether the best practices published by the International Organization of Securities Commissions (IOSCO) in their May 2023 [Good Practices Relating to the Implementation of the IOSCO Principles for Exchange Traded Funds](#) (Good Practices Report) are appropriate for the Canadian market. The Good Practices Report is intended to offer a set of best practices for consideration by regulators, ETF sponsors and trading venues with the development of eleven recommended measures

for consideration, which were designed to support IOSCO's [*Principles for the Regulation of Exchange Traded Funds*](#) released in 2013. IOSCO encourages regulators, ETF sponsors and trading venues to review and adopt these practices, where appropriate, within each jurisdiction's regulatory framework.

The measures proposed by IOSCO may provide the ETF industry with insight about the issues the CSA may review, as well as areas for potential regulation. These measures fall into four main categories:

1. Effective product structuring

Measure 1 – Range of asset classes and investment strategies: IOSCO encourages regulators and responsible entities to consider the range of asset classes and investment strategies that may be appropriate for the ETF structure. IOSCO recognizes that in most jurisdictions, the range of assets and strategies for ETFs are no different from their unlisted counterparts; however, IOSCO encourages regulators to consider whether a particular asset class or strategy is appropriate. We would be surprised if the CSA outright ban a particular asset class from using the ETF structure in Canada. IOSCO highlighted that certain jurisdictions have specific requirements designed to encourage product providers to identify the target market and consider investor interests in the design of their products. While similar requirements are not statutorily mandated in Canada, the decision in *Wright v. Horizons ETFS Management (Canada) Inc.* sheds light on the extent to which product suitability for particular investors is encompassed in a manager's duty of care, and the robust know your product (KYP) rules under National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*, which apply on the distribution side, necessitate managers to design products suitable for investors.

Measure 2 – Portfolio transparency: IOSCO encourages regulators to consider requirements regarding the transparency of an ETF's portfolio to facilitate effective arbitrage. IOSCO equates full daily portfolio transparency with facilitating an effective arbitrage mechanism, resulting in narrower premiums/discounts, tighter spreads and better liquidity in an ETF. They note that some jurisdictions impose daily public portfolio disclosure and make the same information available to all ETF investors and market participants. Canada's requirements tend towards lagged disclosure. Full portfolio holdings are required in financial statements issued twice annually, along with top 25 holdings on a quarterly basis. Full disclosure of the basket is permitted to market makers ahead of the public. For countries with lagging disclosure obligations, IOSCO encourages regulators to consider whether supplemental portfolio information may be needed on a timelier basis to facilitate effective arbitrage. Notably, in Canada, despite the lack of requirements to do so, the majority of index tracking ETFs voluntarily disclose portfolio holdings daily to the public on their websites. For active ETFs however, portfolio transparency impacts proprietary trading activities and is typically only provided to market makers on a confidential basis. It will be interesting to see how the CSA assess the current portfolio disclosure requirements on the effectiveness of the arbitrage mechanism in Canada and whether greater portfolio transparency may be mandated.

Measure 3 – Indicative net asset value (iNAV): For jurisdictions that mandate the provision of iNAV (a real-time estimate of intraday NAV), regulators and/or the trading venues are encouraged to consider how to enhance the accuracy and usefulness of

iNAV. iNAV isn't mandated in Canada currently, and we expect the CSA may assess the usefulness of this tool.

Measure 4 – Due diligence on designated brokers and dealers: ETF providers are encouraged to conduct initial and ongoing due diligence on designated brokers and dealers and to avoid exclusive arrangements with them if it may unduly affect the effectiveness of the arbitrage mechanism. IOSCO provides an outline of what should be assessed in this due diligence process, including reviewing financials, ownership structure and regulatory history, assessing hedging and inventory management capabilities, and assessing whether authorized dealers and market makers can support the arbitrage mechanism and liquidity both in normal markets and under stressed conditions. This due diligence outline is a helpful list for ETF providers to look at when supplementing their due diligence programs around designated broker and dealer selection.

Measure 5 – Arrangements for facilitating arbitrage: ETF providers are encouraged to put in place appropriate arrangements to facilitate an effective arbitrage mechanism. IOSCO provides examples of practices that may facilitate effective arbitrage, many of which are focused on having a wide roster of dealers for each ETF that are able to facilitate creations and redemptions, and that promote competition between those dealers. IOSCO also focuses on the need for portfolio transparency, encouraging ETF providers to provide portfolio transparency on a daily basis, even if not legally required.

Measure 6 – Conflicts management: IOSCO encourages regulators to consider whether the securities laws and exchange requirements appropriately address conflicts of interest, specifically those arising from affiliations between an ETF and designated brokers, dealers, index providers and counterparties. For example, IOSCO sees the potential for designated brokers and dealers to exert undue influence on affiliated managers, including pressure to construct creation baskets that favour the dealer to the detriment of the ETF. With the CSA's current focus on conflicts of interest, we expect the CSA to assess whether these affiliations lead to problematic conflicts. ETF managers should consider their relationships with these service providers and the steps taken to address any conflict, including bringing the conflict-of-interest matter to the IRC in compliance with National Instrument 81-107 *Independent Review Committee for Investment Funds*.

2. Disclosure

Measures 7, 8 and 9: IOSCO encourages regulators to consider appropriate requirements for the adequacy and appropriateness of disclosures of ETF-specific investment features and for the disclosures of fees and expenses for investing in ETFs. Additionally, regulators are encouraged to consider appropriate disclosure to help investors differentiate ETFs from unlisted funds. We note that the CSA already turned their minds to ETF disclosure issues when developing the ETF Facts. ETFs are required to dedicate a full section of the ETF Facts to explaining ETF trading, including a plain language description of the bid-ask spread and the difference between an ETF's market price and NAV. ETFs are also required to disclose trading data to help investors understand the ETF's liquidity and pricing data to help investors understand the costs associated with ETF investing. However, IOSCO highlights that certain jurisdictions, like the U.S., go further to require more timely disclosure of this sort of information, including daily disclosure of market price and premium or discount to NAV as of the end of the

prior business day. It will be interesting to see whether the CSA are satisfied with the level of disclosure we have in Canada, or if they see value in more frequent disclosure.

3. Liquidity

Measure 10: Regulators and trading venues are encouraged to monitor secondary market trading and market making activities and have rules governing the orderly trading of ETF securities. IOSCO identifies the fragmentation of trading venues as an impediment to assessing the true liquidity of an ETF. IOSCO also recommends contingency plans if a market maker withdraws from the market. How this recommendation is addressed by the CSA will be of great interest to exchanges, as well as ETF providers, in Canada.

4. Volatility control mechanism

Measure 11: Regulators and trading venues are encouraged to appropriately calibrate volatility control mechanisms (VCMs). In Canada, VCMs are triggered when trading prices cross certain pricing thresholds based on historical secondary market trading, whereas VCMs in other jurisdictions restrict the divergence of the ETF price from iNAV. It will be interesting to see whether the CSA conclude there are any issues with volatility controls in Canada, and whether there is any need to implement rules to narrow the gap between NAV and market price.

Other matters under review

Although not specifically addressed in the Good Practices Report, one area that needs to be addressed by the CSA is to clarify how the statutory rights of action under Canadian securities laws apply to ETF investors purchasing ETF securities on an exchange. This point has been highlighted in *Wright v. Horizons ETFs Management (Canada) Inc.* with the statements by Justice Perell that the current regulation of ETFs places “the distribution of ETFs in a problematic and uncertain state” that “may require legislative initiative to resolve”. The CSA are aware of this issue, and we anticipate that they may use the opportunity of this review to clarify that all persons who purchase ETF securities will be entitled to secondary market civil liability rights.

What to expect next

The CSA are still in the early stages of conducting their review, which is scheduled to continue through to the end of 2023. It is uncertain what sort of regulatory changes, if any, are expected to develop in Canada as a result of this review but we anticipate that the CSA will report on the effective health of the ETF industry in Canada and how this growing industry is supporting investors.

For any questions about the CSA review and its potential implications for your business and operations, please contact one of the authors or key contacts listed below.

This article was prepared with the assistance of Griffin Murphy, articling student-at-law with BLG.

¹ OSC Staff Notice 81-733 Summary Report for Investment Fund and Structured Product Issuers (Oct.19, 2022).

By

[Kathryn M. Fuller](#), [Melissa Ghislanzoni-Foster](#), [Lynn McGrade](#), [Whitney Wakeling](#), [Griffin Murphy](#)

Expertise

[Investment Management](#)

BLG | Canada's Law Firm

As the largest, truly full-service Canadian law firm, Borden Ladner Gervais LLP (BLG) delivers practical legal advice for domestic and international clients across more practices and industries than any Canadian firm. With over 800 lawyers, intellectual property agents and other professionals, BLG serves the legal needs of businesses and institutions across Canada and beyond – from M&A and capital markets, to disputes, financing, and trademark & patent registration.

blg.com

BLG Offices

Calgary

Centennial Place, East Tower
520 3rd Avenue S.W.
Calgary, AB, Canada
T2P 0R3

T 403.232.9500
F 403.266.1395

Ottawa

World Exchange Plaza
100 Queen Street
Ottawa, ON, Canada
K1P 1J9

T 613.237.5160
F 613.230.8842

Vancouver

1200 Waterfront Centre
200 Burrard Street
Vancouver, BC, Canada
V7X 1T2

T 604.687.5744
F 604.687.1415

Montréal

1000 De La Gauchetière Street West
Suite 900
Montréal, QC, Canada
H3B 5H4

T 514.954.2555
F 514.879.9015

Toronto

Bay Adelaide Centre, East Tower
22 Adelaide Street West
Toronto, ON, Canada
M5H 4E3

T 416.367.6000
F 416.367.6749

The information contained herein is of a general nature and is not intended to constitute legal advice, a complete statement of the law, or an opinion on any subject. No one should act upon it or refrain from acting without a thorough examination of the law after the facts of a specific situation are considered. You are urged to consult your legal adviser in cases of specific questions or concerns. BLG does not warrant or guarantee the accuracy, currency or completeness of this publication. No part of this publication may be reproduced without prior written permission of Borden Ladner Gervais LLP. If this publication was sent to you by BLG and you do not wish to receive further publications from BLG, you may ask to remove your contact information from our mailing lists by emailing unsubscribe@blg.com or manage your subscription preferences at blg.com/MyPreferences. If you feel you have received this message in error please contact communications@blg.com. BLG's privacy policy for publications may be found at blg.com/en/privacy.

© 2026 Borden Ladner Gervais LLP. Borden Ladner Gervais LLP is an Ontario Limited Liability Partnership.