

# Securities Analysts Journal®

January 2017.Vol. 55 No.1

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#### This month's focus: "Development of Exchange Traded Funds"

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#### Articles

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This paper discusses several characteristics of Japan's ETF market. More than 200 ETFs are listed but the top five, in terms of outstanding amount, account for approximately 70 percent of the market. Awareness of ETFs by ordinary investors is still low in spite of the rapidly growing market. The purchase of ETFs for monetary policy purposes by the Bank of Japan is strongly related to the growth of the market, translating into an increasing risk inherent in Japan. It is thus necessary to implement measures and policies to encourage greater use of ETFs by individual and institutional investors in order to expand the market.

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It is inevitable that institutional use of ETFs has increased tremendously in recent years in Japan. This article elaborates on the institutional use of ETFs from a global perspective, introducing the latest trends and case studies seen in the past one/two years: notably fixed income ETFs, smart beta ETFs, and factor-based investing.

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There are many concerns regarding the Bank of Japan's purchases of ETFs. Two major ones are: "Is there any inappropriate influence on stock price formation?" "Are there any problems in exercising voting rights or in terms of governance?" Findings showed there to be no problems. Takeaways in this context include: Do not be influenced by the mood; analyze the market with a calm mind; do not be overly anxious. However, monitoring must be maintained because the Bank of Japan is purchasing more and more ETFs.

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| <p>Counterparty risk occasioned by derivative transactions and securities lending, once considered as a risk for ETFs, is now understood as an issue not specific to ETFs. Liquidity risk attaching to open-ended funds caused by large redemptions is recognized to be rather small for ETFs. Regulatory issues specific to ETFs will, as an IOSCO report mentioned, include disclosure about characteristics of ETFs and addressing potential conflicts of interest raised by ETFs which use indexes designed specifically for the funds. In addition, issues concerning ETF secondary markets like bid/ask spreads and difference between market price and NAV will remain important.</p> |   |    |
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