

ETF Due Diligence Checklist

The Canadian ETF Marketplace has expanded significantly. With hundreds of Canadian listed ETFs currently available, it has become increasingly important for investors to understand how to evaluate ETFs.

Identifying the Right Provider

It is important to choose a trusted provider. As the industry matures, ETF closures may occur, putting greater importance on using established providers.

Key Questions:

- ☐ What is the firm's total assets under management (AUM) and total ETF AUM?
- ☐ How experienced is the firm in managing & launching ETFs?
- ☐ Does the firm provide direct access to Portfolio Managers and ETF Specialist?
- ☐ For any operational issues, what kind of product support can you expect?
- ☐ What resources does the firm have to provide relevant market insights? How often?
- ☐ What are firms policies? (Distributions and year end estimates.)
- ☐ How active is the firm in their advocacy and voting relative to their environmental, social, governance goals?

Considerations:

- AUM signals a provider's stability in the ETF marketplace
- Established providers can provide local support and ongoing insights to best use their products and help to get to answers quickly
- Timely market insights and on going education helps investors and their Advisors know their products better and how to effectively use them
- An experienced Portfolio Management team and long track records of products signal strong operational capabilities
- Sustainable distribution policies ensure stable and reliable yields for investors
- Active advocacy and voting ensures responsible stewardship of AUM.

Identifying the Right Exposure

Review the merits of portfolio construction to compare intended exposures with the expected outcomes of the ETF.

Key Questions:

- ☐ Are the investment objectives clearly defined and is the portfolio aligned?
- ☐ Is the index market cap weighted, rules based?
- ☐ Are the holdings available on a daily basis?
- ☐ Is the ETF concentrated in a few holdings, sectors or countries, or is it diversified?
- ☐ How tax efficient is the yield?

Considerations:

- Different index weightings can lead to variances in performance, change risk characteristics and can provide targeted exposures depending on investors goals
- Reporting holdings on a daily basis gives greater transparency to investors
- Investors should understand how diversified the ETF is in a particular sector or holding
- It's important to understand how much after tax yield the investor is actually receiving

Identifying the Right Structure

Key Questions:

- ☐ How many levels of withholding taxes are within the ETFs structure and are they recoverable?
- ☐ Does the ETF employ leverage?
- ☐ Is the risk aligned within your client objectives?
- ☐ What are the portfolio constraints to prevent over concentration in a sector or security?

Considerations:

- If the ETF holds international securities directly, foreign taxes can be claimed
- Investors need to understand the benefits and risks of leverage and how they are used to meet the investment objective of the ETF
- Determine what constraints are used to deliver effective portfolio construction

What is the ETFs Total Cost?

Evaluating total cost is a key consideration for ETFs. The longer the time horizon the greater the impact cost has on performance.

Key Questions:

- ❑ What is the ETF's total cost including TERs?
- ❑ What is the average bid/ask spread¹ on the ETF?
- ❑ How closely does the ETF track its index or exposure?

Considerations:

- For ongoing costs, investors should consider the management expense ratio (MER)², trading expense ratio (TER)³ and understand if there are any withholding taxes
- For trading ETFs, a smaller spread indicates a lower cost to enter and exit their positions
- The ETF should aim to tightly track its index with minimal return differences

Liquidity

Key Questions:

- ❑ What is the weighted average daily dollar volume of its underlying securities?
- ❑ Does the provider offer support to help investors receive the best execution?
- ❑ How has the ETF performed in stressed markets?

Considerations:

- Higher volume of the underlying securities means the ETF is liquid even if it has low trading volume
- The provider should frequently stress test for liquidity and minimize illiquid securities
- The provider should offer trade facilitation on large orders

Important Resources

- [ETF Comparison Tool](#)
- [ETF Tax FAQ](#)

¹ Bid-Ask Spread: When placing a trade a security, the bid ask spread is difference between the quotes to buy and sell. Or highest price that a buyer is willing to pay for an asset and the lowest price that a seller is willing to accept.

² Management expense ratio (MER): The overall total cost of managing and operating the fund, expressed as a percentage of the fund's assets

³ Trading expense ratio (TER): Calculating only the trading costs and dividing it by the average value of fund assets for the annual reporting period.

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