

ETF Due Diligence Checklist

Identifying the Right Provider

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 local support and on-going education?
- Is the provider a leader in the industry? What ETFs does the product shelf include: broad based, smart beta, fixed income, innovative solutions?
- When does the provider post tax parameters, monthly and year end distributions? Do they provide estimates?

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
- A diverse product shelf helps investors develop relationships and increase comfort with a provider
- It's important that tax numbers and distributions are timely and accessible to investors

Identifying the Right Exposure

Key Questions:

- Are the investment objectives clearly defined and is the portfolio aligned?
- Are the holdings available on a daily basis?
- Is the index widely recognized or does it provide an innovative exposure?
- How is the index weighted - market capitalization, rules based?
- Is the ETF concentrated in a few holdings, sectors or countries, or is it diversified?
- How tax efficient is the yield?

Considerations:

- Consistent portfolio construction rules make an ETF a transparent portfolio building tool
- Reporting holdings on a daily basis gives greater transparency to investors
- Investors may prefer known market barometers, or the ETF may be providing a specific exposure
- Different index weightings can lead to variances in performance, change risk characteristics and can provide targeted exposures depending on investors goals
- Investors should understand how diversified the ETF is in a particular sector or holding
- It's important to understand how much net yield the investor is actually receiving

Identifying the Right Structure

Key Questions:

- What method does the ETF use to track its index - Optimized, Replicated, Sampling?
- Does the provider offer securities lending on its product suite? What are the limits?
- How many levels of withholding taxes are within the ETFs structure and are they recoverable?
- Does the ETF hold derivatives?
- Is the ETF reliant on back tested data? Is there a track record and how has it performed over past market cycles?
- What are the constraints on the factor to ensure there isn't over concentration in securities or sectors?

Considerations:

- Full replication lowers tracking error, while optimization may be effective on certain indexes
- If the ETF holds international securities directly, foreign taxes can be claimed
- Investors need to understand the benefits and risks of derivatives and how they are used to meet the investment objective of the ETF
- Review if the ETF has delivered based on its expected performance.
- Determine what constraints are used to deliver effective portfolio construction.

What is the ETFs Total Cost?

Key Questions:

- What is the ETFs total cost?
- What is the average bid/ask spread on the ETF?
- How closely does the ETF track it's index or exposure?

Considerations:

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

Liquidity

Key Questions:

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

Considerations:

- Higher volume can indicate enhanced liquidity beyond the underlying portfolio
- 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
- Wide bid/ask spreads incur trading costs and should be compared within an asset class