

Covered Call ETF Due Diligence Checklist

Identifying the Right Provider

Key Questions:

- ☐ How broad is the provider's Covered Call ETFs product shelf?
- ☐ What is the firm's total Covered Call ETF assets under management (AUM)?
- ☐ How experienced is the firm in managing and launching Covered Call ETFs?
- ☐ Does the firm provide local support and ongoing education?
- ☐ Does the firm have a policy on sustainable distributions?

Identifying the Right Product

Key Questions:

ETF Structure

- ☐ What method does the ETF use to construct its underlying portfolio? Do they use a dividend methodology?
- ☐ What % of the portfolio are call options written on?
- ☐ How far out-the-money are call options written?
- ☐ Do you understand the implications of writing at-the-money options?
- ☐ How tax efficient is the yield?
- ☐ How transparent is portfolio construction and option overlay approach?
- ☐ Does the ETF employ leverage?
- ☐ Is the ETF reliant on back tested data? Is there a track record and how has it performed over past market cycles

Fees

- ☐ What is the ETFs total cost?
- ☐ Are there any embedded fees/double-dipping?
- ☐ Are Management Expense Ratios and Trading Expense Ratios included in the ETF Facts?
- ☐ What is the average daily dollar volume of the ETF?

Liquidity

- ☐ 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:

- A broad product shelf helps investors develop relationships and increase comfort with a provider.
- AUM signals a provider's stability in the ETF marketplace and economies of scale can help lower option trading costs.
- An experienced Portfolio Management team is more likely to have the requisite expertise to appropriately structure, manage and implement option overlays.
- Established providers can provide local support and ongoing insights to best use their products.

Considerations:

- A strong underlying dividend base allows for further out of the money calls' options to be written for better market appreciation.
- Striking the right balance between generating income and participating in rising markets depends on the % of the overwritten portfolio.
- Option premiums² are taxed as capital gains to provide tax efficient income³.
- A transparent rule based methodology and up to date option statistics can help investors gauge what is suitable for their portfolios.
- Investors need to understand the benefits and risks of leverage and how it is used to meet the investment objectives of the ETF.
- Additional funding required for leverage can put a drag on performance.
- Review if the ETF has delivered based on its expected performance.
- 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
- 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.

¹ **Option Moneyness:** Options can be written in, out, or at the money. This describes the distance between the strike price and the underlying asset price. The further the strike price is written from the underlying asset price (or out-the- money) the less likely the written call option will be exercised, leaving more room for asset appreciation.

² **Option Premiums:** The current market price of the call option and the income received by the seller or writer of the call option.

³ **Capital gains tax efficiency:** In Canada, 50% of the value of any capital gains is taxable relative to interest income which is 100% taxable.



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