iShares
by BlackRock

ETF DUE DILIGENCE CHECKLIST

Even if you only have a few minutes to make your assessment, the abbreviated checklist below can be used to do a quick analysis to help you identify the ETF that best fits your needs.

01 Exposure
What is the ETF's investment objective?

02 Structure
What are the implications of the ETF's structure?

03 Performance
How should you evaluate the performance of an ETF?

04 Taxes
Does the ETF comply with the required tax-reporting requirements?

05 Trading and Costs
Can you trade when you need to?
What is the total cost of ownership of the investment?

01 Exposure

QUESTIONS TO ASK

- [ ] What is the name and objective of the index that the ETF seeks to track?
- [ ] What is the underlying index methodology (component selection criteria, rebalancing, reconstitution, initial public offering, inclusion criteria, etc.)?
- [ ] How widely followed is the index and how long has it existed?
- [ ] How often are ETF holdings published?
- [ ] What is the base currency of its underlying securities?
- [ ] How closely has the ETF tracked its benchmark in the past?
- [ ] Does the ETF use leverage or inverse strategies?

02 Structure

QUESTIONS TO ASK

- [ ] What is the AUM of the ETF?
- [ ] What type of securities does the ETF hold? Does the ETF use physical or synthetic exposures to deliver performance?
- [ ] What is the ETF's method for tracking the index (replication, optimisation, representative sampling or other)? Why was this method chosen?
- [ ] Is securities lending utilised? If so, what are the collateralisation processes, risk management techniques and performance impact?
- [ ] Does the ETF use leverage or inverse strategies?

03 Performance

QUESTIONS TO ASK

- [ ] What experience and expertise does the provider have in developing, managing and supporting ETFs?
- [ ] Does the firm have sufficient relationships with market participants to ensure proper tracking, spread, internal transaction costs?
- [ ] What are the firm's risk management processes?
- [ ] What is the fund's tracking error? What is the fund's tracking difference? How should they be calculated?
- [ ] What is causing an ETF's tracking error/difference?
- [ ] What are other factors to consider when evaluating tracking error/difference?
- [ ] How does an ETF track in a crisis period?

04 Taxes

QUESTIONS TO ASK

- [ ] Does the ETF comply with the required tax-reporting requirements? How does it affect the investor?
- [ ] What is the basis for distribution payments?
- [ ] If hedging is applied, does the manage consider hedge accounting?
- [ ] Is there any tax leakage with the ETF structure?

05 Trading and Costs

QUESTIONS TO ASK

- [ ] What is the average daily volume for the ETF as well as its underlying securities?
- [ ] How is the ETF's liquidity managed, is the ETF covered by multiple market makers?
- [ ] How has liquidity been affected by market volatility in the past?
- [ ] Does the ETF provider offer resources to help advisers achieve the best possible execution for clients?
- [ ] What is the Management Fee?
- [ ] When is the underling market trading. For example, for underlying exposures on Asian markets, consider trading when those underlying markets are open
- [ ] Are there other fees reported in the product disclosure document that may impact the holding cost? (e.g. trading costs)
- [ ] How do the spread and volume factor into overall cost on a trade?

Frequently asked questions about ETF due diligence

WHAT KINDS OF ASSETS DO ETFs INVEST?

ETFs attempt to replicate an index like the S&P 500 or the MSCI World. When buying an ETF unit, you therefore invest in each individual company contained in the relevant index. Even though ETFs are traded like equities, you can also invest in ETFs that replicate bond, commodity, and real estate indices. All the major asset classes are covered by the ETFs and are also available for country-specific, regional, and global investment. They cover almost all sectors, including technology, telecommunications, renewable energy sources, and consumer goods. It is also possible to invest in government, corporate, or emerging market bonds via ETFs.

WHAT ARE THE RISKS ASSOCIATED WITH ETFS?

Investors should be aware that, like any other investment, ETFs are subject to risks. As there are many different types of ETFs, some funds are riskier than others. For international ETFs, fund returns may be affected by exchange rate fluctuations. Many ETFs hedge currencies to reduce this risk. There is also the risk that fund returns may deviate from the return of the index due to costs, cash holdings, additional returns or other factors.

ARE ALL ETFs IDENTICALLY STRUCTURED?

No. In general, there are two types of ETF structures, which differ in whether an ETF actually acquires ownership in the investments. A physically replicating ETF is an exchange-traded fund that holds all the securities contained in an index or (in the case of optimised funds) at least some of them. On the other hand, a synthetically replicating ETF only acquires a derivative (usually a swap) from a contracting party or counterparty, who has to provide a benchmark return payable to the ETF. Synthetically replicating funds are therefore dependent on their swap counterparty, which can increase their default risk. As a result, they may have a worse risk profile than a physically replicating fund. On the other hand, a major advantage of synthetically replicating ETFs is that they enable investments in markets closed to physically replicating funds, such as certain commodity markets or hard-to-access emerging markets.

Want to know more?

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