# Glossary of Exchange-Traded Fund and Other Related Financial Terms

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**actively managed ETF.** A fund with an investment objective that does not seek to track the return (or the inverse or a multiple of the return) of a particular index. Instead, the fund relies on fundamental research, quantitative modeling, technical analysis, or other factors or techniques to inform investment decisions designed to achieve its investment objective (e.g., capital appreciation, current income, or total return), which may include outperforming its benchmarks and/or peer group average. Contrast index-based ETF.

**arbitrage opportunity.** A scenario where an investor can take advantage of a price difference between two or more markets by simultaneously buying and selling securities, derivatives, or other assets to make a profit after transaction costs. For ETFs, arbitrage opportunities exist when the market price of the ETF is above or below its real-time net asset value (NAV), which is primarily determined by the market prices (or in certain circumstances, the fair value) of the securities held in the ETF's portfolio in addition to variable costs associated with the portfolio, such as taxes or currency conversions.

**authorized participant (AP).** A member or participant of a clearing agency registered with the SEC that has a written agreement with the ETF distributor or one of its service providers that allows the AP to place orders for the purchase and redemption of creation units directly with the fund in the primary market. An AP may act as principal and transact on its own behalf or as an agent to facilitate creations or redemptions on behalf of its clients.

**average daily volume (ADV).** The average number of shares of an ETF traded in the secondary market over a specified number of days. This figure is most commonly based on 20- or 30-day periods.

**basket.** The securities, cash, or other positions, plus a cash balancing amount, in exchange for which an ETF issues (or in return for which it redeems) creation units.

**bid/ask spread (bid/offer spread).** The difference between the highest price a buyer is willing to pay to purchase shares of the ETF (bid) and the lowest price a seller is willing to accept for shares of the ETF (ask or offer).

**cash balancing amount.** An amount of cash to account for any difference between the value of the securities or other positions in the basket and the NAV of one creation unit. This also may be referred to as *estimated cash* or *rounding cash*.

**commission.** Since ETF shares trade like stocks on national securities exchanges, ETF investors may pay fees to financial intermediaries when they buy or sell ETF shares. This fee is called a commission (or *brokerage commission*).

**Commodity Exchange Act of 1936.** An act regulating the trading of commodity futures in the United States and that requires futures to be traded on an organized exchange.

**Commodity Futures Trading Commission (CFTC).** An independent US government agency, created in 1974, that regulates the futures and options markets.

**commodity pool.** An enterprise in which funds contributed by a number of persons are combined for the purpose of trading futures contracts or options on futures, retail off-exchange foreign exchange contracts, or swaps, or to invest in another commodity pool. Commodity pools are regulated by the CFTC and the National Futures Association (NFA). Also known as *managed futures funds*. See also derivatives-based commodity ETFs.

**creation unit.** A specified number of ETF shares that the ETF will issue to (or redeem from) an AP in exchange for the deposit (or delivery) of a basket.

**custom basket.** Unlike a pricing basket, a custom basket may be composed of a nonrepresentative selection of the ETF's portfolio holdings (securities and other positions that do not reflect a pro rata representation of the ETF's portfolio holdings, a representative sample of the ETF's portfolio holdings, or changes resulting from a rebalancing or reconstitution of an index-based ETF's underlying index). See also pricing basket.

**Depository Trust Company (DTC).** Established in 1973, it is a subsidiary of the Depository Trust & Clearing Corporation (DTCC) that provides safekeeping through electronic recordkeeping of securities balances. Additionally, it acts as a clearinghouse to process and settle trades.

**derivatives-based commodity ETFs.** ETFs that invest in commodity derivatives, typically futures and/or options, to obtain exposure to commodities, including precious metals, oil and gas, and currencies. These ETFs are regulated primarily by the CFTC as commodity pools. They also register their securities with the SEC under the Securities Act and are subject to regulation by the national securities exchanges. See also commodity pool and physical commodity ETFs.

**discount.** Occurs when either: (1) an ETF's last price is lower than the concurrent NAV of the fund's portfolio holdings or (2) an ETF's closing price is lower than the end-of-day NAV of the fund.

**distributor.** The entity that sells/distributes ETF shares; often an affiliate of the ETF's sponsor. Distributors are registered under the Securities Exchange Act as broker-dealers, and are subject to strict rules governing how they offer and sell securities to the AP. The distributor's services are provided pursuant to a contract with the fund, and the distributor's compensation is typically tied, in part, to the assets of the fund. Also known as the *principal underwriter*.

**ETF agent.** An organization, usually a bank, that serves as the ETF's custodian by safeguarding the securities and other assets of the ETF; also often provides fund accounting, fund administration, and transfer agent services.

**ETF issuer.** Often the fund's investment adviser or its affiliate, this term generally describes the entity responsible for the management of the fund.

**ETF sponsor.** A term generally used to describe the entity responsible for the costs of operating the fund. The sponsor also may be the ETF issuer or a third party that has contracted with the ETF issuer to operate the fund.

**exchange-traded fund (ETF).** Typically, an investment company, either an open-end fund or unit investment trust (UIT), that issues (and redeems) shares only in creation units to (and from) APs in the primary market in exchange for a basket, and whose shares are listed on a national securities exchange and traded in the secondary market at market-determined prices. See also exchange-traded note.

**exchange-traded note (ETN).** An unsecured debt security, which, like a bond, can be held to maturity by an investor. These securities are registered under the Securities Act but not under the Investment Company Act. ETNs and ETFs are similar in that they both trade throughout the day on a national securities exchange. Also, like many ETFs, an ETN's value is linked to the performance of a given benchmark index or strategy; however, ETNs are not funds because they do not hold a pool of securities. Instead, an ETN's value depends on the creditworthiness of the ETN provider.

**exchange-traded product (ETP).** A financial product whose shares are listed on a national securities exchange and traded in the secondary market at market-determined prices. ETPs include, among others, ETFs and ETNs.

**expense ratio.** A measure of a fund's annual operating expenses paid by the shareholders, expressed as a percentage of the fund's net assets. This ratio is disclosed in the fund's prospectus and shareholder reports.

**Financial Industry Regulatory Authority (FINRA).** A self-regulatory organization created under the Securities Exchange Act and charged with regulating broker-dealers. To fulfill its responsibilities, FINRA adopts rules, conducts inspections, and imposes sanctions on broker-dealers that violate its rules. FINRA's activities are overseen by the SEC.

**implied liquidity.** The number (or value) of ETF shares that could theoretically be traded in a single day based on a percentage of the 30-day ADV of the ETF's basket constituents.

**income equalization.** Some ETFs may accrue income using an income equalization arrangement. This ensures the level of income accrued per fund share is not affected by the increase or decrease in shares outstanding that result from creation or redemption activity.

**index-based ETF.** A fund designed to track the performance of a specified index (for example, the S&P 500), or in some cases, a multiple of or an inverse (or multiple of an inverse) of an index. Compare with an actively managed ETF.

**index provider.** An entity that calculates and disseminates one or more indexes based on the performance of a basket of securities or other assets representing a specific segment of the global capital markets.

**in-kind creation or redemption.** A process by which an AP delivers securities (stocks, bonds, etc.) to the ETF in return for ETF shares during a creation and vice versa, receiving securities in return for ETF shares in a redemption. The AP is generally charged a create/redeem fee by the ETF to compensate the fund or its custodian for costs incurred as a result of the creation or redemption order (e.g., settlement costs).

**intraday indicative value (IIV).** A real-time delivery of an ETF's intraday value, usually based on the last price of the underlying securities. Third-party providers calculate and disseminate this measure every 15 to 60 seconds during securities market trading hours. Also known as *indicative optimized portfolio value (IOPV), intraday value, intraday net asset value (INAV),* or *indicative net asset value (INAV).*

**investment adviser.** The entity registered under the Advisers Act that is responsible for the management of a fund's day-to-day operations, including investment decisions, pursuant to a written contract with the fund. The investment adviser may delegate some or most of its responsibilities to another investment adviser, referred to as a *subadviser.*

**Investment Advisers Act of 1940 (Advisers Act).** This act requires all advisers to be registered investment companies and other large advisers (i.e., managing $110 million or more in client assets) to register with the SEC. The Advisers Act contains provisions requiring fund advisers to meet recordkeeping, custodial, disclosure, reporting, fiduciary, and other regulatory responsibilities.

**investment company.** A corporation, trust, partnership, or other entity that invests pooled shareholder dollars in securities appropriate to its objective. An investment company invests the money it receives from investors on a collective basis, and each investor shares in the profits and losses in proportion to the investor's interest in the investment company. Mutual funds (legally known as open-end companies), closed-end funds, UITs, and ETFs are the main types of SEC-registered investment companies.

**Investment Company Act of 1940 (Investment Company Act).** This act regulates registered investment companies through a combination of disclosure requirements and restrictions on day-to-day operations. Among other things, the Investment Company Act addresses investment company capital structures, custody of assets, investment activities (particularly with respect to transactions with affiliates and other transactions involving potential conflicts of interest), and the duties of fund boards.

**lead market maker (LMM).** The primary liquidity provider on an ETF's primary listing national securities exchange. The national securities exchange requires the LMM to meet minimum performance standards such as best bid and offer, minimum displayed time, and minimum quoted spread.

**leveraged/inverse ETF.** A fund that seeks investment results, before fees and expenses, that correspond to a stated multiple, inverse, or inverse multiple of the performance of a market index or benchmark over a fixed period. Most leveraged/inverse ETFs "reset" daily, meaning that they are designed to achieve their stated investment objectives on a daily basis. Also known as *geared ETFs*.

**liquidity.** The measure of the ability to convert a financial asset (e.g., stocks and bonds) into cash.

**market data vendors.** Entities that provide a wide variety of services to assist their clients with their trading activities.

**market maker.** An entity that quotes both a buy price (bid) and a sell price (ask) in a security or other financial instrument, hoping to make a profit on the difference between the bid and ask prices or other arbitrage opportunities. Market makers facilitate the exchange of securities between end investors by bridging the gap between the time when natural buyers and natural sellers enter the market. Market makers also help with price discovery by engaging in arbitrage, which helps keep an ETF's market price in line with its real-time NAV. Other entities can act in a market making capacity without being registered with a national securities exchange. These entities are commonly referred to as *liquidity providers*.

**National Securities Clearing Corporation (NSCC).** A subsidiary of the Depository Trust & Clearing Corporation (DTCC) that provides clearing, settlement, risk management, and central counterparty services. The NSCC also guarantees the completion for certain transactions for virtually all broker-to-broker trades involving equities, corporate and municipal debt, American depositary receipts, ETFs, and UITs.

**national securities exchange (or stock exchange or listing exchange).** A securities exchange that has registered with the SEC under the Securities Exchange Act where brokers and traders can buy and sell securities, such as shares of stock and bonds and other financial instruments. Securities traded on a stock exchange include stock issued by listed companies, unit trusts, derivatives, pooled investment products (such as ETFs and closed-end funds) and bonds. Examples of national securities exchanges include the Cboe Global Markets, Inc., the Nasdaq, and the New York Stock Exchange. In the United States, ETFs typically are listed on the NYSE Arca, Inc., the Nasdaq Stock Market, LLC, or the Cboe BZX Exchange, Inc.

**net asset value (NAV).** The per-share value of an investment company, calculated by dividing the total assets, minus liabilities, allocated to the share class by the number of fund shares outstanding for that class. ETFs calculate their NAVs at least once daily on each day the financial markets are open.

**physical commodity ETFs.** An ETF that holds physical commodities, typically precious metals or currencies. These ETFs register their securities with the SEC under the Securities Act and are subject to regulation by the national securities exchanges. Contrast derivatives-based commodity ETFs.

**premium.** Occurs when either: (1) an ETF's last price is higher than the concurrent NAV of the fund's portfolio holdings or (2) an ETF's closing price is higher than the end-of-day NAV of the fund.

**pricing basket.** A basket that is generally a representation of the ETF's portfolio holdings. Contrast custom basket.

**primary market.** Capital market that deals with the issuance of new securities. The number of ETF shares outstanding can increase or decrease through the creation (issuance) of new shares or redemption of existing shares through the primary market. An AP conducts these creation/redemption transactions directly with the ETF. Contrast secondary market.

**redeemable securities.** Securities that any holder may present to the issuer in exchange for approximately his/her share of the issuer's current net assets.

**secondary market.** A financial market, such as a national securities exchange, in which previously issued financial instruments such as stocks, bonds, ETFs, options, and futures are bought and sold. Contrast primary market.

**Securities Act of 1933 (Securities Act).** This act regulates public offerings of securities, including investment company shares. The Securities Act also requires that all investors receive a current prospectus that describes the fund.

**Securities and Exchange Commission (SEC).** The primary US government agency responsible for the regulation of day-to-day operations and disclosure obligations of registered investment companies as well as the regulation of securities markets, trading venues, and broker-dealers.

**Securities Exchange Act of 1934 (Securities Exchange Act).** This act regulates the trading, purchase, and sale of securities, including investment company shares. The Securities Exchange Act also regulates broker-dealers, including investment company principal underwriters and others that sell investment company shares, and requires them to register with the SEC.

**self-indexed ETF.** An index-based ETF that tracks an index for which an "affiliated person," as defined in Section 2(a)(3) of the Investment Company Act, or an affiliated person of an affiliated person, of the investment company, the investment adviser, the subadviser, the distributor, or a sponsor of the ETF will serve as the index provider. Self-indexed ETFs may have additional requirements to ensure the independence of the index methodology, and to distinguish from actively managed ETFs, including the hiring of a third-party index calculation agent and daily portfolio holdings disclosure requirements.

**tracking error.** A risk statistic that measures the annualized variability of return between an ETF and the index it intends to track. It provides a standardized metric for how reliably the ETF met its index-tracking objective. This statistic is often calculated on the ETF's NAV and closing price. Results can be skewed by application of fair valuation methodologies to portfolio holdings when the index is calculated using closing prices, which is usually the case.

**trading volume.** The number of shares or contracts traded on a security. Volume data are tracked and reported daily by major stock exchanges.

**Undertakings for the Collective Investment in Transferable Securities (UCITS).** A European Commission regulatory framework that creates a harmonized regime throughout Europe for the management and sale of retail investment funds.

**unit investment trust (UIT).** A type of fund that blends characteristics of mutual funds and closed-end funds. Like mutual funds, UITs issue redeemable units. UITs often issue only a specific, fixed number of units, like closed-end funds. A UIT does not actively trade its investment portfolio. Instead it buys and holds a fixed portfolio of securities until the UIT's set termination date, at which time the trust is dissolved and proceeds are paid to shareholders.

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