NBI ETF FAQ

What is an exchange-traded fund (ETF) and how does it differ from a mutual fund?

› Much like a regular mutual fund, an ETF may invest in an underlying pool of assets such as stocks, bonds, currencies, options or commodities. Unlike regular mutual funds, however, the units of ETFs are listed and trade on a stock exchange just like common stock. This means that pricing is transparent and ETF units can be bought and sold throughout the regular trading day.

› ETFs are flexible investment tools designed to be used by both individual and institutional investors. As a basket of investments, ETFs offer the diversification of mutual funds, but typically at a fraction of their cost.

› Each ETF has a designated broker obligated to create and redeem its units. In addition, there are other institutional traders, known as market makers, which also participate in the market to provide units on the exchange. This enables an investor to buy and sell units of the ETF at a price that is close to the Net Asset Value (NAV) unit price.

What is the difference between the NAV and price?

› All ETFs have two end-of-day "values". They have a closing market price per unit, as determined on the exchange, (the trading session's last trade), and a NAV per unit, as determined by the ETF's accounting process after the market closes.

› The closing price is typically the last transaction price of the ETF recorded by the stock exchange, whereas the NAV per unit is an independent calculation created by the ETF's fund accountant, which calculates the market value of each unit based on the underlying value of the securities held by the ETF net of all its liabilities.

› Since there may be a lag between the last time the ETF traded and changes in the underlying value of the ETF's holdings, the NAV per unit would generally be considered a more accurate representation of the market value of the ETF.

How is the trading price of an ETF determined?

› The trading price of an ETF is expected to be approximately equal to the trading value of the underlying securities held in the fund plus any undistributed net income, less fees and expenses. The ETF's market value will trade during the day based on supply and demand, but generally is expected to trade at or close to the fund's NAV.

Why does an ETF trade at a premium or discount to its NAV?

› A premium or discount to an ETF's NAV per unit occurs when the market price of an ETF is above or below that NAV per unit. If the market price is higher than the NAV, the ETF is said to be trading at a "premium". If the price is lower, it is trading at a "discount".

› The importance of understanding a premium and a discount is relevant when considering investing in an ETF. The level or size of premiums and discounts is generally greater when:

- the underlying assets of the ETF trade at different hours from the ETF (i.e. commodities)
- the underlying assets trade infrequently (e.g. bonds)
- the markets are in a greater state of uncertainty or volatility (e.g. at the open and close of a trading day)

What is the difference between a bid and offer and why is there a spread?

› Considering an ETF is traded on an exchange and has a volume and liquidity properties; at any given time during trading hours there are two prices for an ETF. The price that someone is willing to buy the ETF is referred to as the "bid"; and the price that someone is willing to sell the ETF is known as the "ask". The difference between these two prices is measured as the bid-ask spread.

› Bid-ask spreads can differ depending on certain factors:

1. **Similar spreads on the underlying securities**
   - Determining how liquid the underlying assets and securities held in the ETF will determine how liquid the ETF is and as such will have a narrow or large spread. As such, if the underlying securities in the ETF are very liquid, it is safe to say that the ETF itself will be very liquid and will have a small spread (i.e. basket of large-cap stocks).
2. **Cost of portfolio construction and trading**
   - ETFs that invest in foreign securities will have additional costs associated; such as foreign currency exchanges and or foreign holding taxes.
3. **Trading volume**
   - An investor willing to make a very large purchase of an ETF may force the market maker to generate more units of the ETF causing a spike in demand which would ultimately drive the "ask" price higher. This action is called "market impact costs."

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4. **Market risks**
   - Bid-ask spreads can also widen during times of increased market volatility. If market makers are required to take extra steps to facilitate their trades during periods of volatility, spreads of the underlying securities may be wider, which will mean wider spreads on the ETF.

What are "actively managed ETFs"?

› Active ETFs combine the benefits of active management with the traditional structural advantages of ETFs, which results in lower fees, greater flexibility, liquidity, and convenience.

› They also seek to deliver better risk-adjusted returns than an index counterpart by selecting the portfolio securities for the ETF that meet its investment goals.

Do active ETFs pay distributions?

› All of NBI's actively managed ETFs can make distributions. The distribution frequency (if any) and amounts are available on NBI's website via the active ETF price and performance page.

What are the costs associated with ETFs?

› Similar to fees surrounding a mutual fund, ETFs also incur expenses related to the management of the fund.

› **Management Expense Ratio (MER):** The percentage of a fund's average net assets paid out of the fund each year to cover the day-to-day and fixed costs of managing the fund. The figure is reported in the Fund's annual management report of fund performance. MER includes all management fees and GST/HST paid by the fund for the period, including fees paid indirectly as a result of holding other ETFs.

› **Management fee:** The annual fee payable by the fund to the manager of the fund (e.g. RBC Global Asset Management) for acting as trustee and manager of the fund. This fee forms the largest portion of the MER. Included in the Management Fee are the costs associated with paying the custodian and valuation agents, registrar and transfer agents, and any other service providers retained by the manager.

› **Operating expenses:** Other operating costs such as fees associated with complying with national regulations and the fees payable to members of the board of governors of the ETFs.

Comparative example of costs – Mutual funds vs ETFs

	MER	Commission per trade	Number of transaction	Total Commission	Total MER ($)	Total Cost after a year
Scenario 1: $1,000 to invest and $250 per month of contribution						
Fund	1.20%				$30.00	**$30.00**
ETF	0.95%	$9.99	13	$129.87	$23.75	$153.62
Scenario 2: $10,000 to invest and $250 per month of contribution						
Fund	1.20%				$138.00	**$138.00**
ETF	0.95%	$9.99	13	$129.87	$109.25	$239.12
Scenario 3: $100,000 to invest and $250 per month of contribution						
Fund	1.20%				$1,218.00	$1,218.00
ETF	0.95%	$9.99	13	$129.87	$964.25	**$1,094.12**

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