

# iSHARES INVESTIGATES: THE ETF ECOSYSTEM

## Part 2 | Authorized participants by the numbers

The rapid growth of exchange trade funds (ETFs) is supported by a robust, dynamic “ecosystem” made up of many players. Among the key contributors to smooth ETF operations are authorized participants (APs). These financial institutions work with ETF issuers to create and redeem shares in the primary market.

To learn more about the role of authorized participants, see [Part 1](#).

This paper looks deeper into the U.S. ETF ecosystem to analyze the breadth and scope of the AP universe. It draws on data disclosed by fund companies annually, as required by the Securities and Exchange Commission (SEC).<sup>1</sup>

## A broad, diverse universe

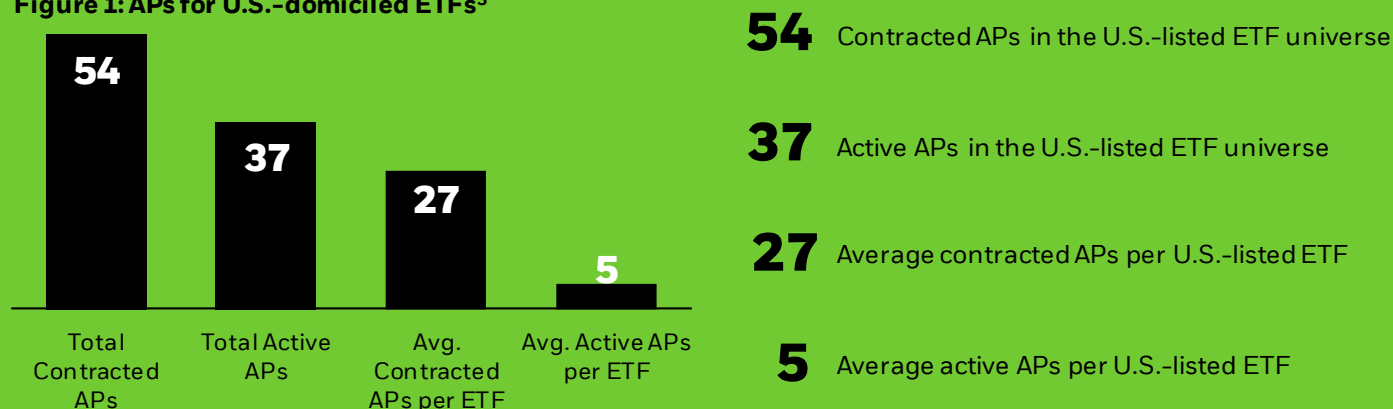
Most ETFs are supported by numerous APs. On average, U.S.-domiciled ETFs have 27 “contracted” APs and five “active” APs (**Figure 1**).

A contracted AP has an effective agreement in place with an ETF issuer, even if the AP does not regularly create or redeem ETF shares. An active AP has created or redeemed shares of an ETF within the fund’s most recent fiscal year.<sup>2</sup>

Not all APs are active at the same time.

For example, some institutions may complete formal paperwork to become an AP so they can participate when they see opportunities to profit. This presence of contracted APs helps ensure vibrant competition exists to provide ETF creation and redemption services. If an active AP were to step away, another contracted AP could step in to execute creation and redemption activity—even if they hadn’t been active in the fund previously.

**Figure 1: APs for U.S.-domiciled ETFs<sup>3</sup>**



<sup>1</sup> Form N-CEN was proposed by the SEC in October 2016, with a compliance date of June 1, 2018. For more information on Form N-CEN see <https://www.sec.gov/rules/final/2016/33-10231.pdf> <sup>2</sup> As reported in Form N-CEN; see ‘Important Notes’ <sup>3</sup> Source: BlackRock, Form N-CEN. Retrieved from SEC EDGAR database <https://www.sec.gov/edgar/searchedgar/webusers.htm>. As of 03/27/2020.

## Size matters

Because larger funds—those with more assets under management (AUM)—typically have higher trading volumes, they tend to be supported by a greater number of APs than funds with smaller AUM (**Figure 2**).

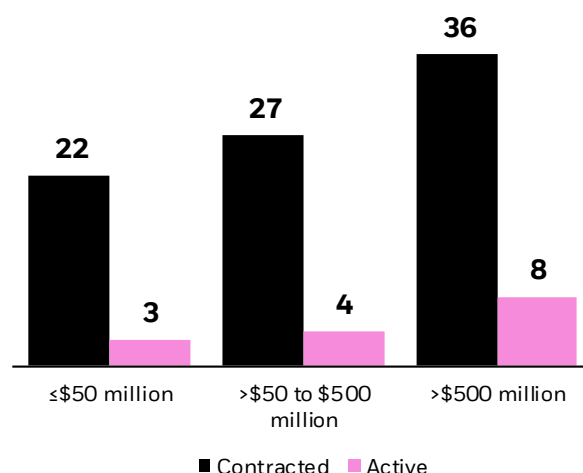
In fact, it is not uncommon for small funds to have limited or no primary market activity.

There were no creations or redemptions over the reporting period in nearly 7% of funds with \$50 million or less in assets.<sup>4</sup>

Generally, increased trading volumes result in a higher number of active APs.

For example, funds that had an average daily volume (ADV) of \$100 million or more had an average of 12 active APs over the reporting period, while funds with an ADV of \$2 million or less had an average of three active APs.<sup>5</sup>

**Figure 2: Average contracted and active APs by ETF AUM<sup>6</sup>**

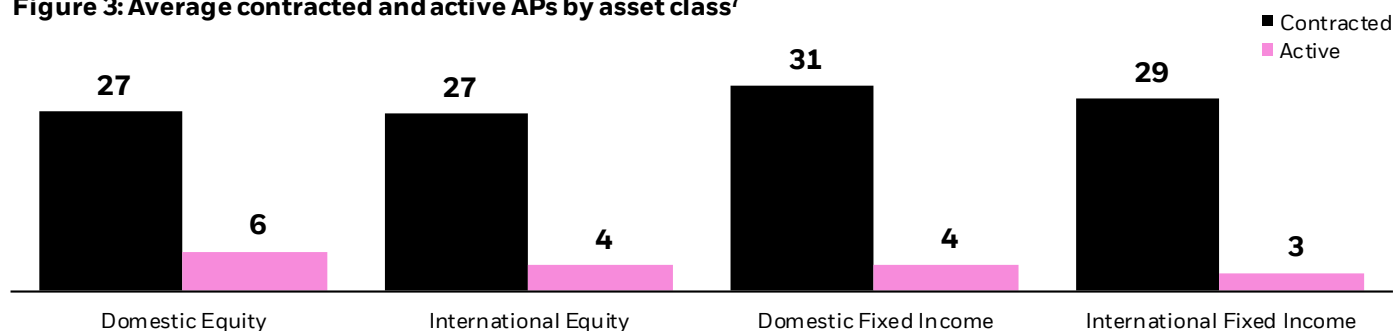


## Participation across asset classes

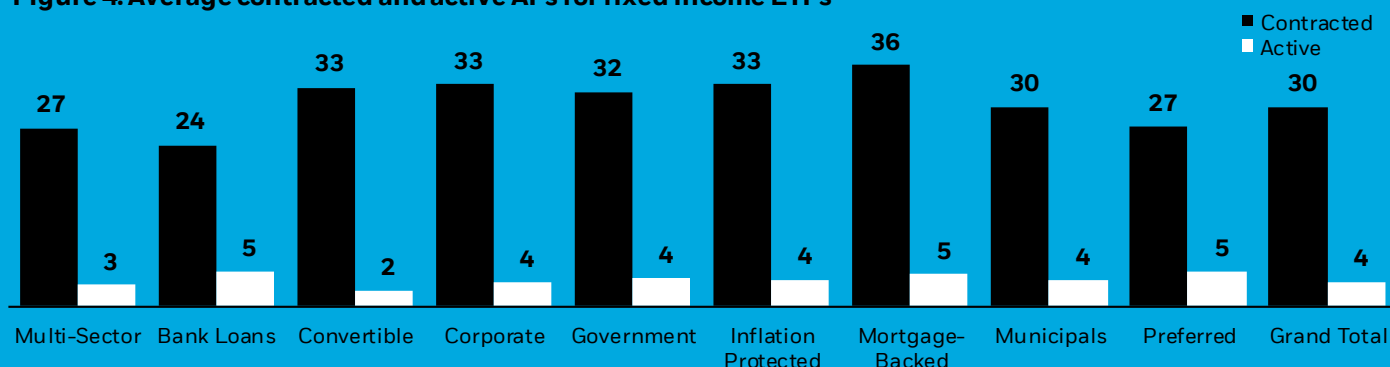
Some asset classes require specialized infrastructure and/or expertise, resulting in fewer APs that are equipped to support these funds.

Still, there's a robust group of APs at the ready even in these more complex products.

**Figure 3: Average contracted and active APs by asset class<sup>7</sup>**



**Figure 4: Average contracted and active APs for fixed income ETFs<sup>8</sup>**



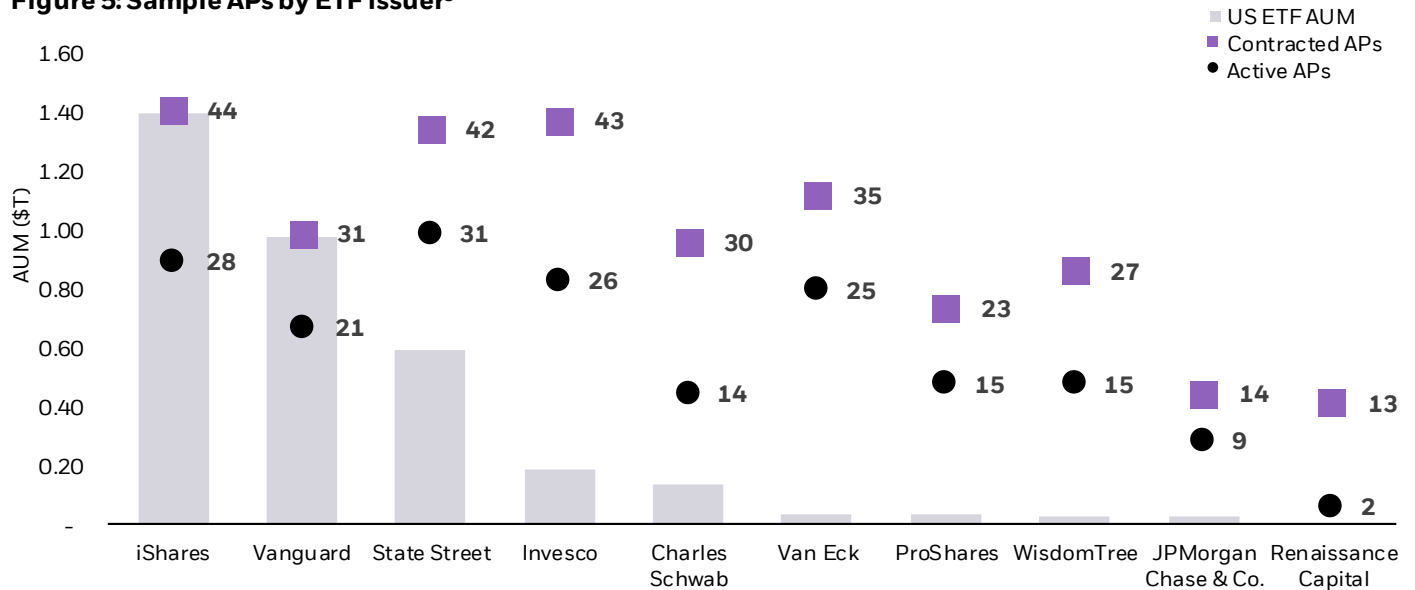
<sup>4</sup> Source: Bloomberg, BlackRock, Form N-CEN. As of 03/27/2020. <sup>5</sup> Source: Bloomberg, BlackRock, Form N-CEN. As of 03/27/2020. <sup>6</sup> Source: Bloomberg, BlackRock, Form N-CEN. As of 03/27/2020. <sup>7</sup> Source: Markit, BlackRock, Form N-CEN. As of 03/27/2020. <sup>8</sup> Source: Markit, BlackRock, Form N-CEN. As of 03/27/2020.

# Engagement between ETF issuers and APs

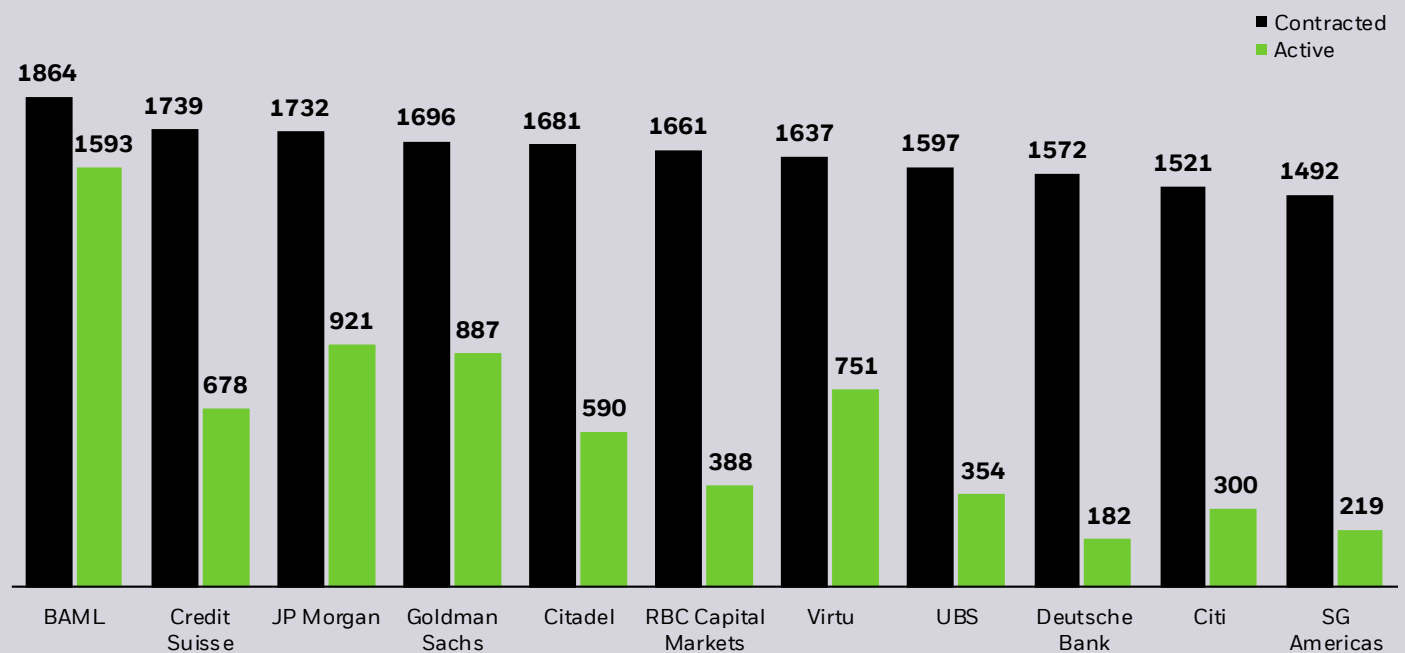
Even small ETF issuers by AUM utilize the breadth of the ETF marketplace and engage with multiple APs (**Figure 5**).

APs capitalize on the wide range of ETF offerings. The top APs have contracts for 1,500 to 1,900 ETFs each, and actively engage with anywhere between 180 and 1,600 ETFs (**Figure 6**).

**Figure 5: Sample APs by ETF issuer<sup>9</sup>**



**Figure 6: ETF ticker coverage for the top ten APs<sup>10</sup>**



<sup>9</sup> Source: BlackRock, Form N-CEN. As of 03/27/2020. <sup>10</sup> Source: Bloomberg, BlackRock, Form N-CEN. As of 03/27/2020.

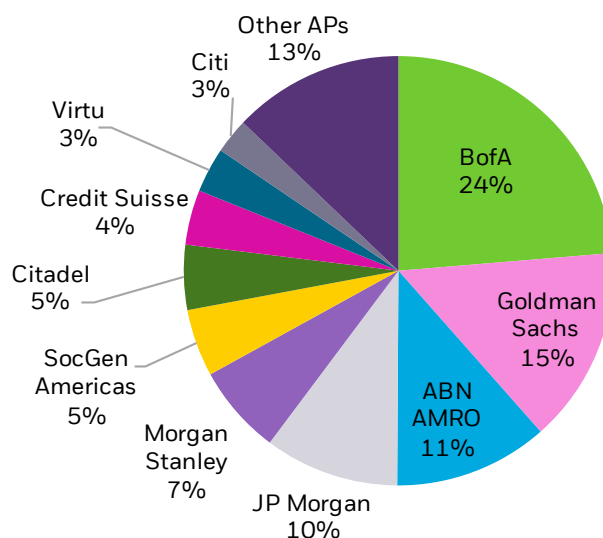
## A diverse playing field

The breadth of the AP universe should assuage concerns that ETFs rely too heavily on a limited number of institutions. Indeed, total creation and redemption activity is spread across dozens of APs.

In total, 37 APs created and redeemed shares over the reporting period.

The AP with the highest percentage of activity, Bank of America Securities (BofA), accounted for less than one-quarter of all ETF creations and redemptions by dollar value (**Figure 7**).

**Figure 7: Gross creation and redemption activity by AP<sup>11</sup>**

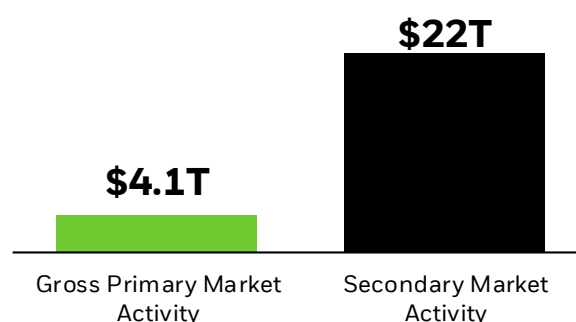


## The real activity is on-exchange

APs are key contributors to smooth ETF operations, but they are responsible for only a small percentage of ETF activity.

The ratio of secondary market activity to primary market activity is 5:1. This means that for every \$5 of trading that takes place between investors on exchange, only \$1 flows through into the primary market.<sup>12</sup>

**Figure 8: Industry primary and secondary market activity<sup>13</sup>**



## The bottom line

ETF creations and redemptions are spread over a large and diverse base of APs. ETF issuers of all sizes generally have agreements in place with a multitude of APs, and while every AP is not always active in all funds at the same time, additional APs stand ready to step in when opportunities arise.

Larger funds, by assets and by trading volume, may typically have more APs than smaller funds, but even small funds take advantage of the scope of the AP universe.

ETFs that invest in complex asset classes also leverage the existence of multiple APs.

Overall, this broad engagement by APs supports a healthy ETF ecosystem.

<sup>11</sup> Source: BlackRock, Form N-CEN. As of 03/27/2020. <sup>12</sup> Source: Bloomberg, BlackRock, Form N-CEN. As of 03/27/2020. <sup>13</sup> Source: Bloomberg, BlackRock, Form N-CEN. As of 03/27/2020.

## Important notes:

Data in this paper, unless otherwise noted, was compiled using Form N-CEN disclosures, publicly available at <https://www.sec.gov/edgar.shtml>. Additional information on Form N-CEN is available at <https://www.sec.gov/files/formn-cen.pdf>

Only funds subject to the Investment Company Act of 1940 are required to file Form N-CEN disclosures. As of March 27, 2020, ETFs representing 99% of eligible ETF AUM have filed Form N-CEN.

Funds captured in this analysis must have: a) filed a Form N-CEN prior to March 27, 2020 and b) still been active (i.e., had not been liquidated or delisted) as of March 27, 2020.

Form N-CEN filings may have different reporting periods based on the reporting fund's fiscal year-end or legal structure.

Form N-CEN data in this paper covers forms with report ending periods from January 1, 2019 to December 31, 2019.

All reporting ETFs were aggregated to the issuer's parent company.

Authorized participant filing names were aggregated under the institution's primary legal entity.

Gross notional value was calculated by summing the reported "Authorized Participant Purchase Value" and "Authorized Participant Redeem Value" fields of Form N-CEN.

Bloomberg fund strategy data was used for asset class categorization.

# ETFs and mutual funds: Know the differences

- **Strategy:** Fund management styles are typically categorized as “active” or “index”. Active funds (most mutual funds) seek to outperform market indices, while “index” funds (some mutual funds and most ETFs) seek to match the fund’s performance to an established market index, such as the S&P 500.
- **Trading:** Mutual funds are bought and sold directly from the mutual fund company at the current day’s closing price, or the Net Asset Value (NAV). ETFs are traded throughout the day at the current market price, like a stock, and may cost slightly more or less than NAV. Mutual fund transactions do not include commissions to a brokerage, while some ETF transactions do.
- **Transaction fees:** For mutual funds, transaction fees may include sales charges (sales loads) or redemption fees. These are paid directly by investors. ETF transactions may include brokerage commissions (like stocks), which are paid directly by investors.
- **Tax implications:** Mutual fund shareholders redeem shares directly from the fund, so the fund manager must often sell fund securities to honor redemptions, potentially triggering capital gains for the fund’s remaining shareholders. Because ETF investors buy and sell shares with other investors on an exchange, the ETF manager doesn’t have to sell holdings – potentially creating capital gains – to meet investor redemptions. ETF shareholders can incur tax consequences when they sell shares on the exchange, but that tax consequence is not passed on to other ETF shareholders.
- **Transparency:** ETFs generally disclose holdings daily. Mutual funds generally disclose holdings quarterly.

	Mutual Funds	Index Mutual Funds	ETFs	Stocks
Diversified	✓	✓	✓	
Traded on exchange			✓	✓
Intraday pricing			✓	✓
Intraday trading			✓	✓
Management fees	✓	✓	✓	
Commission fees			✓	✓
Tax management*			✓	✓
Index-tracking		✓	✓	

\* Due to fund structure, mutual fund holders may be subject to taxable capital gains distributions due to other investors’ redemptions directly to the mutual fund. Taxable capital gain distributions can occur to ETF investors based on stocks trading within the fund as the ETF creates and redeems shares and rebalances its holdings. ETFs and stocks will also distribute taxable capital gains when an investor sells their own shares. Certain traditional mutual funds can also be tax efficient.

## Risks

**Capital at risk.** The value of investments and the income from them can fall as well as rise and are not guaranteed. Investors may not get back the amount originally invested.

Past performance is not a reliable indicator of current or future results and should not be the sole factor of consideration when selecting a product or strategy.

Changes in the rates of exchange between currencies may cause the value of investments to diminish or increase. Fluctuation may be particularly marked in the case of a higher volatility fund and the value of an investment may fall suddenly and substantially. Levels and basis of taxation may change from time to time.

All figures are denominated in U.S. dollars, unless otherwise noted.

### ***Important Information about iShares ETFs***

**For U.S. investors: Carefully consider the Funds' investment objectives, risk factors, and charges and expenses before investing. This and other information can be found in the Funds' prospectuses or, if available, the summary prospectuses which may be obtained by visiting [www.iShares.com](http://www.iShares.com) or [www.blackrock.com](http://www.blackrock.com). Read the prospectus carefully before investing.**

### **Investing involves risk, including possible loss of principal.**

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Shares of iShares ETFs may be bought and sold throughout the day on the exchange through any brokerage account. Shares are not individually redeemable from the ETF, however, shares may be redeemed directly from an ETF by Authorized Participants, in very large creation/redemption units.

Although market makers will generally take advantage of differences between the NAV and the trading price of iShares ETF shares through arbitrage opportunities, there is no guarantee that they will do so.

Buying and selling shares of ETFs may result in brokerage commissions. Diversification may not protect against market risk or loss of principal.

There can be no assurance that an active trading market for shares of an ETF will develop or be maintained.

Investment comparisons are for illustrative purposes only. To better understand the similarities and differences between investments, including investment objectives, risks, fees and expenses, it is important to read the products' prospectuses.

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