

When ETFs shut down

Even as investors flock to exchange-traded funds (ETFs) and exchange-traded notes (ETNs), more of them are closing their doors.

Last year, a record 128 ETFs and ETNs were shuttered, up from 101 in 2015. Roughly one-quarter of the more than 2,700 ETFs and ETNs ever launched no longer trade. Closings largely stem from a lack of commercial success, as many funds don't attract enough money to be profitable for fund providers. In some cases, entire fund companies folded after closing all their funds.

Brokers typically notify shareholders when a fund is closing. While timing depends on the fund provider, investors generally receive a two- to six-week warning.

You have two options if one of your funds announces it is closing. For a commission, you can sell in the open market prior to the closing date, just like under normal trading. Funds on the chopping block may see their bid-ask spreads widen, so we recommend you use limit orders, which are executed at a specific price. Before setting a limit order, it's helpful to learn the approximate per-share value of a fund's underlying holdings. Called the intraday indicative value, it shows the reasonableness of a fund's market price. To find the value, use a fund's ticker with "IV" added at the end.

The lazy option — and one we don't recommend — is to do nothing. Investors who hold onto a fund will typically have their shares automatically liquidated for cash based on net asset value (NAV) on the last day of operation. While liquidating avoids a commission, the ending cash value might differ from the final market price. Moreover, cash values may be reduced by expenses incurred to sell holdings and wind down operations. In rare cases, a fund may be delisted and not liquidated, forcing investors to sell shares in the over-the-counter market, a process that can be difficult.

For income-tax purposes, the outright sale or liquidation of a fund will generate a gain or loss depending on an investor's cost basis. A liquidated fund may also distribute a capital gain from the sale of its securities.