CAPITAL GROUP®

Custom in-kind baskets:

A powerful tool for ETF tax efficiency

Key takeaway

Custom in-kind baskets (CIBs) give ETF portfolio managers targeted precision over what goes into the **in-kind redemption basket**, allowing managers to remove unwanted positions and deliver out holdings with embedded gains, which can help reduce – and in some cases avoid – capital gain distributions for shareholders.

ETFs offer improved tax efficiency, transparency and intraday tradability compared to mutual funds. The tax efficiency largely comes from the **creation/redemption mechanism**: when shares are redeemed in-kind, the ETF manager can meet flows and minimize embedded gains without selling securities in the market (which would be a taxable event). CIBs amplify this mechanism by allowing the issuer to choose which holdings go into the in-kind basket – enabling more precise, tax-aware portfolio adjustments.

Understanding custom in-kind baskets

In-kind transactions use a "basket" of securities (or a combination of cash and securities) exchanged between the ETF and an **authorized participant (AP)**. In a standard create/redeem process, the basket generally represents a **pro-rata** slice of the ETF's complete holdings. A custom basket can be non-representative, meaning an ETF manager can choose which position(s) they want to move out of the ETF. That discretion lets managers target **low-cost-basis positions** and manage embedded gains while rebalancing or changing exposures.

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Key terms

Custom in-kind baskets: a non-representative mix of securities that can be transacted with a trading partner (aka an AP, which stands for authorized participant) in the primary market

In-kind redemption basket: the mix of securities an ETF issuer delivers to an AP in exchange for shares of the ETF

Creation and redemption mechanism: a process that occurs in the primary market in which an authorized participant (AP) exchanges a defined basket of securities (or cash) with the ETF issuer in return for new ETF shares (creation) or delivers ETF shares back to the ETF in return for a basket of securities (redemption). Because these exchanges are typically done in kind rather than through selling securities in the open market, the process has the potential to help ETF managers meet flows and manage portfolio changes with fewer taxable capital gain distributions to shareholders

Authorized participant (AP): a broker-dealer who has a contracted opportunity with the ETF issuers to create and redeem shares in the primary market to meet market demand

Pro rata: literally means "in proportion" and is used to describe the allocations of securities ETF fund issuers deliver to APs in exchange for ETF shares

Low-cost-basis positions: specific lots, or batches, of securities held within a fund that have appreciated from their purchase price and carry embedded, or unrealized, capital gains

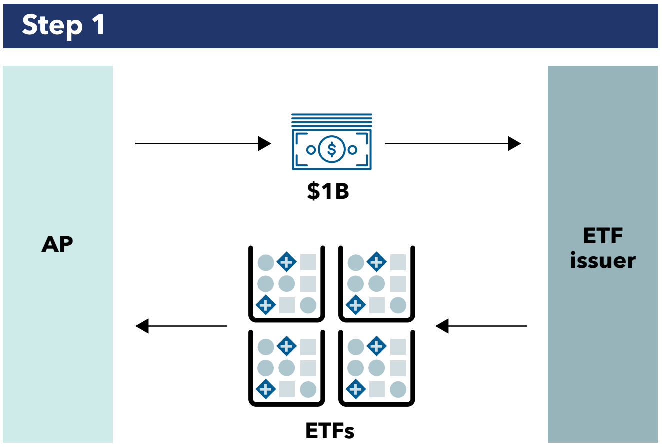
Primary market: the section of the capital market where APs work with ETF issuers to adjust the supply of ETF shares in the market, either creating new shares or redeeming excess shares

Secondary market: an aftermarket where investors buy and sell ETF shares on an exchange

Investments are not FDIC-insured, nor are they deposits of or guaranteed by a bank or any other entity, so they may lose value.

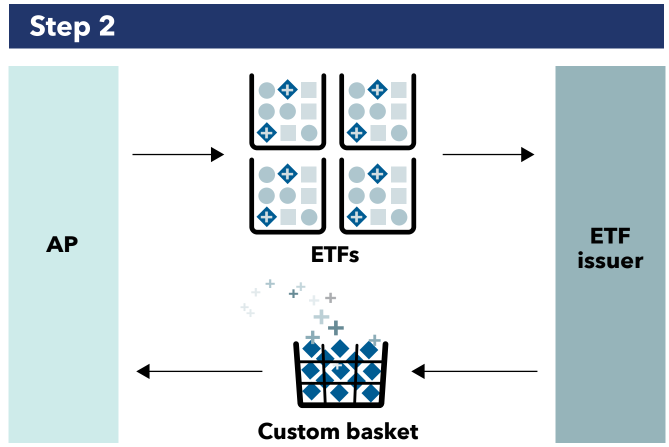
CIBs in action: A hypothetical case study

Consider an ETF manager who wants to exit a $1 billion position in a long-held, highly appreciated tech stock. Using the CIB tool, the manager can remove the position via an in-kind transaction, which would avoid a capital gain distribution to shareholders.



AP sends **$1B** to **ETF issuer**.

In exchange**, ETF issuer** sends **$1B** of newly created ETF shares to **AP**.



The AP returns the **$1B** of newly created ETF shares to the **ETF issuer.**

In exchange, the **ETF issuer** delivers the **$1B** position in the tech stock with the embedded gains via a custom basket to the **AP**.

+ = embedded capital gains

End result: The **ETF issuer** successfully removed the **$1B** position in the tech stock from the ETF using a custom in-kind basket, avoiding a capital gain distribution to the ETF's shareholders.

For illustrative purposes only.

What differentiates Capital Group from other active managers

Executing CIBs at scale requires operational readiness and trusted partner relationships. Capital Group supports this through a capital markets team dedicated to active ETFs and an ETF infrastructure built to facilitate CIBs across U.S. equity, international equity and fixed income. In 2025, the team completed more than $10 billion in ETF custom basket transactions – representing over 200 individual CIBs with more than 20 market maker partners.* Together, this execution experience, specialized infrastructure and breadth of relationships position us to support CIBs across a range of market environments.

*Source: Capital Group, as of 12/31/2025.

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