HSBC Asset Management

ETF trading and settlement cycle

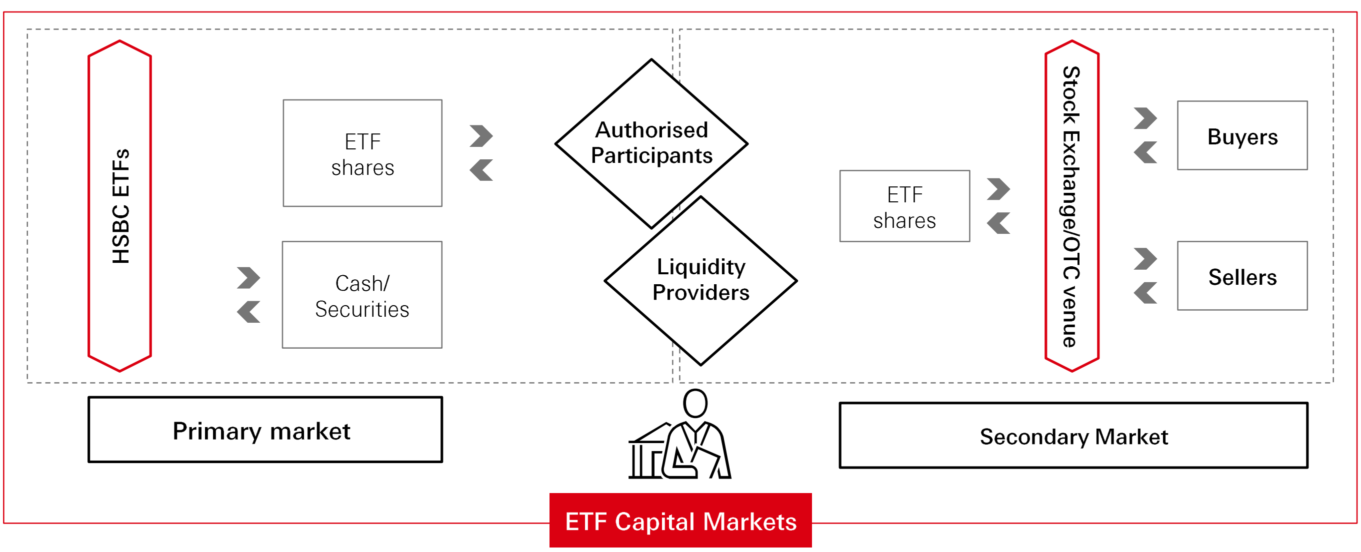
For Professional Clients only

Overview of trading and settlement

- ETFs are like securitised mutual funds, and as such, have similar – albeit different – creation and redemption mechanisms to traditional mutual funds
- ETFs have both primary and secondary markets
- Primary markets are where creation and redemption trades take place between the ETF provider and the AP (Authorised Participant)
- Secondary markets are where investors buy and sell existing units of the ETF with other investors over exchanges or OTC (Over The Counter)

The creation and redemption process

- Creation and redemption trades take place in the primary market between the ETF provider and the AP and trades are transacted at the NAV of the fund once a day. This is similar to mutual fund process
- The dual pricing structure of an ETF sets it aside from pooled index funds
- APs are the only parties who will transact directly with the ETF issuer
- Primary trades are transacted in basket sizes which will be determined by the ETF and the index that it tracks. Usually, a fund with larger number of constituent securities will require a larger basket size
- Redemption of ETF shares are completed in a transaction reverse to the creation, where securities are sold and cash is returned to the AP in exchange for ETF shares, again in basket sizes
- All costs associated with creating or redeeming units of the fund are charged to the AP and hence to investors that buy or sell units. This helps the fund to have lower costs and hence lower tracking error



Key risks

The value of an investment in the portfolios and any income from them can go down as well as up and as with any investment you may not receive back the amount originally invested.

- **Concentration Risk:** The Fund may be concentrated in a limited number of securities, economic sectors and/or countries. As a result, it may be more volatile and have a greater risk of loss than more broadly diversified funds
- **Counterparty Risk:** The possibility that the counterparty to a transaction may be unwilling or unable to meet its obligations
- **Derivatives Risk:** Derivatives can behave unexpectedly. The pricing and volatility of many derivatives may diverge from strictly reflecting the pricing or volatility of their underlying reference(s), instrument or asset
- **Emerging Markets Risk:** Emerging markets are less established, and often more volatile, than developed markets and involve higher risks, particularly market, liquidity and currency risks
- **Exchange Rate Risk:** Changes in currency exchange rates could reduce or increase investment gains or investment losses, in some cases significantly
- **Index Tracking Risk:** To the extent that the Fund seeks to replicate index performance by holding individual securities, there is no guarantee that its composition or performance will exactly match that of the target index at any given time ("tracking error")
- **Investment Fund Risk:** Investing in other funds involves certain risks an investor would not face if investing in markets directly. Governance of underlying assets can be the responsibility of third-party managers
- **Investment Leverage Risk:** Investment Leverage occurs when the economic exposure is greater than the amount invested, such as when derivatives are used. A Fund that employs leverage may experience greater gains and/or losses due to the amplification effect from a movement in the price of the reference source
- **Liquidity Risk:** Liquidity Risk is the risk that a Fund may encounter difficulties meeting its obligations in respect of financial liabilities that are settled by delivering cash or other financial assets, thereby compromising existing or remaining investors
- **Operational Risk:** Operational risks may subject the Fund to errors affecting transactions, valuation, accounting, and financial reporting, among other things
- **Real Estate Investments Risk:** Real estate and related investments can be negatively impacted by any factor that makes an area or individual property less valuable

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