

How ETFs Are Created and Redeemed

Exchange traded funds (ETFs) in the global market place today cover a wide variety of asset classes. There are ETFs that track broad market indices, specific sectors, as well as fixed income, commodity, currency and leveraged products. In the simplest terms, ETFs are a collection or “basket” of securities that typically track a specific market index. ETFs have characteristics of unit trusts and stocks. Similar to a stock, they are priced intraday and trade on the exchange. Like unit trusts, ETFs are transparent¹ with their expenses and holdings. While there are some similarities, the main difference between ETFs and other investment vehicles like unit trusts or stocks is the process through which fund units are created and redeemed. This is called the creation/redemption process, also known as the application/redemption process, and takes place in the primary market between the fund and authorised participants (APs). APs are Australian Securities Exchange (ASX) registered stockbrokers.

Authorised participants create fund units in large increments—known as creation units—by assembling the underlying securities of the fund in their appropriate weightings to reach creation unit size (typically 100,000 fund units) and then delivering those securities to the fund in-kind. In return, the AP receives fund units which are then introduced to the secondary market where they are traded between buyers and sellers through the exchange. As a result of the creation/redemption process, the ETF’s portfolio manager typically does not have to buy or sell securities except for rebalancing purposes thus assisting to keep transaction costs low in comparison to traditional unit trusts.

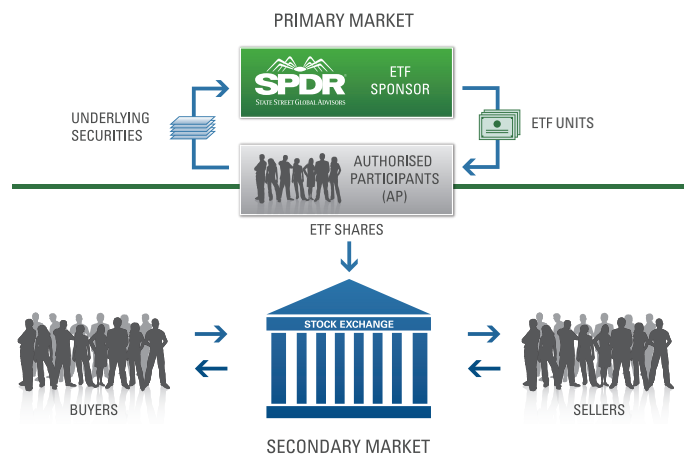
APs also have the ability to redeem fund units through the same process in reverse. Large increments of fund units—known as redemption units—are collected in the secondary market and then returned to the issuer for cancellation in exchange for the underlying securities in the appropriate weighting equaling that redemption unit (again, typically 100,000 fund units) which leads to a reduction in the outstanding shares.

To help illustrate this process, let’s walk through a specific example (Figure 1). Suppose an authorised participant wants to create units of the SPDR® S&P®/ASX 200 Fund [STW]. First, the AP would reference a list of the exact securities and their weightings within the fund. The list is provided daily by the ETF fund sponsor. The AP would gather those same securities in their appropriate weightings in the creation unit. Next, the AP would transfer the securities in-kind to State Street in exchange for fund units of STW. To complete the creation process, the AP would introduce these newly created SPDR S&P/ASX 200 Fund units into the secondary market where they would be traded between buyers and sellers through the exchange.

When the authorised participant wants to redeem fund units of STW, they would follow the same process in reverse. In the secondary market, the AP would gather large increments of fund units for redemption. Then in the primary market, the AP would deliver the redemption units to State Street in exchange for the underlying securities in the appropriate weightings equaling that redemption unit. Additionally, fund units can also be redeemed by “Qualifying Australian Residents”^{*} who are stockbrokers or have appointed a stockbroker to act for them in redeeming the units.

Understanding the creation/redemption process is key to understanding the unique structure of ETFs, allowing investors to more efficiently buy and sell ETFs. It is this process that sets ETFs apart from other investment vehicles like unit trusts or stocks.

FIGURE 1: ETF CREATION/REDEMPTION



^{*} Units in each Fund may only be redeemed by “Qualifying Australian Residents” —broadly Australian residents for tax purposes for the relevant financial year. If a redeeming Unitholder is not a Stockbroker, they must appoint a Stockbroker to act for them in redeeming their Units.

Redemption may only be made once a Redemption Form is completed, lodged and the units are delivered. The Form is available from www.spdrs.com.au or by contacting the Administrator. The Redemption Form sets out instructions for completing the form.

There may be adverse tax implications for non-Stockbrokers redeeming their Units—see Section 7 of the fund’s *Product Disclosure Document (PDS)*—“Taxation”.

INDEX DEFINITION

S&P/ASX 200 INDEX

The S&P/ASX 200 Index is recognised as one of the leading investment benchmarks for the Australian equity market. The index represents the 200 largest and most liquid publicly listed entities in Australia. The S&P/ASX 200 Index provides investors and fund managers with an effective benchmark for Australian equity performance, as it offers a broader representation of the Australian market.

ABOUT SPDR ETFs

Offered by State Street Global Advisors, SPDR ETFs are a family of ETFs that provide investors with the flexibility to select investments that are precisely aligned to their investment strategy. Recognised as an industry pioneer, State Street Global Advisors created the first ever ETF in 1993—the SPDR S&P 500[®], which is currently the world's largest ETF². In 2001, SSgA introduced ETFs in Australia when it launched the SPDR S&P/ASX 200 Fund and the SPDR S&P/ASX 50 Fund. Currently, State Street Global Advisors manages approximately US \$266 billion of ETF assets worldwide³.

For more information about our ETFs or how to invest, please call +612 9240 7600 or email info@spdrs.com.au.

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¹ Transparency is defined as the accessibility of information on the order flow for a particular stock, allowing knowledge of the quantities of stock being offered and the bids at the various price levels.

² Bloomberg, as of 31 March, 2011.

³ As of 30 June 2011. This AUM includes the assets of the SPDR Gold Trust (approx. US \$58 billion as of 30 June 2011), for which State Street Global Markets, LLC, an affiliate of State Street Global Advisors serves as the marketing agent.

IMPORTANT RISK INFORMATION

The issuer of units in SPDR S&P/ASX 200 Fund (ARSN 097 712 377) is State Street Global Advisors, Australia Services Limited (ABN 16 108 671 441, Australian financial services licence number 274900). A product disclosure statement ("PDS") for the fund is available at www.spdrs.com.au. Investors should consider the PDS in deciding whether to acquire, or continue to hold, units in an ETF. An investment in a Fund does not represent a deposit with or a liability of any company in the State Street Corporation group of companies including State Street Bank and Trust Company (ABN 70 062 819 630, AFSL 239679) and is subject to investment risk including possible delays in repayment and loss of income and principal invested.

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ETFs trade like stocks, are subject to investment risk, fluctuate in market value and may trade at prices above or below the ETFs net asset value. Brokerage commissions and ETF expenses will reduce returns.

These investments may have difficulty in liquidating an investment position without taking a significant discount from current market value, which can be a significant problem with certain lightly traded securities. Diversification does not ensure a profit or guarantee against loss.

Passive management and the creation/redemption process can help minimise capital gains distributions. Frequent trading of ETFs could significantly increase commissions and other costs such that they may offset any savings from low fees or costs.

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