What is an Exchange Traded Fund (ETF), UCITS?

ETF is a fund traded on stock exchanges just like shares and are linked to a specific reference portfolio (also called benchmark).

The benchmark is often a broad stock market index such as the Eurostoxx 50, S & P 500 or more country-specific indices such as the German stock index DAX. The benchmark may also be a bond, commodity or currency indices.

A distinction is made between two types of ETFs, Passive or actively managed.
Although increasingly actively managed ETFs exists, most ETFs not actively managed and no personal assessment and decision on asset price potential is made. ETF's are typically managed passive in the sense that they are intended to follow the benchmark as closely as possible.

Like an Investment fund, an ETF can be UCITS approved (Undertakings for Collective Investments in Transferable Securities). This means that the fund complies with a number of EU requirements with respect to spread, risk management and risk exposure. Therefore, there are some fixed minimum requirements which the UCITS approved the ETF must meet.

Who are ETFs relevant for?
An ETF is appropriate for you who want to diversify your investment, and are interested in a return and a risk that is close to a specific reference portfolio (also called benchmark).

Possibilities with ETFs
An ETF allows you to diversify risk in a variety of securities. Your return is less affected by positive or negative development in a single company or industry.

ETFs sometimes trades above or below their net asset value this could be in scenarios with market turmoil or in connection with extraordinary demand / supply in the individual ETF. This means that you as an investor can experience to pay a premium or discount to the intrinsic value. For some ETFs, this difference can be very high.

Pros and cons

Pros	Cons
• An investment that usually has good spread. Often, the underlying transparent and easily understood. • Generally lower cost than traditional Investment funds • Traded on the stock exchange just like a stock.	• ETFs with great diversity provides less opportunity to exploit high returns of individual assets. • The return on the ETF can deviate negatively from the return on the benchmark (see section below on Tracking Error). Depending on the strategy that the ETF use in order to track a benchmark, there may be a counterpart risk. • ETFs may also have a complex composition based on derivatives, gearing etc.

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What happens in practice?
An ETF is listed on an Exchange and can be traded throughout the trading day, in the same way you trade a stock. To buy an ETF you must have the full purchase price available in your account.

Benchmark indices for equity ETFs often contain many shares, and therefore it is not necessarily cost efficient for the fund to invest in all shares in the benchmark index. In these situations, a portfolio that approximately follows the benchmark is composed. The difference between price developments in ETF and its benchmark is called "tracking error". ETFs differ somewhat from each other in terms of cost and the tracking error, but also in relation to the administration, benchmarks and construction. As mentioned earlier, some ETFs are passively managed and others actively managed. There are UCITS and non UCITS approved funds.

There are ETFs which use gearing and/or derivatives. Instead of physical investments in individual assets, the fund use derivatives (e.g. Swaps, futures, forwards). These facts will be apparent from the fact sheet of the respective ETF.

Income
Your income consists of changes to the price and any dividends the fund may pay. The price development is the increase or decrease in price, ie the price of the underlying securities. The costs of running an ETF will be deducted from your return.
The cost is shown in the fact sheet for the ETF.

Risk
Depending on the choice of assets and the geographical area or asset classes invested in, the risk is influenced. The diversification is not necessarily always good in an ETF. This depends mainly on the weighting of the individual securities in the fund.
When you invest in an ETF, worst case, you can lose your entire investment.

If you invest in a UCITS approved ETF, which is physical based, ie the ETF tracks the benchmark by physically buying a number of assets that approximately track the benchmark, the risk compares to investing in a typical mutual fund.

Some ETFs make use of securities lending, resulting in a counterpart risk. Securities lending is widely used in the market and it is used in particular because the holder of the security during the period of lending will save on the cost of owning the security. Counterpart risk occurs when the borrower for example cannot return the security at the end of the loan period.

If you invest in an ETF, mainly swap based (A swap is an agreement between two parties to exchange cash flows on agreed terms over an agreed period), ie synthetic based, the ETF has a counterparty risk in the swap. This means, if the counterparty in the swap is bankrupt, you may lose your entire investment. If you invest in a UCITS approved ETF, the counterparty risk is limited to 10% of the ETF's assets.

If you buy an ETF denominated a currency (eg. USD) different to your base currency (eg. British Pounds), you accept a degree of foreign exchange risk.

Some ETFs may also have incorporated some form of lending, which means additional risk.

If you are unsure or are not quite familiar with concepts like derivatives, lending etc., but are planning to invest in non UCITS approved ETFs, we encourage you to seek the advice from your Investment advisor before taking any action.

We recommend that you seek advice to clarify the accounting and tax implications before buying ETFs.

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Good to know before you act

We recommend that you have a review of your investment profile before you act. Likewise, we recommend that you contact your adviser if you are unsure about some of the content in this fact sheet, or if you want an in depth conversation about the product.

ETFs with good liquidity are relatively easy to sell and buy. As investor you should be aware that especially illiquid ETFs can sometimes be hard to sell and that risk is often exacerbated by market turmoil. Often, the various ETFs have a market maker who provides current prices, but it's not a guarantee.

Tax

We do not give advise on tax issues in connection with specific transactions.

If you wish to learn about specific importance of the tax rules for you, we recommend that you consult your accountant.

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