

## How ETFs Are Created and Redeemed

Exchange traded funds (ETFs) in the market place today cover a wide variety of asset classes. There are ETFs that track broad market indexes, 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 both stocks and mutual funds. Similar to a stock, they are priced intraday and trade on the exchange. Like indexed mutual funds, ETFs are transparent<sup>1</sup> with their expenses and holdings. While there are some similarities, the main difference between ETFs and other investment vehicles like traditional mutual funds or stocks is the process through which fund shares are created and redeemed. This is called the creation/redemption process and takes place in the primary market between the fund and authorized participants (APs). APs are registered, self-clearing broker dealers who meet certain criteria and sign a participant agreement with a particular ETF sponsor or distributor to become authorized participants of the fund. APs are highly scrutinized for their integrity and operational competence; they are the only parties who transact directly with the fund.

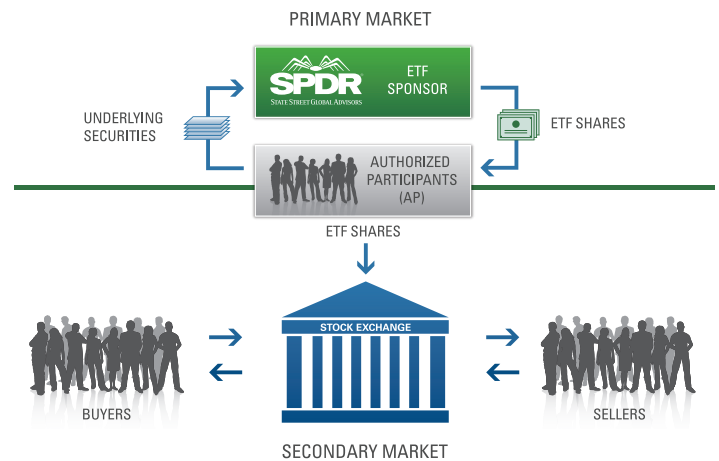
Authorized participants create fund shares in large increments—known as creation units—by assembling the underlying securities of the fund in their appropriate weightings to reach creation unit size (typically 100,000 fund shares) and then delivering those securities to the fund in-kind. In return, the AP receives fund shares 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.

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

To help illustrate this process, let’s walk through a specific example (Figure 1). Suppose an authorized participant wants to create shares of the SPDR® Straits Times Index ETF [STTF]. 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 into a creation unit. Next, the AP would transfer the creation unit in-kind to State Street in exchange for shares of STTF

To complete the creation process, the AP would introduce these newly created SPDR Straits Times Index ETF shares into the secondary market where they would be traded between buyers and sellers through the exchange.

**FIGURE 1: ETF CREATION/REDEMPTION**



When the authorized participant wants to redeem fund shares of STTF they would follow the same process in reverse. In the secondary market, the AP would gather large increments of fund shares into a redemption unit. Then in the primary market, the AP would deliver the redemption units to State Street in-kind in exchange for the underlying securities in the appropriate weightings equaling that redemption unit. Only authorized participants are able to create or redeem ETF shares in the primary market.

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 traditional mutual funds or stocks.

**TALK TO YOUR FINANCIAL ADVISOR**

If exchange traded funds interest you, speak to your broker or financial adviser to determine if you could benefit from incorporating ETFs in your investment plans.



## INDEX DEFINITION

### STRAITS TIMES INDEX

The Straits Times Index (STI) is the most globally recognised benchmark index and market barometer for Singapore. With a history dating back to 1966, it tracks the performance of the top 30 companies listed on the Singapore Exchange ranked by market capitalisation. The STI adopts FTSE's international methodology for compiling stock indices and has been designed to be tradable to meet the needs of both domestic and international investors.

### ABOUT SPDR ETFS

Offered by State Street Global Advisors, SPDR ETFs are a family of exchange traded funds that provide investors with the flexibility to select investments that are precisely aligned to their investment strategy. Recognized as the industry pioneer, State Street Global Advisors created the first ETF in 1993 – SPDR S&P 500®, which is currently the world's largest ETF.<sup>1</sup> SSgA introduced Singapore's first local ETF when it launched the SPDR Straits Times Index ETF in 2001. Currently, State Street Global Advisors manages approximately US\$260 billion of ETF assets worldwide.<sup>2</sup>

For comprehensive information on our ETFs, visit us at [spdrs.com.sg](http://spdrs.com.sg).

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<sup>1</sup> Bloomberg, as of 31 May 2011.

<sup>2</sup> As of 31 March 2011. This AUM includes the assets of the SPDR Gold Trust (approx. US\$56 billion as of March 31, 2011), for which State Street Global Markets, LLC, an affiliate of State Street Global Advisors serves as the marketing agent.

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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. Frequent trading of ETFs could significantly increase commissions and other costs such that they may offset any savings from low fees or costs. Diversification does not ensure a profit or guarantee against loss. Asset Allocation may be used in an effort to manage risk and enhance returns. It does not, however, guarantee a profit or protect against loss.

In general, ETFs can be expected to move up or down in value with the value of the applicable index. Although ETFs may be bought and sold on the exchange through any brokerage account, ETFs are not individually redeemable from the fund. Investors may acquire ETFs and tender them for redemption through the fund in creation unit aggregations only, please see the prospectus for more details.

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