TRACKERS OR EXCHANGE TRADED FUNDS (ETF)

An **ETF** is a listed fund that tracks the movements of a specific index or basket of equities or bonds, etc. That is why this type of investment is also called a **tracker**.

We make a distinction between ETFs with physical and synthetic replication:

- An ETF with **physical replication** buys practically all the shares, bonds, etc. which are part of the tracked index. If the index changes, the tracker buys or sells the corresponding securities. In this way, the ETF can continue to track the index closely. The benefits of this method are simplicity and transparency, but the costs are slightly higher than for a tracker with synthetic replication.
- An ETF with **synthetic replication** enters into **swap agreements** with one or more counterparties in order to generate a return on the index. The swap counterparty assures a return on the index in exchange for a return on the collateral (= the investors' money in the ETF). Consequently, there is a risk for investors: if the swap counterparty cannot fulfil its obligations, investors could lose some of their investment.

Features

- An ETF has no fixed **term**.
- An ETF combines the benefits of shares and investment funds. An ETF offers both the **simplicity** of a share (buying and selling via the stock exchange) and the **diversification** of an investment fund.
- Compared with mutual funds, ETFs have the advantage of allowing **transactions in real time**. SICAVs and mutual funds can only be traded once a day, and the price is (usually) the closing price of the markets in which the fund invests.
- An ETF cannot choose what to invest in because it has to **replicate the underlying index**; this is in contrast to an actively managed investment fund where, for example, the manager can invest in more defensive securities if the market displays a downward trend.
- ETFs can pay out a **dividend**. Read the prospectus to see whether a specific ETF pays out a dividend.

Risks

Currency risk: if you invest in an ETF in foreign currency, there is a currency risk against the euro. The amount in euro that you receive in the event of sale or on the expiry date can be more or less than the amount that you originally invested owing to the exchange rate.

Liquidity risk: we use the word 'liquidity' to express how easy it is to buy and sell an investment product. The liquidity risk is low for ETFs.

Market risk: the return on an ETF depends on the underlying asset. For example, if you invest in an ETF that tracks a European equity index, the return will be determined by the evolution of that equity index.

Capital risk: in many indexes, a small number of major shares predominate. A price fall for those shares can/will therefore have a major impact on the EFT. This is because, unlike an actively managed fund, an ETF cannot change its composition.

Price volatility risk: we say that a price is volatile when it fluctuates significantly. Price volatility depends mainly on the products in which the ETF invests. The upward and downward price movements of the underlying investment products can be due to various factors: the exchange rate of foreign currencies, rising or falling interest rates, and of course the evolution of market prices.

Performance risk: this risk only arises if you invest in an ETF that pays out dividends. It may be that the ETF does not pay out a dividend, as a result of which you will receive less income than you hoped. In addition, you must take into account the fact that dividends are sometimes also taxed by foreign authorities.

Counterparty risk: if the swap counterparty cannot fulfil its obligations concerning an ETF with synthetic replication (see above), investors could lose some of their deposit.

Costs and taxes

When you buy an ETF, it is in your best interest to take the fees and taxes that you will have to pay into account. This is because they will affect the return on your investment.

COSTS

Brokerage: banks charge fees to execute your orders on the secondary market.

Custody fee: most banks charge fees for keeping your ETFs in a custody account.

TAXES

Stamp tax on share deals: if you buy or sell an ETF on the secondary market, you must pay stock exchange tax.

Withholding tax on dividends: withholding tax is payable on the dividends paid out by the ETF. Sometimes dividends are also subject to taxation by foreign authorities.

Capital gains tax: ETFs that invest more than 25% of their assets in debt instruments (bonds, cash, etc.) are, in principle, subject to capital gains tax in the event of sale. ETFs are not subject to speculation tax.

Want to know more about ETFs?

Read our *Financial instruments information sheet* on our website at www.bnpparibasfortis.be.

Responsible editor: A Moenaert - BNP Paribas Fortis SA/NV, Montagne du Parc/Warandeberg 3, 1000 Brussels, RPM/RPR Brussels, VAT BE0403.199.702 – june 2016.

032809800668

BNP PARIBAS FORTIS

The bank for a changing world