



**TRADING THE PSE ETF SHARES  
AYALA BROKER'S LOUNGE  
4:00 - 6:30 p.m.  
July 2, 2013**

# BACKGROUND

- **SEC ETF Rules Sec. 22** - A **registered salesman of an Authorized Participant** or trading participant in an Exchange, prior to trading ETF shares, **shall present a certification to the Commission that he has undergone a relevant training on ETF** provided for by the Commission and/ or any person authorized by the Commission.

**SEC has accredited the PSE to conduct ETF training as required by Section 22**

# WHAT IS AN ETF?



- an open-ended investment that is traded in the exchange

**Note:** *Open-ended means that the ETF company continuously issues and redeems ETF units in exchange for a basket of securities*

- composed of a basket of securities or assets that seeks to mirror the performance of an index

# ETF ADVANTAGES

- Instant diversification
- Investor enjoys returns of the overall market with minimum capital outlay
- More transparent pricing
- Greater trading flexibility
- Can be arbitrated
- ETF share price is aligned with value of underlying shares
- Unlike mutual funds, ETFs have no sales-loads (marketing fees, early redemption fee, etc.)



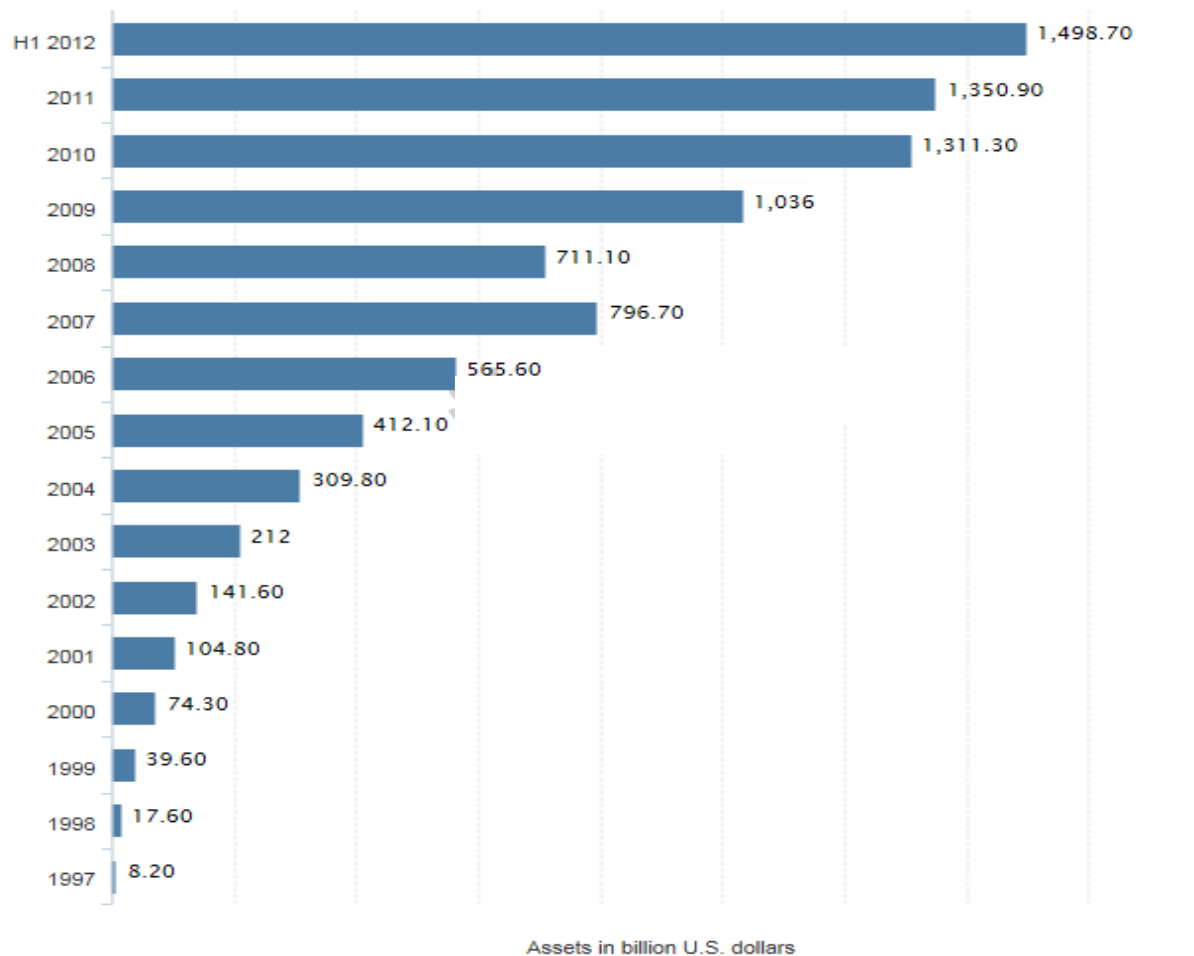
# DIFFERENCE OF ETFs VS. MF & UITF

Issue	ETFs	Mutual funds	UITF
Intraday Trading	Can be traded intraday at market price  <i>*iNAV is published every minute</i>	Purchase at NAV which is calculated at end of day	Purchase at NAV which is calculated at end of day
Management	Generally Passive	Usually Active	Can be both
Fees / Costs Involved	Similar to trading a stock - brokers commission, transaction fees , etc.  <i>*no sales load, no early redemption</i>	Front end load, back end load, redemption fee (if held less than the minimum time required)	Early redemption fee
Management Fees	Lower management fees	Higher management fees	Higher trustee fee
Redemption	Cash and/or in kind	Cash	Cash

# ETF AUM 1997 - 2012

WORLDWIDE ETF ASSETS UNDER MANAGEMENT UP TO 2012

Development of worldwide ETF managed assets between 1997 and the first half of 2012 (in billion U.S. dollars)



## STATISTICS FROM PEER EXCHANGES 2012

<b>Exchange</b>	<b>No. of ETFs</b>	<b>Total ETF Value Turnover (in USD mil)</b>	<b>Total Market Value Turnover (in USD mil)</b>
Australian SE	68	5,790.80	935,987.51
BSE India	29	433.70	110,345.89
Bursa Malaysia	5	51.00	124,332.91
Hong Kong Exchange	100	67,327.00	1,106,608.49
Indonesia SE	3	0.80	94,585.69
Japan Ex - Osaka	18	30,588.80	142,498.20
Japan Ex - Tokyo	123	24,271.90	3,463,094.79
Korea Exchange	135	120,445.00	1,517,896.93
Nat. SE of India	32	2,591.60	526,162.70
Shanghai SE	29	48,072.70	2,598,805.40
Shenzhen SE	18	27,846.90	2,369,079.56



## STATISTICS CONTINUED

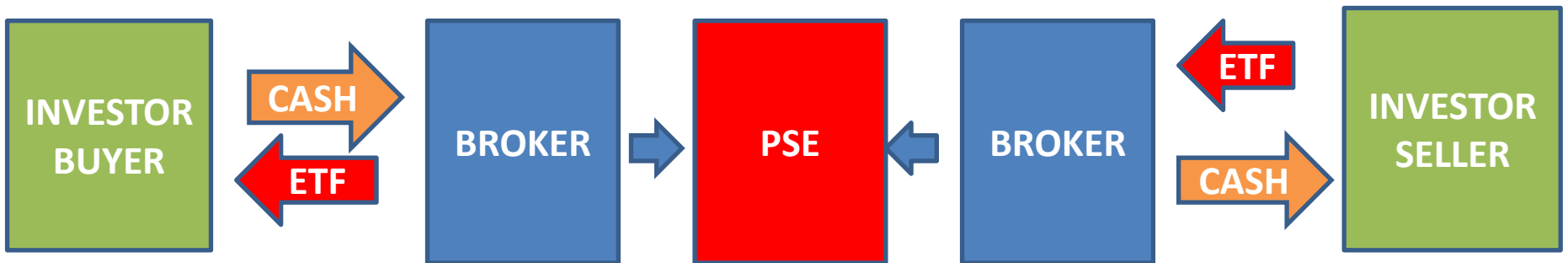
<b>Exchange</b>	<b>No. of ETFs</b>	<b>Total ETF Value Turnover</b> (in USD mil)	<b>Total Market Value Turnover</b> (in USD mil)
SET	11	454.20	236,024.91
SGX	91	4,151.00	256,055.92
Taiwan SE	21	9,145.00	678,514.52
Total Region	683	341,170.50	14,159,453.41
Total ASEAN	110	4,657.00	710,999.42



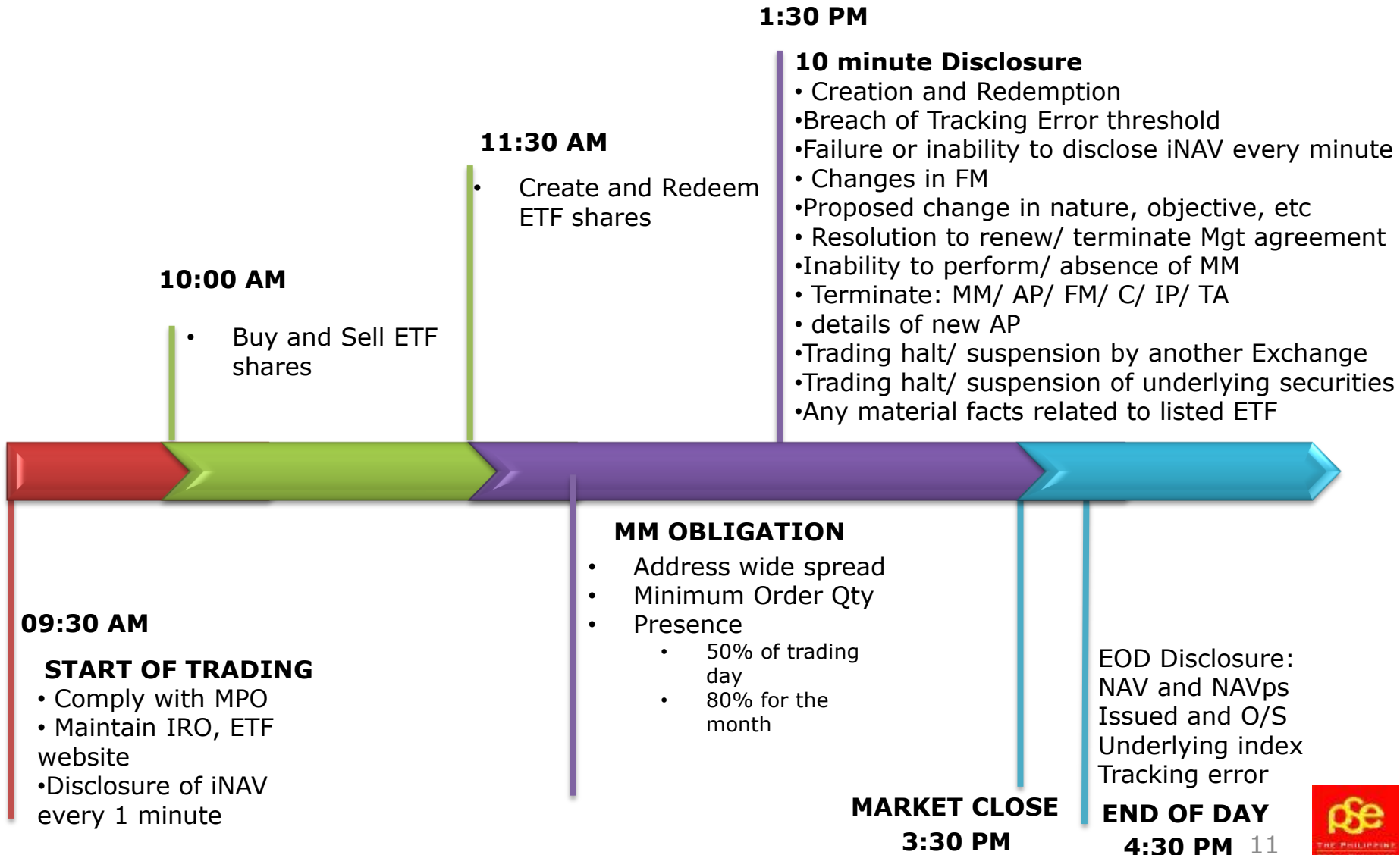
A blurred night photograph of a busy city street. The scene is filled with motion blur, suggesting a long exposure. In the background, there are several multi-story buildings with illuminated signs. One prominent sign on the left reads "SAVE THE PLANET" above a circular logo. Another sign above it says "LOVE ALL THINGS ALL". To the right, there are more brightly lit buildings with various signs, including one that looks like "KFC". The foreground is dominated by the blurred figures of people walking, their forms streaked across the frame. The overall atmosphere is one of a vibrant, bustling urban environment at night.

# ETF PROCESSES

# ETF Shares trade like existing shares



# A DAY IN THE LIFE OF AN ETF



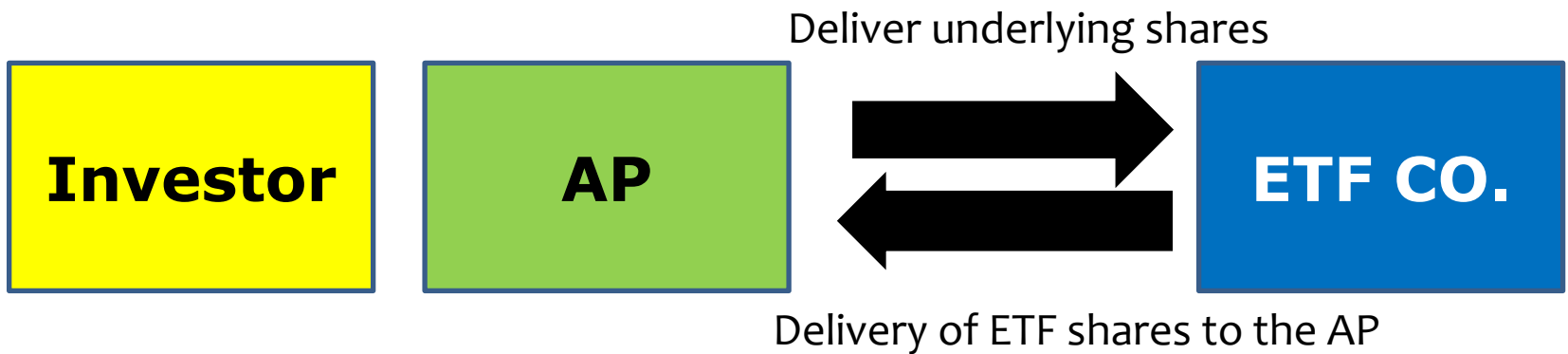
# CREATION AND REDEMPTION UNIT

Creation Unit is the smallest block of ETF shares that can be created or redeemed by an Authorized Participant from the ETF as prescribed and disclosed in the Registration Statement. (SEC ETF RULES)

- Each creation unit represents the ETF's underlying securities.
- Example: 50,000 ETF shares = 1 creation unit of ETF

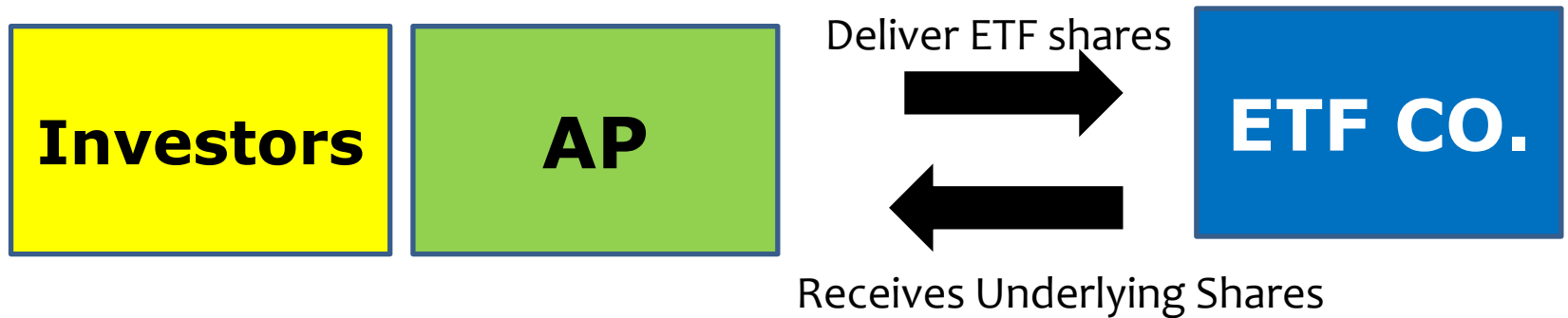
# CREATION PROCESS

ETF SHARE PRICE > iNAV



# REDEMPTION PROCESS

ETF SHARE PRICE < iNAV



# ETF Vital Stats

- ETF price – market price
- NAV – total value of the net assets of the fund  
(Market Value of U/S + Cash – Liabilities) at EOD
- iNAV – approximation of NAVps
- Underlying Index
- Tracking Error
- Arbitrage



# TRACKING ERROR

**Tracking error** is the standard deviation of the difference in relative returns between the ETF and its underlying index. (**SEC ETF Rules**)

## Calculation

**Step 1:** Obtain the NAV values and the Total Return (TR) Index values for each day of the total time period required

**Step 2:** Calculate the percentage change in the NAV and TR Index for each day over its previous day

*Percentage change in the NAV*

$$\text{NAVPC} = \frac{\text{NAV as on day } (t) - \text{NAV as on day}(t-1)}{\text{NAV as on day } (t-1)}$$

*Percentage change in the TR Index (TRI)*

$$\text{TRIPC} = \frac{\text{TRI as on day } (t) - \text{TRI as on day}(t-1)}{\text{TRI as on day } (t-1)}$$

**Step 3:** Calculate the difference between the percentage change in the NAV and the percentage change in the TR Index for each day

# TRACKING ERROR

**Step 4:** Calculate the standard deviation of the difference obtained from day(1) to day(T) in Step 3

$$\text{Standard deviation } (\sigma) = \sqrt{\frac{\sum_{t=1}^T (\text{NAVPC} - \text{TRIPC})^2}{T-1}}$$

Where: NAVPC = NAV percentage change

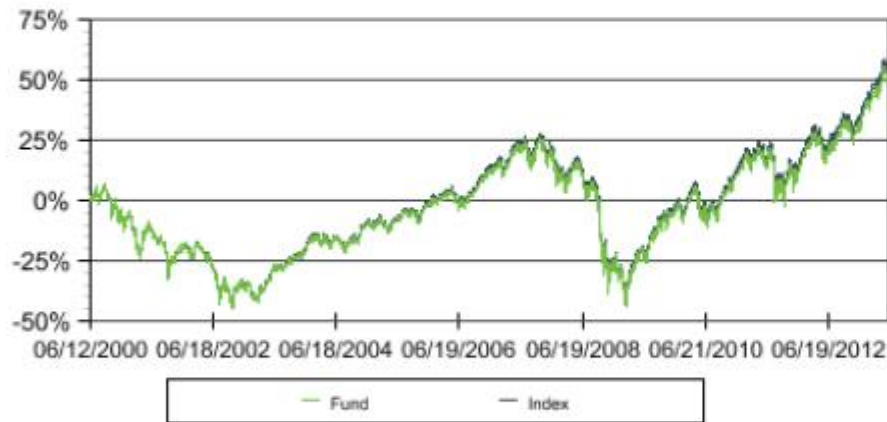
TRIPC = TR Index percentage change

T = total number of days (return periods), normally one year

Report created on June 17, 2013

## iShares Dow Jones U.S. ETF (IYY)

Inception Date: 06/12/2000



Base Currency of Fund: USD

Performance is calculated cumulatively based on the start date indicated above. The default start date is the fund inception date.

Period	06/12/2000 to 06/17/2013
Annualized performance difference	0.20%
Fund return	51.72%
Index return	55.50%
Management Fees	0.20%
*Acquired Fund Fees and Expenses	0.00%
Total Annual Fund Operating Expenses	0.20%
Less Fee Waivers	N/A
Net Expenses	0.20%



# PARTIES IN AN ETF

# KEY PARTIES IN AN ETF

- ETF Company
- Fund Manager
- Custodian
- Transfer Agent
- Index Provider
- Exchange
- Authorized Participant
- Market Maker
- Auditor
- iNAV Calculator

**ETF COMPANY – ESTABLISHED IN ACCORDANCE WITH ICA AND REGISTERED WITH SEC**

<b>PSE ETF Rules</b>	<b>SEC ETF Rules</b>
Sec. 4.a Established in accordance with ICA and registered with SEC	Sec. 6 Incorporated and Registered as ETF
Sec. 5 Minimum ACS and Paid-up capital of P 250M	6.2 a) Name of corporation must contain Exchange Traded Fund or ETF
	b) Purpose to engage in business of investing, reinvesting or trading securities; shall issue and redeem its shares of stock in a defined creation unit in exchange for delivery of a basket of securities representing an index
	c) All Filipino Board of Directors
	d) Minimum paid up capital of P 250M

## AUTHORIZED PARTICIPANT – CREATES AND REDEEMS ETF SHARES

<b>PSE ETF Rules</b>	<b>SEC ETF Rules</b>
Sec. 4c Registered Broker –dealers Active trading participants	Sec. 8 At least 2 AP shall be appointed by the ETF provided that at least 1 shall act as Market Maker
Php 100M minimum paid up capital	Sec. 16.2 Registered Broker – dealer Authorized trading participant of an Exchange
ETF must have 2 APs at all times	Adequate resources including competent staff and appropriate systems, procedures and processes to execute transactions in ETF shares in proper and efficient manner
Meet requirements in SEC ETF Rules: Sec. 16.2, 16.3, 16.4	Adequate and effective internal control procedures
	Formal written agreement with ETF
	Sec. 16.3 Provide measures for eliminating conflict
	Sec. 16.4 Other duties including acting as MM in accordance with agreement with ETF



# FUND MANAGER - OPERATES AND ADMINISTERS THE ETF

<b>PSE ETF Rules</b>	<b>SEC ETF Rules</b>
Must comply with requirements in Sec.15 SEC ETF Rules	Sec. 15 Must be reputable Fund Manager
Must have been in operation for the last 2 years	FM shall register as Investment Company Adviser in accordance with the requirements of ICA
Satisfactory experience in managing funds	Majority of directors and officers shall have a track record of 5 years in managing funds
	Shall be compliant with ETF agreement, ICA, SRC, Corp Code, IRR including these rules, circulars, orders, terms and conditions prescribed by the Commission

## CUSTODIAN - TAKES CUSTODY AND CONTROL OF ETF ASSETS

<b>PSE ETF Rules</b>	<b>SEC ETF Rules</b>
Sec. 4 Must comply with the requirements in Sec. 17 SEC ETF Rules	Sec. 17.1 Appoint a qualified custodian
	17.2.1 Registered universal or commercial bank with trust license or a non-bank entity with a trust license or a registered securities depository
	17.2.2 Adequate resources, competent staff, appropriate systems, procedures and processes
	17.2.3 Adequate and effective internal control procedures, independence between and among its different office units, satisfactory risk management procedures
	17.3 Measures to eliminate conflict of interest

## TRANSFER AGENT – MAINTAINS REGISTRY FOR RECORDING TRANSFERS OF SHARES

<b>PSE ETF Rules</b>	<b>SEC ETF Rules</b>
Sec. 4.f Paid in capitalization of P 100M	Sec. 18 Registered Transfer Agent
Compliant with SEC ETF Rule Sec. 18	

## AUDITOR – PERFORMS INDEPENDENT AUDIT OF ETF'S FINANCIAL RECORDS

<b>PSE ETF Rules</b>	<b>SEC ETF Rules</b>
Sec. 4.g Independent Accredited by SEC Acceptable to PSE	

## INDEX PROVIDER - RESPONSIBLE FOR CONSTRUCTION CALCULATION OF ETF'S UNDERLYING INDEX

<b>PSE ETF Rules</b>	<b>SEC ETF Rules</b>
Sec. 4.h Independent	Sec.14 Must have an agreement with ETF
Compliant with Sec. 14 SEC ETF Rules	Shall adopt measures reasonably designed to prevent misuse of non-public information between ETF and Index Provider

## MARKET MAKER – ENSURES LIQUIDITY

PSE ETF Rules	SEC ETF Rules
Sec. 4 d At least 1 of the designated AP of the ETF shall be designated as ETF Market Maker	Sec. 5.14 Market Maker is an Authorized Participant
Sec. 13 a. Must be a Trading Participant, Must <b>have at least 1 Licensed Salesman accredited as a Designated Specialist</b>	Sec. 8.2 At least 1 of the appointed APs shall act as the ETF Market Maker
13.b Must be <b>registered as authorized ETF Market Maker</b>	
Implementing Guidelines of ETF MM Rules:	
Sec.1.a (i) Licensed to act as a broker/dealer by the Commission	
Sec.1.a (ii) Registered as a trading participant of the Exchange	
Sec.1.a (iii) Has been continuously operating as broker/dealer for the 5 year period preceeding filing of application	
Sec.1.a (iv) Has at least one Designated Specialist	
Sec.1.a (v) Has no violations of laws or serious non- compliance with rules and regulations for the last 2 years prior to filing the application	

## DESIGNATED SPECIALIST ACCREDITATION

- **PSE ETF Rules Sec. 13.a.** – ...the Trading Participant shall fulfill such requirements that may be imposed by the Exchange and the Commission, including, without limitation, the requirement to have at least one (1) licensed Salesman who has been **accredited as a Designated Specialist by the Exchange** or any person authorized by the Commission. Designated Specialists, as defined in the PSE Trading Rules, shall mean the appointed licensed Salesman employed by a Market Maker to perform Market Making obligations.
- **PSE ETF Rules Sec. 13.f.** - **Only accredited Designated Specialists** are allowed to perform the Market Making functions and obligations of the ETF Market Maker



# MARKET MAKER OBLIGATIONS

The ETF Market Maker shall be obliged, upon occurrence of Wide Spread, to perform the following:

Ensure two-sided ETF Orders into the System in quantities not less than the minimum volume required by the Exchange; (5 board lots)

Observe a maximum bid and offer spread throughout a mandatory period; and

Price		Maximum Spread
From	To	
0.0001	0.4950	20 ticks
0.5000	19.9800	15 ticks
20.0000	999.5000	10 ticks
1000.0000	UP	5 ticks

Presence in the market within the period required by the Exchange (50% each trading day, 80% each month)

# MARKET MAKER OBLIGATIONS

## *Definition of a Wide Spread*

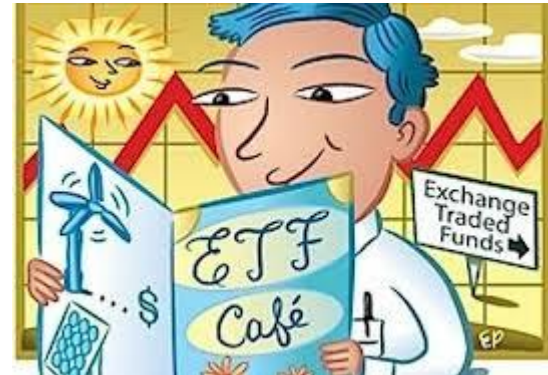
- Wide spread shall mean the occurrence of **any** of the following situations:
  - the bid and ask spread is larger than a limit specified by the Exchange from time to time; OR
  - there is only one-sided quotation; OR
  - there is no existing quotation on both the bid and ask queues.



# PSE ETF LISTING RULES

# GENERAL RULES FOR LISTING

1. Minimum authorized capital stock and paid-up capital of Php250 million.
2. May undertake offering of its shares; NOT covered by IPO Rules on Distribution of Shares.
3. May apply for shelf listing equivalent number of shares subject of SEC Registration Statement.
4. Underlying securities comprising the index which the ETF Co. intends to track must be listed and traded in a registered exchange and have sufficient liquidity.
5. PSE Suitability Rule shall apply.



# CONTINUING LISTING REQUIREMENTS

1. Minimum Public Ownership of at least **10%**. ETF shares held by APs are considered public.
2. Investor Relations Office that manages IR program, including website with information on financial reports, disclosures/news and stock data.
3. Shelf-listed shares will only be eligible for trading once notice is issued by **ETF Co.'s authorized officer** and confirmed by the **Custodian and Transfer Agent** that such number of ETF shares has been created/issued.



# CONTINUING LISTING REQUIREMENTS

## 4. Periodic Reports

- iNAV disclosure every 1 minute
- End of day disclosure, no later than 4:30PM of NAV, issued and outstanding shares, underlying index and tracking error
- Annual and Quarterly Reports
- Monthly issuance and redemption report of ETF creation units
- End of each dividend distribution period: net amount per share and record date





# CONTINUING LISTING REQUIREMENTS

## 4. Periodic Reports (continued)

### ▪ **10-minute rule:**

- ✓ Any creation and redemption with resulting issued and outstanding ETF shares
- ✓ Breach of tracking error threshold
- ✓ Inability to: disclose iNAV; Market Maker in performing obligations
- ✓ Any proposed change in nature, investment objective of the ETF
- ✓ Any resolution to terminate agreements with Fund Manager, Market Maker, AP, Custodian, Index Provider and TA
- ✓ Any trading halt or suspension of the underlying securities and lifting thereof, with percentage of said underlying securities to current index value





# PSE ETF RULES (continued)

- **Trading Halt** (1 hour) on 1<sup>st</sup> day of occurrence of:
    - Breach of tracking error threshold
    - Trading is halted for one or more underlying securities accounting for at least 20% of index value
    - If iNAV is not timely published
  
  - **Trading Suspension** under the following:
    - If underlying securities accounting for 20% or more are suspended
    - Absence of Fund Manager, Custodian, Index Provider, AP or TA
    - Absence of a Market Maker for 1 month
    - When SEC issues an order of suspension or revocation
  
  - **Delisting** :
    - Continued breach of tracking error threshold for at least 1 year
    - Revocation of ETF shares registration
- ***ETF Co. undergoing delisting must purchase or redeem more than 90% of its issued and outstanding shares.***

# PSE RULES (continued)



## ▪ **Penalties**

### **Daily Fines:**

- *Php100.00* for non-compliance with required number of APs
  - *Php500.00* for absence of a Market Maker
- ➔ Penalties and Fines under Disclosure Rules shall apply

# PSE RULES CONTINUED

- **Fees:**
  - Processing fee:  
**Php50,000.00**
  - Listing fee:  
**Php100,000.00**
  - Annual Listing Maintenance Fee: 1/200 of 1% of total market cap but no more than **Php250,000.00**



# Thank You

© The Philippine Stock Exchange, Inc. (PSE). All rights reserved.

This document is a property of the PSE and cannot be used or reproduced, distributed or forwarded by any person or company, in any form and in any manner, without the written consent of the PSE. Any and all unauthorized reproduction, distribution or forwarding of this document, in whole or in part, is subject to legal action.

This document is not intended for general circulation and does not, in any form, constitute legal, financial or investment advice and neither does it make any recommendation or endorsement to buy and/or sell any kind of investment product(s). The PSE reserves the right to make adjustments, omissions, corrections, and other similar actions to this document at any period of time. The PSE does not warrant or represent, expressly or impliedly, the accuracy, validity, correctness and completeness of the information stated in this document. The PSE, together with its affiliates and subsidiaries, expressly disclaim any and all liability arising from any actions or decisions made on the basis of this document, its content, and/or any changes, omission or error of the aforementioned.

Any views or opinions, either defamatory or complimentary, are solely those of the author/speaker and do not necessarily represent those of the PSE. The PSE together with its affiliates and subsidiaries will not accept any liability arising from the consequences of, and any actions or decisions made in respect to any statements expressed henceforth.