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Frequently Asked Questions about ETFs

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Exchange-Traded Funds (ETFs) have evolved far beyond their initial role as passive investment vehicles. Today, they are dynamic wrappers that encompass all major liquid asset classes and strategies, offering unparalleled flexibility and efficiency for a diverse range of investors.

According to ETFGI, assets invested in the global ETFs industry reached a new record high of US$13.61 trillion at the end of July 2024. ETFGI also reports that the global ETFs industry had a record 877 new products listed in the first half of 2024.

Common Questions About ETFs

Below, our Waystone ETFs team answer some common questions about ETFs:

What is an ETF?

An ETF is a type of investment vehicle that holds a basket of assets like stocks, bonds, or commodities (in the case of Exchange Traded Commodities (ETCs)). ETFs trade on stock exchanges throughout the trading day at market prices, similar to individual stocks. Investors can buy and sell ETF shares via a broker or brokerage account.

ETFs share characteristics of both open-ended and closed-ended funds. Like closed-ended mutual funds, ETFs are traded on stock exchanges without changing the number of shares. However, like open-ended funds, ETFs allow for in-kind creation and redemption of units, which helps in maintaining liquidity and aligning the ETF’s price with its underlying net asset value (NAV).

How do ETFs work?

ETFs work by tracking the performance of an index, sector, commodity and other asset classes or seek to outperform a benchmark in the case of active. They are managed by an investment manager, which uses the pooled capital from investors to buy the underlying assets. ETFs can be either passively managed, where they mirror a specific index, or actively managed, where the fund manager makes discretionary investment decisions.

How do ETFs compare to mutual funds?

- **Access and trading flexibility:** ETFs trade intraday on exchanges, while mutual funds trade once daily at the end-of-day NAV.
- **Costs:** ETFs generally have lower expense ratios compared to mutual funds.
- **Tax efficiency:** ETFs are generally considered more tax-efficient than mutual funds. In the US this is due to their “in-kind” creation and redemption process which helps limit ETF capital gain distributions and investor

taxes. In Europe, Ireland domiciled ETFs benefit from a lower withholding tax rate on US equity dividends, thereby delivering better performance returns for investors.

- **Transparency:** ETFs provide daily transparency of holdings, while mutual funds may only disclose holdings quarterly. The transparency requirements can vary by country/region.
- **Intraday Pricing:** ETFs provide real time intraday pricing to investors while mutual funds provide NAV pricing on a T+1 basis

What are ETNs and how do they differ from ETFs?

Exchange-Traded Notes (ETNs) are debt securities issued by financial institutions. They are designed to provide investors with exposure to the performance of a particular index, commodity, currency, or other benchmark, minus fees. Unlike ETFs, ETNs are not funds since they do not hold the underlying assets; instead, they are debt instruments backed by the credit of the issuer that are structured to mimic the performance of a reference benchmark.

How do you buy and sell ETFs?

ETFs can be bought and sold through a brokerage account, similar to individual stocks. Investors place orders with their broker or through an online trading platform, where they can execute trades at real-time market prices.

Are there different types of ETFs?

Yes, there are several types of ETFs, including:

- **Equity ETFs:** Track stocks from various sectors or indices.
- **Bond ETFs**: Track fixed-income securities.
- **Sector and Industry ETFs:** Focus on specific sectors or industries.
- **Thematic ETFs:** Focus on specific themes like technology, clean energy, or robotics.
- **Active ETFs**: Managed by fund managers with the goal of outperforming a specific benchmark and can encompass multiple asset classes.
- **Commodity ETCs:** Track commodities like gold or oil.

What are the tax implications of investing in ETFs?

ETFs are generally tax-efficient due to their structure. In the US, capital gains are minimised through the “in-kind” creation and redemption process. In Europe, lower withholding taxes can improve the performance outcome compared to a mutual fund. However, investors are still subject to taxes on dividends and any capital gains realised from selling ETF shares. Tax rates can vary based on the type of ETF (equity, bond, commodity), the holding period and the investor’s jurisdiction.

Can ETFs be used for long-term investing?

Yes, ETFs are suitable for long-term investing. They offer a cost-effective way to build a diversified portfolio and can be used to achieve various investment goals over the long term. Given the typically lower cost of ownership, ETFs are very good for investors’ long term portfolios as there can be significantly lower costs over the lifetime of the investment.

What are the benefits of ETFs for investors?

The benefits of investing in ETFs include:

1. Access and trading flexibility:
ETFs can be traded intraday on stock exchanges, providing liquidity and flexibility similar to stocks. This contrasts with mutual funds, which only trade at the end-of-day NAV.

2. Transparency:
ETFs offer daily portfolio transparency, allowing investors to see the underlying holdings, unlike mutual funds which may only disclose holdings quarterly. However, transparency requirements can vary by country/region.

3. Tax efficiency:
ETFs are generally considered more tax-efficient than mutual funds. In the US, this is due to their "in-kind" creation and redemption process which helps limit ETF capital gain distributions and investor taxes. In Europe, Ireland domiciled ETFs benefit from a lower withholding tax rate on US equity dividends, thereby delivering better performance returns for investors.

4. Lower costs:
ETFs typically have lower expense ratios compared to mutual funds, leading to reduced total cost of ownership.

5. Diversification:
ETFs provide exposure to a wide range of asset classes, sectors and geographies, enabling diversified investment portfolios.

What are the benefits of ETFs for issuers?

1. Distribution:
The exchange-traded nature of ETFs provides issuers access to a broad market of investors with brokerage accounts, making it easier to reach a diverse audience. Additionally, ETFs are well-suited to growing digital wealth management platforms, often favoured by younger investors.

2. Operational efficiency:
ETFs offer operational efficiencies through their create-redeem mechanism, which reduces the operational burden associated with secondary market activities. This facilitates smoother transactions and enhances overall market efficiency.

3. Branding and market visibility:
Entering the ETF market enhances brand visibility for issuers. The multi-listing nature of ETFs allows for increased regional and country-specific brand awareness, allowing issuers to create a presence in various markets. This heightened visibility can attract more investors and strengthen the issuer's market position.

4. Investment performance:
In terms of investment performance, Irish-domiciled ETFs benefit from a favourable US tax treaty, reducing withholding tax on dividends to 15%, compared to 30% for non-Irish UCITS. Additionally, ETFs provide access to hard-to-reach liquidity pools, such as emerging market fixed income, through Authorised Participants (APs), further improving investment opportunities and performance.

What are the benefits for fund managers in using a white-label ETF platform operator such as Waystone?

Fund managers will benefit from Waystone's:

1. Time to market:
Launching ETFs with Waystone can take as little as three months; significantly reducing time and cost barriers to entry.

2. Relationships:
The are multiple actors in the ETF industry that all need to come together to make an ETF work. Approved participants, listing venues, custodians and distributors are just a few. At Waystone, we have deep established relationships with recognised ETF experts and our white-label clients get complete access to this established network.

3. Cost:
We leverage the scale of the Waystone Group to drive better pricing outcomes for clients when launching and operating ETFs. On average, set-up costs are five times lower and at least three times lower on an ongoing basis when using Waystone solutions versus launching in-house.

4. ETF experience:
ETFs are different to other fund wrappers. It is imperative for Issuers to have a depth of ETF talent to structure, launch and maintain ETF operating models which are fundamental to successful ETFs. At Waystone, we have these experts across the ETF value chain that support our clients' ETFs.

5. ETF capital markets:
Unique to ETFs is the requirement to have a comprehensive capital markets infrastructure to ensure efficient trading of ETFs on exchange and RFQ platforms. Our clients benefit from Waystone's fully outsourced capital markets capability which owns the day-to-day oversight and operations.

6. Listing strategy:
We provide a tailored listing strategy that is directly correlated to distribution. This includes country exchanges and currency considerations for international ETFs.

7. Trading:
We offer a best-in-class trading and execution team as part of our suite of capabilities. There is no requirement for our clients to hire additional trading resources or outsource to a third party.

How do I launch an ETF in Europe?

You can find our comprehensive overview on how to enter the ETF market in Europe here.

How are ETF prices determined?

ETF prices are determined by market demand but generally closely track the net asset value (NAV) of their underlying assets. A well governed and operationally robust ETF has a network of market makers and Authorised Participants that ensures the on exchange pricing is accurate with minimal bid/offer spreads. In addition, the intraday NAV (iNAV) provides a real-time indication of the value of the ETF's holdings, helping investors gauge how closely the market price aligns with the NAV.

What is the role of Authorised Participants (APs) in ETFs?

Authorised Participants (APs) are large financial institutions that manage the creation and redemption of ETF shares. They help maintain the liquidity and market price of ETFs by engaging in arbitrage opportunities to align the ETF's market price with its NAV. APs create ETF shares by delivering a basket of securities to the fund and redeem shares by receiving a basket of securities from the fund.

About Waystone's ETF Solutions

Waystone is an institutional ETF platform operator. We offer a comprehensive suite of ETF fund hosting capabilities and solutions, backed by our dedicated team of ETF professionals across Europe, the Americas and Asia Pacific. Our experts have specialised ETF expertise, including access to digital channels and strong relationships with the global investment community.

Waystone ETFs collaborates with leading financial institutions to develop superior investment products using open architecture solutions. This approach allows us to tailor our offerings to meet the specific needs of our clients, leveraging our extensive market knowledge and proven track record to take an ETF from inception to success.

If you have any questions about Waystone ETFs or would like to sign-up to receive our communications, please contact your usual Waystone representative or our team below.

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