Exchange Traded Funds

Introducing and operating ETFs in the UK
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1 Introduction

In April 2000, London Stock Exchange launched the first UK listed Exchange Traded Fund (ETF). The market was launched in recognition of developments in financial products and is designed to provide trading access and visibility for those wishing to deal in them, both institutional and retail.

Since then there had been steady growth in the number of ETFs listed on London Stock Exchange, creating the leading European centre for ETFs, with funds ranging from emerging markets, bonds, sector specific to currencies.

London Stock Exchange is committed to innovation and further developing its offerings to its client in the Exchange Traded Funds space and encourages potential issuers to discuss their plans from the start of the project.

For further information please contact London Stock Exchange ETF Product Management team on +44 20 7797 3054.

This brochure provides a guide to the steps that are required for launching ETFs in the UK.

1.1 Introduction to the admission process in the UK

The admission process in the UK is made up of two stages; listing and admission to trading.

Admission of companies to the Official List is controlled by the UK Listing Authority (UKLA), a division of the Financial Conduct Authority (FCA). The FCA retains responsibility for the approval or recognition of authorised collective investment scheme prospectuses e.g. Undertakings for Collective Investment in Transferable Securities (UCITS) scheme. However issuers seeking admission to the Official List will also need to submit listing particulars to the UKLA. London Stock Exchange is responsible for admitting securities to trading on the Main Market.

An ETF issuer seeking a London listing for its securities must apply for admission to the Official List (a ‘listing’) through the UKLA. The listing is dependent on the securities gaining admission to trading on the Main Market through satisfying the Exchange’s Admission and Disclosure Standards.

ETFs which are already listed with an EEA Competent Authority (CA) can apply directly to London Stock Exchange for admission to trading on the Main Market. This is can be done once the FCA has recognised the fund under the UCITS scheme. This route does not provide a London listing, however it will allow investors to trade the securities on London Stock Exchange.
## 2 Overview of introducing ETFs into the UK

Issuers have a choice of two routes to market:
- Apply to the UKLA for a London listing and to London Stock Exchange for admission to trading on the Main Market
- Apply to London Stock Exchange for admission to trading on the Main Market based on an existing EEA listing utilising a recognised scheme.

The below diagram gives an overview of two main routes to market using the most common scheme UCITS:

### Chart key
- Issuer action
- Admission requirement

### Timescales
- At issuer’s choice
- 2–8 weeks
- 3 business days prior to start of trading
- 1 business day
- For EEA route: at least 11 business days prior to start for parent funds. At least 5 business days for sub-funds.
- For UKLA route: at least 5 business days

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The main parties that will have to be approached in order to admit ETFs are:
- Financial Conduct Authority (FCA)
- UK Listing Authority (UKLA) (if listing)
- London Stock Exchange
- Euroclear UK & Ireland or Euroclear Bank.

Whilst particular authorities have set times for review, the overall timetable depends on the issuer and their schedule for the project. A typical admission from first submissions to the start of trading is two to eight weeks.
3 Financial Conduct Authority

3.1 Fund authorisation or recognition

The most common legal entity for an ETF is an open-ended investment company, utilising a collective investment scheme. Collective investment schemes cannot be promoted to the general public unless they are authorised or recognised under the Financial Services and Markets Act 2000 (FSMA).

Depending on the legal form of the authorised collective investment scheme, they will be governed by FSMA, the Open-Ended Investment Companies Regulations 2001 and/or the Collective Investment in Transferable Securities (Contractual Scheme) Regulations 2013.

For more information regarding collective investment schemes, please see the below Collective Investment Schemes sourcebook (COLL) and FCA website:

www.handbook.fca.org.uk/handbook/COLL/1/?view=chapter

Issuers have a choice of two routes to market, which will determine the fund authorisation or recognition:

1. Apply to the UKLA for a London listing and to London Stock Exchange for admission to trading on the Main Market. For this route the fund must be an authorised collective investment scheme and must take the legal form of an Authorised Unit Trust scheme (an AUT), an Investment Company with Variable Capital (an ICVC), or an Authorised Contractual Scheme (an ACS). The authorised collective investment scheme must be established in the UK and utilise the Undertakings for Collective Investment in Transferable Securities (UCITS) scheme.

Please see the below link for more information regarding FCA recognised schemes: www.fca.org.uk/firms/authorised-recognised-funds/apply-fund-recognition

Both routes to market utilise the UCITS scheme, thereby benefiting from the principle of mutual recognition within the EU and a high level of acceptance by regulators worldwide.

The review for UCITS compliance and obtaining recognition status is conducted in one submission by the FCA Collective Investment Scheme Department.

The fund will have to provide, among others, the following documents:

— A certificate of UCITS compliance from the home regulator
— A copy of the fund prospectus
— A recognition application form (acquired from the FCA)
— Details of the fund – registered office address, marketing plan etc.

Prospective fund issuers are advised to seek their own advice on admitting investment funds in to the UK.

2. Apply to London Stock Exchange for admission to trading on the Main Market based on an existing EEA listing utilising a recognised scheme. For this route the fund must be complaint with one of the FCA recognised schemes, these are schemes established outside the UK that can be promoted to the general public in the UK. UCITS schemes are marketable in the UK under section 264 of FSMA (Schemes constituted in other EEA States).

3.2 Approval of associated parties

— Any company acting for the fund in the UK, namely the fund manager and custodian, need to be approved by the FCA in order to operate
— The process to obtain approval to conduct investment business in the UK is separate from that of obtaining ‘recognition’ status for the issuing fund
— The fund and its associated parties are advised to seek their own advice and approach the FCA directly with regard to conduct authorisation.
The UK Listing Authority (UKLA), a division of the FCA, took over the function of admitting to the Official List from London Stock Exchange in May 2000. Although part of the FCA, the listing procedure is separate from the process of gaining recognition for the fund. Issuers are only required to complete the UKLA listing process if they are seeking a London listing for their fund.

4.1 Framework of rules for Exchange Traded Funds

The listing rules that become applicable to ETFs are determined by the legal entity of the issuer. The usual form an issuer takes is that of an open-ended investment company, and is addressed accordingly in the FCA Handbook.

The FCA Handbook sets out all the rules for securities on the Official List, covering both listing approval and continuing obligations. The FCA Handbook can be found at www.fca.org.uk/handbook

4.2 Listing procedure

The steps taken to acquire a London listing through the UKLA are as follows:

— A sponsor will need to be appointed by the fund in order to manage the listing, and will act as the contact between the Fund and the UKLA. A list of sponsors is available from the UKLA or on their website www.fca.org.uk/firms/markets/ukla

— The sponsor will advise on the contents of the FCA Handbook and assist in the production of the listing particulars that will be submitted to the UKLA for approval

— The sponsor submits the listing particulars to the UKLA

— The listing particulars will be reviewed by the UKLA. It is advisable to submit the listing particulars as soon as possible, and not just prior to the desired date for the start of trading

— Once UKLA approval has been granted, the Exchange can process the application for admission to the Exchange and initiate trading readiness, such as the allocation of ISINs.

Admission to trading on the Main Market based on EEA listing

London Stock Exchange offers an alternative route to the Main Market for ETFs listed in Europe to support greater flexibility and efficiency for ETF issuers.

For this route the fund must be compliant with one of the FCA recognised schemes, these are schemes established outside the UK that can be promoted to the general public in the UK. UCITS schemes are marketable in the UK under section 264 of FSMA (Schemes constituted in other EEA States).

Funds most commonly gain recognition under UCITS; this enables European issuers to cross-list such securities. London Stock Exchange aims to support European ETF issuers who want to cross-list securities in London. For issuers who want to make their securities available for trading without obtaining a listing through the UK Listing Authority (UKLA), this alternative route to the Main Market offers a cost-effective and efficient option.

EEA listed ETFs are admitted to trading on the Main Market alongside London listed ETFs. There are designate sectors for EEA listed ETFs which enables market participants to identify funds that are not listed in London but are listed elsewhere in the EEA. A breakdown of segments and sectors can be found at www.lseg.com/markets-products-and-services/our-markets/fixed-income-markets/downloads

ETF issuers can apply for their EEA listed ETFs to be admitted to trading on the Main Market through the UKLA. There are designate sectors for EEA listed ETFs which enables market participants to identify funds that are not listed in London but are listed elsewhere in the EEA. A breakdown of segments and sectors can be found at www.lseg.com/markets-products-and-services/our-markets/fixed-income-markets/downloads

The Exchange currently maintains criteria on fund characteristics to ensure the characteristics are favourable to the market and maintaining liquidity:

— The underlying vehicle for the ETF is an open-ended investment fund
— The fund is FCA authorised or recognised e.g. UCITS
— The ETF is either settleable in CREST or Euroclear Bank, depending on the trading service utilised.

Exchange Traded Funds seeking admission to London Stock Exchange will utilise either SETS or Trading Service for ETFs – Euroclear Bank settlement. This will depend on settlement venue and trading/settlement currency requirements.

5.1 Fund admission

The application for admission to the Exchange can be administered by the fund’s sponsor or directly by the issuer. As soon as possible in the admission process (i.e. once it has been determined what funds are to admit) it is necessary to arrange for the creation of the relevant trading codes.

**ISIN/SEDOL**

ISINs are normally allocated by the country of domicile of the issuer. The Exchange is then responsible for allocating a SEDOL code which is a unique instrument identifier. Please email the Pricing Supplement(s) to smfnewissues@londonstockexchange.com and allow 48 hours for these to be assigned.

**TIDM**

A Tradable Instrument Display Mnemonic (TIDM) is the three or four character identifier specific to London Stock Exchange. Issuers may request a specific TIDM which will be issued provided it is not already in use or reserved. Once reserved, these are held for a period of six months. Requests should be made to the Market Admission and Data Management team, who manage new admissions to London Stock Exchange. Please email the issuer name and the description of each line (multi-currency lines require unique TIDMs), making it clear that it is a TIDM request to:

admissions@lseg.com
Telephone +44 (0)20 7797 4513
Fax +44 (0)20 7920 4607

London Stock Exchange reserves the right to reject or withdraw a TIDM, at its sole discretion, at any time.

5.2 Multi-currency lines

It is possible to trade an ETF in Sterling (GBP and GBX), Euros and US dollars through the SETS trading service. It is also possible in addition to the previous currencies to trade an ETF in Chinese Renminbi, Hong Kong dollar and Swiss Franc through Trading Service for ETFs – Euroclear Bank settlement. The same ETF may be traded in all trading service specific currencies, utilising multiple segments for multiple currency lines within that trading service.

Multiple currency lines require unique TIDMs and SEDOL codes, however the ISIN of the multi-currency line will be identical to that of the original line within the trading service. The ISIN will not be cross compatible between the two trading services.

Continued overleaf

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1 Sub-funds only. Parent funds still require the full 11 business days.
2 For funds with CNY as the underlying fund currency, we require at least three weeks’ notice.
5.2 Multi-currency lines continued

Multiple currency lines can be applied for with the original application, or at a later date. If applying for multi-currency lines at a later date, we require the same documentation to the same timetables as above, with the exception of the prospectus/pricing supplements (these are not required). Each line is required to have a registered Market Maker to support pricing. See list of Market Makers at www.lseg.com/markets-products-and-services/our-markets/london-stock-exchange/exchange-traded-funds/market-makers

Any forms and other listing documentation for ETFs can be found at www.lseg.com/markets-products-and-services/our-markets/london-stock-exchange/exchange-traded-funds/listing-and-admissions

Please forward this documentation to the Market Admission and Data Management team at the Exchange as above.

5.3 Issuer fees

Admission fees and annual fees are payable by issuers on each individual ETF admitted to trading on London Stock Exchange’s Main Market, excluding multi-currency lines.

Full details can be found in the Fees for Issuers document which is available at www.lseg.com/markets-products-and-services/our-markets/london-stock-exchange/exchange-traded-funds/listing-and-admissions

5.4 Market Maker registration

For a Market Maker to register in the security they must complete and send in a Registration Information Form (RIF) before 5.30pm the day prior to listing, although we strongly suggest this is sent in earlier if possible to account for any corrections to the form that may be needed.


Completed forms should be submitted to:
rf@lseg.com
Fax +44 (0)20 7920 4526

5.5 Exchange membership

The fund and fund manager are not obliged to be members of London Stock Exchange, though the Fund Manager would have to be authorised by the FCA in order to conduct investment business (this is a separate process to that of obtaining fund approval, outlined above).

Membership of London Stock Exchange would allow access to all Exchange markets, not just ETFs. If fund agents or prospective market intermediaries want to become a member, they should:
— have an initial meeting with the Exchange’s Membership team to discuss their prospective requirements
— complete an application form and submit to the Exchange together with associated documentation
— work with the Membership team to ensure appropriate trading and settlement links.

An application form for membership is available on the London Stock Exchange website at www.lseg.com/areas-expertise/our-markets/markets-membership/london-stock-exchange-become-member

Market participants acting as Exchange Market Makers, trading, creating and redeeming ETF shares would have to be members of London Stock Exchange.

5.6 Trading environment for Exchange Traded Funds

The market for ETFs operates in an order-driven environment on SETS with integrated Market Maker liquidity provision, delivering guaranteed two-way prices. Market Makers must provide continuous bid-offer orders throughout the trading day in a minimum size and maximum spread regime.

It is the responsibility of the issuer to arrange at least one registered Market Maker per security, however to ensure competitive pricing and protection from any individual member firm’s system issues it is advised that issuers should look to engage at least two Market Makers to register in each ETF.
The order book provides continuous execution from after the open auction (which takes place from 7.50am to 8.00am) until the start of the closing auction at 4.30pm on all London business days. Participants are able to use both limit and unpriced orders during continuous trading.

The closing auction runs from 4.30pm until at least 4.35pm and allows users to participate and trade at the single closing price, generated at the level that would provide the greatest uncrossing volume. The exact uncrossing time is dependent on random end times and price monitoring periods. Market Makers are required to maintain quotes until the completion of the closing auction to ensure that an appropriate closing price is set. This includes the random end period and any price monitoring extensions. The latest possible time of uncrossing is 4.49pm. If no closing auction occurs the closing price will be the mid price of the best bid/offer at the end of the closing auction.

The following link provides details of Market Maker obligations for ETFs on London Stock Exchange:

Real-time market surveillance is provided throughout the trading day. ETFs are treated as ordinary equity in the Exchange rulebook, except with regard to the creation and redemption of ETF shares.

5.7 Information dissemination and publication of NAV

Issuers usually provide details regarding the status of the fund, such as the Net Asset Value and number of shares in issue, on a daily basis to an approved disclosure system such as London Stock Exchange’s Regulatory News Service. The entity that has contact with RNS is typically the entity that conducts the fund valuations, which in most cases is the depositary.
In order to trade ETFs on the SETS trading system of the London Stock Exchange, they must be able to settle through the CREST system or Euroclear Bank Settlement. The ETF issue must allow for dematerialised settlement, but this does not mean that the ETF issue must be exclusively dematerialised.

6.1 CREST

Admitting shares into the CREST system (“CREST”)
The issuer, will have to notify Euroclear UK & Ireland for the securities to be admitted to CREST. CREST members are the direct legal owners of the securities. Under the laws of the UK, Ireland, Jersey, Guernsey and Isle of Man, the legal ownership of dematerialised securities is evidenced by the entries in the register, which is maintained by Euroclear UK & Ireland (for UK securities), or by the issuing company or its registrar (for Irish, Jersey, Guernsey and Isle of Man securities).

Settling non-UK and non-Irish registered ETF shares in CREST
Non-domestic Exchange Traded Funds (i.e. those not constituted under the laws of England & Wales, Scotland, Ireland, Isle of Man, Jersey or Guernsey) can be settled in CREST, providing a Euroclear entity, acting as a depository in respect of the non-domestic ETF, issues dematerialised depositary interests (CDIs) representing such ETF. As securities constituted under English law but which represent an interest in other securities (which may be securities constituted under the laws of other countries) may be issued into, held and transferred in the CREST system. Euroclear UK & Ireland, through one of its CREST Depositories, can hold the ETF shares on the investor’s behalf, via an ICSD link. Creating CDIs is only possible if Euroclear UK & Ireland has link arrangements with an ICSD which in turn is linked with the domestic settlement house of the product.

Access to CREST
The issuers are not obliged to become members of CREST. The depository, acting for the issuers as holder of the assets, would have to be a member. It is likely that the trades of the ETFs would be settled through the depository’s CREST account. This applies equally to creation and redemption as well as secondary market trades that arise from rebalancing the portfolio. Should the issuer or its associated parties want access to CREST, a sponsored member, utilising the service of a CREST Sponsor, can mitigate the need for the party to maintain extensive connection networks.

Becoming a CREST member
If the issuer or any associated party would like to become a direct member of CREST, more information can be found at www.euroclear.com/en/about/Our-clients/becoming-a-client/EUI.html

Settlement in the secondary market
The settlement cycle for ETFs is T+2, with LCH as the Central Counterparty for all on book executions. By clearing through LCH, LSE clearing members benefit from counterparty risk management, settlement netting, straight through processing and counterparty anonymity. LCH’s direct connection to the central securities depositary (CSD) means the customer benefits from the lowest settlement costs and therefore the most efficient corporate event processing is offered.
6.2 Euroclear Bank (EB)

The “Trading Service for ETFs – Euroclear Bank Settlement” segment will allow LSE members to trade a wider range of ETFs

Access to EB
The fund and fund manager are not obliged to become Euroclear Bank participants. The fund’s Transfer Agent will have to be a participant and will use this account to settle all primary market trades (creation and redemption). They will not be involved in the settlement of any secondary market trades.

Settlement
The diagram above illustrates the process from trading to settlement for transactions traded in the “Trading Services for ETFs – Euroclear Bank Settlement” segment.

For more detailed information regarding Euroclear Bank settlement please visit www.euroclear.com/en/campaigns/etf.html

Eligibility of ETFs under the International Settlement model in EB
An issuer creates a Global Share Certificate, to be held by one of the common depositories used by Euroclear and a prospectus defining the international issuance features and requirements.

1. Trading
The London Stock Exchange member trades on the London Stock Exchange.

2. Clearing
After the London Stock Exchange processes the order (matching and execution), trade details are sent to clearing house for clearing.

3. Settlement
Clearing house sends the instruction to Euroclear Bank to be processed for settlement.
7 Other issues

7.1 Stamp duty and the Stamp Office

Stamp duty is exempt on those funds registered in the UK from April 2014. Funds registered outside of the UK are free of stamp duty. Issuers are advised to approach the Stamp Office should they wish to obtain a market intermediary exemption, if the fund is to be registered in the UK and also in relation to enquiries as to the purchase of the underlying free of stamp duty. Advice from a suitably qualified professional should always be sought in relation to any particular matter or circumstances.

7.2 Utilising tax-free wrappers

The fund should seek its own confirmation from its tax advisor or the Inland Revenue as to the eligibility of an ETF as a security that may be included in any PEP/ISA/SIPP wrappers.

7.3 Regulatory capital

Market participants and fund associates are advised to consult with the FCA over the regulatory capital requirements for an ETF, as specific circumstances may exist for each fund. Advice from a suitably qualified professional should also be sought.

“ETFs must be able to settle in either CREST for SETS or Euroclear Bank for Trading Service for ETFs – Euroclear Bank settlement.”
Further information
For further information regarding ETFs, contact etfs@londonstockexchange.com or visit www.lseg.com/etfs