London
Stock Exchange

ETPs for private investors

Simple products.
Sophisticated strategies.

London
Stock Exchange Group

ETPs

Exchange Traded Products (ETPs) such as Exchange Traded Commodities (ETCs) and Exchange Traded Notes (ETNs) are listed exchange traded securities structured as notes which track the performance of an underlying index or a single commodity. They trade on London Stock Exchange's Main Market ensuring a high level of regulatory oversight. These securities trade and settle like ordinary shares with market makers providing continuous liquidity on both sides of the order book.

With these instruments, investors can gain exposure to the performance of various commodities, indices and even currencies. There are a variety of ETPs on London Stock Exchange offering access to previously difficult and expensive-to-reach markets.

Simple products. Sophisticated strategies.

What are ETPs?

Exchange Traded Products

Exchange Traded Commodities — Exchange Traded Notes — Exchange Traded Currencies

ETPs such as ETCs and ETNs are structured as debt securities but unlike conventional bonds these instruments pay no interest and are not rated. ETPs can give investors a means of diversifying investment portfolios without the need to:

— enter into swap agreements or forward contracts,

— take physical delivery of the underlying commodity, or

— hold securities which constitute the underlying index.

As the ETP market has developed, it has expanded beyond the original commodity instruments (ETCs), and now includes notes (ETNs) and currencies (Currency ETCs).

It is important to note that ETPs are different to ETFs in a number of ways. ETPs such as ETCs and ETNs are not funds and therefore lie outside of the remit of UCITS – the Undertakings for Collective Investments in Transferable Securities.[1]

For a full list of ETFs available on London Stock Exchange please visit **www.londonstockexchange.com/etfandetpcategorisation**

	ETPs	ETFs
Type of security	Notes linked to the performance of commodities, indices, currencies and volatility	Open-ended index tracking funds
UCITS	Non-UCITS compliant	UCITS compliant
Collateral	No regulatory collateral requirements – some ETPs are fully collateralised and some are unsecured	UCITS collateral requirements

Collateralisation

There are number of ways ETPs can be collateralised and this will to a degree depend on the underlying.

In ETPs where the underlying is a physical commodity such as gold or other precious metals, the physical commodity itself can be used as collateral secured in a custodian vault.

In cases where the underlying is perishable or is impractical to hold, for example grains or crude oil, collateralisation may be in the form of matching contracts (futures and swaps) purchased from commodity counterparties held by the collateral manager in a pledge account.

Some can be backed by other assets such as Eurozone bonds and UCITS funds held in a segregated account.

[1] UCITS (Undertakings for the Collective Investment in Transferable Securities) products are governed by the UCITS IV Directive (2009/65/EC). The Directive introduces a number of requirements/safeguards that funds must meet to be authorised as UCITS (e.g. segregated assets and limited liability between sub-funds, increased transparency, investment diversification limits, robust risk management).

Different types of ETPs

Commodity ETCs, Currency ETCs and ETNs – including short and leveraged products

352

ETPs listed on London markets

The term ETP is an umbrella term that encompasses ETFs, ETCs (commodities and currencies) and ETNs. In the following note we will briefly outline the key characteristics of ETCs, ETNs and short and leveraged ETPs.

Exchange Traded Commodities and Currencies

Commodity ETCs are designed to give exposure to an individual commodity or a basket of commodities. They are subject to a different regulatory treatment to ETFs and are not governed by UCITS rules. This allows them to provide exposure to a variety of commodities, covering precious metals, energy, agriculture and industrial metals sectors.

Commodity ETCs are typically structured in two ways – physically or synthetically. Physical commodity ETCs are backed by a specific quantity of a commodity and aim to provide exposure to commodity spot prices. In contrast, synthetic commodity ETCs do not hold a physical underlying asset; instead they track futures indices which are constructed to simulate a continuous exposure to futures contract returns.[1]

The currency ETC structure has also been used to offer investors access to currencies, whether as currency pairs or a currency basket. The most traded currency pairs are the US Dollar against the Euro (EUR/USD), the Japanese Yen (USD/JPY) and the British Pound (GBP/USD) with these three currencies making up just half of all foreign exchange transactions.[2] Currency ETCs typically track forward indices which are constructed to simulate a continuous exposure to currency forwards returns.[3]

Single commodity
Aluminium, copper, gold, platinum, silver, nickel, zinc, corn, soya beans, wheat, crude oil, natural gas

Commodity sector
Agriculture, energy, grains, livestock, industrial metals, precious metals, soft commodities

Commodity broad
All commodities, ex-agriculture, ex-energy

Foreign exchange
Pound Sterling, Euro, US Dollar, Canadian Dollar, Australian Dollar, New Zealand Dollar, Swedish Kroner, Norwegian Kroner, Swiss Franc, Japanese Yen, Chinese Renminbi, Indian Rupee

These are the exposures available through London local listings.

[1] A futures contract is an agreement to purchase a commodity at an agreed price, with delivery and payment to take place at a specified point in the future.

[2] Bank of International Settlements Triennial Survey 2013.

[3] Forward contracts are similar to futures contracts however they are private transactions and do not trade on-exchange unlike the latter. This means forward contracts can be tailored to meet the needs of the contracting parties (e.g. delivery dates and size).

£995m

value traded in leveraged ETFs and ETPs in 2013

Short and leveraged ETPs

An investor can gain both short and leveraged exposure to a variety of different asset classes through tactical use of short and leveraged ETPs. Short and leveraged ETP exposures include equities, fixed income, commodities and currencies. Short ETPs provide negative exposure to the performance of a benchmark. Therefore an investor holding a short ETP will profit if the value of an underlying benchmark goes down. Leveraged ETPs are designed to provide exposure to a multiple of the performance of a benchmark. For example, a 3× or -3× leveraged ETP will be designed to reflect three times the daily percentage change in a given unleveraged underlying benchmark (before fees). Both long and short positions can be leveraged.

When investors purchase short and leveraged ETPs they should be aware of the effects of compounding. Short and leveraged ETPs are typically reset on a daily basis which means that a stated leverage factor should apply to the returns of that day. Compounding is when the gains and losses from one period are added to the base from which the next period's returns are calculated. Compounding could have both positive and negative effects, depending on how the benchmark moves. The effects of compounding are magnified when investments are held for longer periods of time.

* **Low-volatility, trending markets**
In the case of the benchmark index which rises each day, the effect of daily compounding is that the base value used to calculate the next day's returns increases every day – therefore, the continued gains are applied to a larger amount. In this example, the 3× ETP rises 18.89% after 7 days, more than 3 times the benchmark index's rise of 6% over the 7-day observation period. On day 6 there was a 1.2% gain on the benchmark index, so a 3.6% gain to be applied on the price of 3× ETP. This gain is applied to the previous day's closing price, 109.64, higher than at any earlier point in the example.

On the contrary, where the benchmark index falls each day, the base value decreases every day – therefore, the continued losses are applied to a smaller amount.

† **High-volatility markets**
In contrast, a volatile market that has daily gains and losses will generally result in the ETP under-performing in comparison with the benchmark's return multiplied by the leverage factor. If a rise in the ETP's value is followed by a loss, the loss is applied to a larger amount. And if the ETP loses value and then makes a gain, the gain is made on a smaller amount (often referred to as path dependency). Therefore, volatility is detrimental to investors holding short and leveraged ETPs for longer periods.

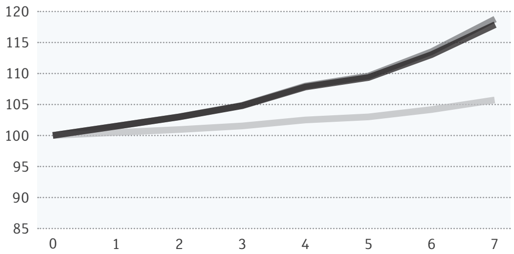
Here, each fall in the benchmark index is followed by a rise, and vice-versa. For example, day 2's gain is applied to the previous day's ETP price of 88.90, while day 3's loss is applied to the higher price of 103.04.

Source: ETF Securities, hypothetical example

etfsecurities.com

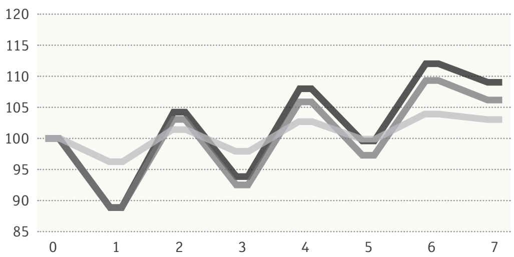
The impact of compounding on returns over longer periods

Low-volatility, trending markets*



Day	Index	Daily change	3× ETP	No compounding
0	100.00	–	100.00	100.00
1	100.50	0.50%	101.50	101.50
2	101.00	0.50%	103.02	103.01
3	101.61	0.60%	104.88	104.83
4	102.62	1.00%	108.02	107.87
5	103.14	0.50%	109.64	109.41
6	104.38	1.20%	113.59	113.13
7	106.00	1.56%	118.89	118.00
Total	**6.00%**		**18.89%**	**18.00%**

High-volatility markets†



Day	Index	Daily change	3× ETP	No compounding
0	100.00	–	100.00	100.00
1	96.30	-3.70%	88.90	88.90
2	101.40	5.30%	103.04	104.21
3	97.96	-3.40%	92.53	93.87
4	102.66	4.80%	105.85	107.97
5	99.90	-2.69%	97.31	99.69
6	103.99	4.10%	109.28	111.98
7	103.00	-0.95%	106.15	109.00
Total	**3.00%**		**6.15%**	**9.00%**

Graphs key

Index · 3× ETP · No compounding

0
stamp duty

ETNs

Unlike ETCs, ETNs are generally issued by banks and hold no assets. An underwriting bank will agree to pay the return of a reference benchmark (less fees), meaning ETNs are entirely reliant on the creditworthiness of the issuing entity. They are not restricted by the UCITS diversification requirements therefore allowing them to provide exposures not otherwise permitted under UCITS rules.

Volatility
Short term futures, mid term futures

Commodity broad
S&P GSCI Index TR, Commodity Index TR

Commodity sector
Agriculture, energy, grains, livestock, industrial metals, precious metals, soft commodities

Single commodity
Gold

These are the exposures available through London local listings.

> "It is more cost-effective to trade ETPs than physical assets."

Benefits of ETPs

Choice and ease of access to markets
The range of ETPs trading on London Stock Exchange covers a wide spectrum of markets such as agriculture, energy, livestock, metals and foreign exchange. Investors can use ETPs to gain exposure to markets which are otherwise difficult and complex to reach.

Cost-efficiency
It is more cost effective to trade ETPs than physical assets to attain the same level of exposure. Holding physical assets can be costly, impractical and in some cases impossible for most investors.

Liquidity
These instruments are traded on-exchange with market makers committed to providing two-way prices. This means investors should always be able to see a tradable price for an instrument.

Portfolio diversification and flexibility
ETPs can be used on their own or in combination with other investment vehicles to form an investment strategy suited to individual investment needs. Investors can trade in and out of ETPs as easily as ordinary shares giving investors greater flexibility and control when cash extraction or a change in portfolio weighting is required.

Individual Savings Accounts (ISAs) and Self Invested Personal Pensions (SIPPs) qualification
Some ETPs qualify for inclusion in ISAs and SIPPs providing a shelter for profits from capital gains taxation.

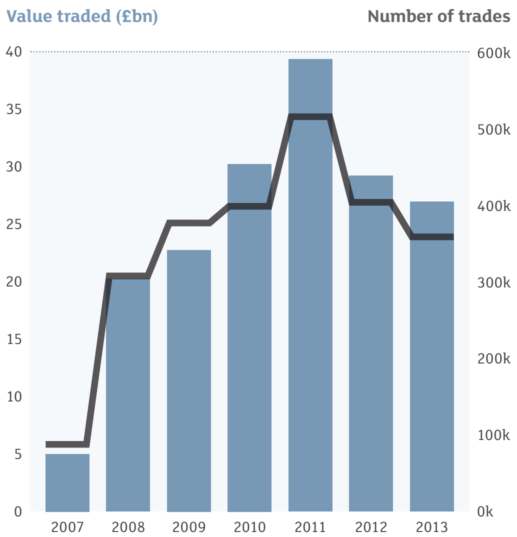
Tradable in multiple currencies
Some ETPs trade in multiple currencies – Sterling, Euro and the US Dollar. Investors can avoid currency risk if their base currency is one of these three.

Capital gains tax
Unlike conventional debt instruments, ETPs are non-interest bearing so investors will incur capital gains tax only when the ETC or ETN is sold, allowing investors to better manage their tax position.

Stamp exemption
There is no stamp duty payable on purchases in the secondary market. Investors should seek their own professional tax advice on the implications of subscribing and disposing of ETPs under the law of their jurisdiction. Tax legislation may change.

Growth of the ETP market

London Stock Exchange is the
leading market for ETPs in Europe.



ETPs in your portfolio

ETPs offer investors diversification, providing access to various global markets and sectors through a single security traded just like ordinary shares, as well as potential tax advantages.

Issuers produce factsheets for their instruments and these are generally available on issuers' websites. Factsheets will typically contain information on investment objectives, collateralisation, trading parameters, key features of the product and details of the corresponding index or commodity.

Investors will incur a management fee usually expressed in basis points or a percentage of the return. The rate will vary across different issuers and individual instruments.

Investors are advised to understand fully the investment objectives and mechanisms of an ETP before undertaking to subscribe for these instruments. If in doubt, investors should consult their broker.

Accessing the market

Investors can access the market via a broker and there are a number of services available:

Execution-only brokers will buy or sell according to investor instructions providing no investment or trading advice.

Advisory brokers provide advice and execute trading decisions made by the investor.

Discretionary brokers will execute trades on investors' behalf and may also make investment decisions without investors' prior approval.

Some brokers offer a Direct Market Access (DMA) service whereby member firms of London Stock Exchange can directly submit customer orders to the order book via their own systems. DMA allows sophisticated investors to take greater control over their trades by enabling them to place buy and sell orders directly on London Stock Exchange's order books and execute with other market participants.

Further information
For further information, please contact
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£26bn

value traded across
all ETPs in 2013

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