HMRC - STSM101060 - Exchange Traded Fund

An Exchange Traded Fund (ETF) is a form of collective investment scheme and contains a pool of investments (‘the scheme property’) derived from the contributions of investors. The pool of investments is divided into equal portions called shares, and investors hold a number of shares depending on how much they have contributed. The investors in the ETF are beneficially entitled to an undivided share of the investments subject to the ETF and are referred to as share holders. The price of shares is determined by the Authorised Corporate Director of the ETF (usually on a daily basis) at the current market value of the investments held in the fund.

In broad terms, ETFs typically track (whether wholly or in part) a particular stock market index (for example, the FTSE 100 - a share index of the 100 most highly capitalised United Kingdom companies listed on the London Stock Exchange. The assets of a typical fund will therefore consist solely of shares in companies which are on the specific index.

Being a corporate body, and therefore similar in structure to an open-ended investment company (OEIC), shares in an ETF can be issued to, and surrendered by, investors with the price of a share being determined by the fund manager according to the Net Asset Value (NAV) of the fund.

But, unlike an OEIC, an ETF can be listed on a stock exchange and therefore its issued shares can also be traded on exchange in the same way as normal stocks and shares. In this respect ETFs are similar to “closed-ended” investment company shares. ETF shares will generally trade on the secondary market at a price that mirrors the NAV of the fund. This potentially denies any opportunity by an investor to profit excessively by creating shares and selling those shares on the secondary market rather than surrendering them to the fund manager.

ETFs enable investors to gain a broad exposure to an entire stock market or trade sector, whilst enjoying low costs in surrendering and purchasing ETF shares and with the facility of settling and holding ETF shares in CREST.

Investors in an ETF (or any collective investment scheme) are not allowed to have day to day control over the management of the ETF fund property.

See STSM101050 for the meaning of an Open-Ended Investment Company

See STSM101090 for the meaning of a ‘closed-ended’ investment company

See STSM101010 for the meaning of a Collective Investment Scheme.

See STSM103040 on how shares in a collective investment scheme are valued.

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