

While investors often focus on the Total Expense Ratio (TER) of their ETFs, it is only one component of the Total Cost of Ownership (TCO), or the true cost of ETF investing. This leaflet will look into the components of TCO and demonstrate ETF investors can save by trading Asia, in Asia.

What is TCO?

The TCO can be divided into trading and holding costs:




TCO =

Trading costs	+	Holding costs
<ul style="list-style-type: none"> <input checked="" type="checkbox"/> Bid/ask spread <input checked="" type="checkbox"/> Broker commissions 		<ul style="list-style-type: none"> <input checked="" type="checkbox"/> Tracking difference <ul style="list-style-type: none"> • TER • Securities lending revenue • Investment level taxation • Transaction costs • Other factors <input checked="" type="checkbox"/> Fund and investor level taxation <ul style="list-style-type: none"> • Dividend and interest withholding tax (WHT). See further details below

Tax saved is alpha created


ETF investors spend considerable time optimising their investment strategies, but few are aware that tax reduction can be a way to maximise return. Learn more about this significant yet overlooked source of alpha:

Three tier taxation*

	<p>Investment level</p> <p>Taxes incurred to an ETF for its underlying investments, including stamp duty and WHT on interest, dividends received or capital gains incurred</p>
	<p>Fund level</p> <p>WHT on dividends, interests and other distributions paid by the ETF. Access to reduced or nil WHT dependent on domicile of the fund</p>
	<p>Investor level</p> <p>Taxes on an individual investor's income, capital gains, estate tax etc. dependent on the investor's profile</p>

Location matters

Tax costs vary widely depending on domicile of the investor, domicile and type of ETF, and the jurisdiction of the underlying portfolio investments. With its tax treaty network and domestic tax rules, Hong Kong offers benefits for investors seeking to gain exposure to Asian markets.

ETF	After tax return received by New Zealand investors
 MSCI AC Asia ex Japan Index	Hong Kong \$72
	Ireland \$72
	Luxembourg \$72
	US \$72
	New Zealand \$72

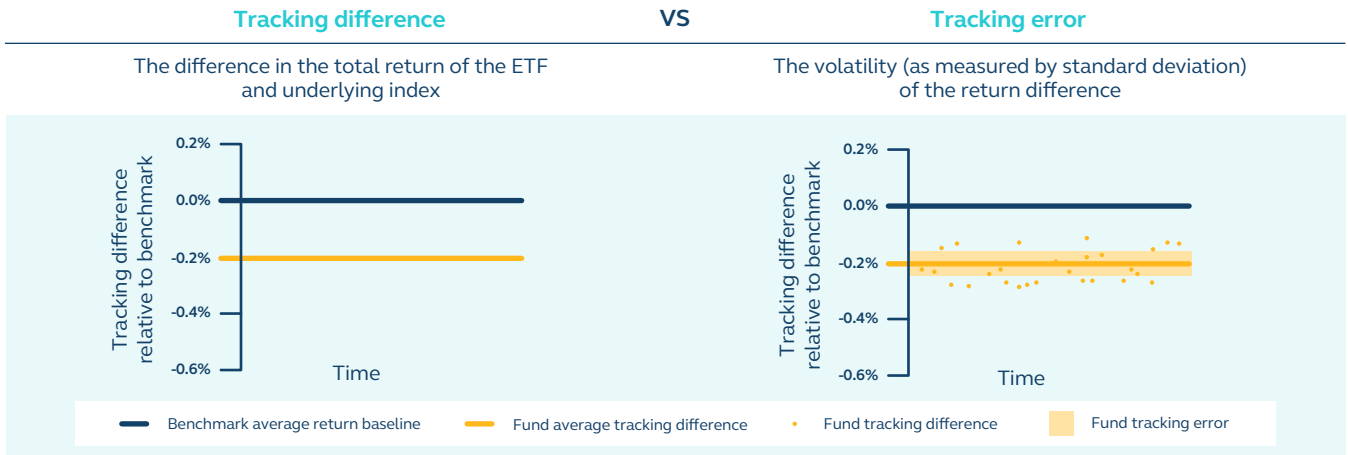
Source: EY report

Example: For New Zealand investors, by investing in MSCI AC Asia ex Japan Index through a Hong Kong-listed ETF, the after tax return from ETF distribution should be 72% of the ETF distribution before three tier taxation, on par with a US-listed ETF on the same underlying.

*Three tier taxation includes portfolio level, ETF level and investor level, and does not take into account any fees to intermediates.

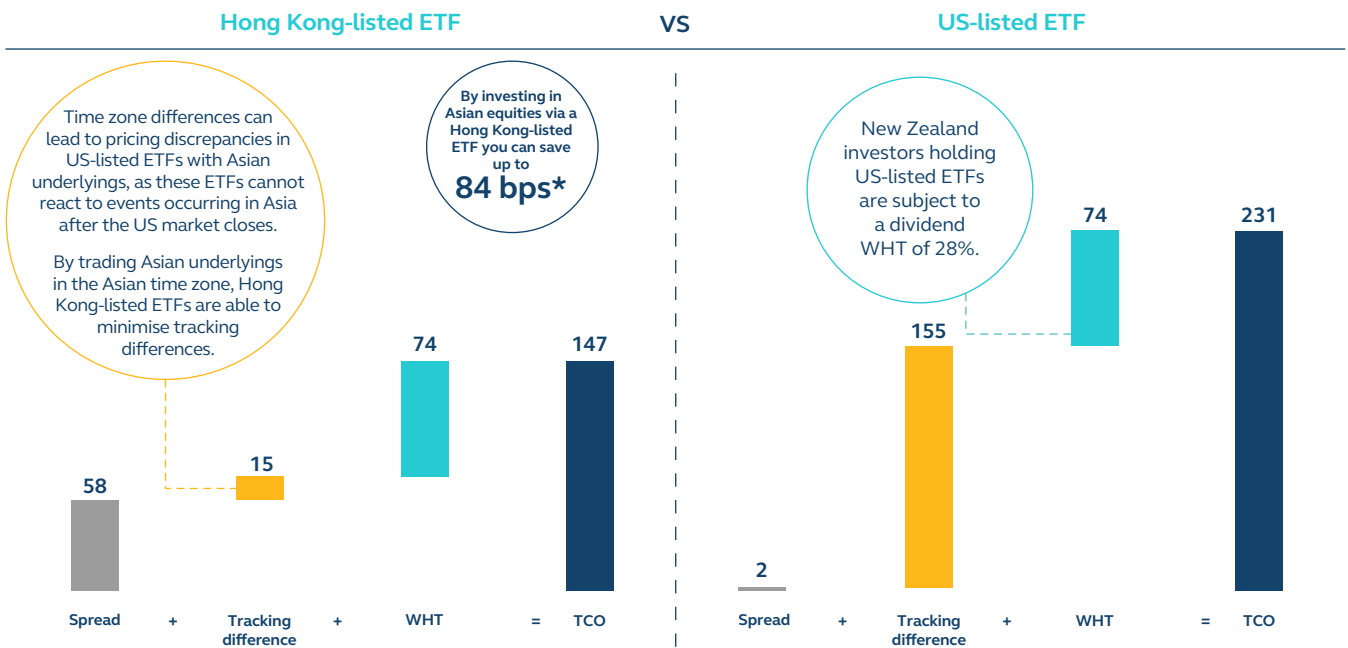
Tracking difference vs tracking error

Tracking difference, an important component of TCO, is often confused with tracking error. Tracking error is the standard deviation of tracking differences. It measures the volatility of tracking differences.



TCO case study: Hong Kong-listed ETF vs US-listed ETF

The following case study compares the TCO incurred by gaining exposure to Asian equities through ETFs listed in Hong Kong versus ETFs in the US. All figures are expressed in basis points.



*The case study and all figures are provided for demonstrating the calculation of TCO and are for reference only. They do not constitute investment advice.

Assumptions:

- Hong Kong ETF: iShares Core MSCI AC Asia ex Japan Index ETF (3010 HK); US ETF: iShares MSCI All Country Asia ex Japan ETF (AAXJ US)
- Tracking difference is measured over a period of 12 months as of 31 January 2023. Data sourced from BlackRock.
- Spread represents the median spread from 1 February 2022 to 31 January 2023. Data sourced from Bloomberg.
- Dividend yield based on dividend payments in the 12 months up to 31 January 2023. Data sourced from Bloomberg.

Estimate
ETF Tax in
Simple Steps



Disclaimer

The information contained in this document is for general informational purposes only and does not constitute an offer, solicitation, invitation or recommendation to buy or sell any securities or other products or to provide any investment advice or service of any kind. This document is solely intended for distribution to and use by professional investors. This document is not directed at, and is not intended for distribution to or use by, any person or entity in any jurisdiction or country where such distribution or use would be contrary to law or regulation or which would subject Hong Kong Exchanges and Clearing Limited, The Stock Exchange of Hong Kong Limited ("SEHK") (together, the "Entities", each an "Entity"), or any of their affiliates, or any of the companies that they operate, to any registration requirement within such jurisdiction or country.

No section or clause in this document may be regarded as creating any obligation on the part of any of the Entities. Rights and obligations with regard to the trading, clearing and settlement of any securities effected on SEHK shall depend solely on the applicable rules of SEHK and the relevant clearing house, as well as the applicable laws, rules and regulations of Hong Kong.

Although the information contained in this document is obtained or compiled from sources believed to be reliable, neither of the Entities guarantees the accuracy, validity, timeliness or completeness of the information or data for any particular purpose, and the Entities and the companies that they operate shall not accept any responsibility for, or be liable for, errors, omissions or other inaccuracies in the information or for the consequences thereof. The information set out in this document is provided on an "as is" and "as available" basis and may be amended or changed. It is not a substitute for professional advice which takes account of your specific circumstances and nothing in this document constitutes legal advice. Neither of the Entities shall be responsible or liable for any loss or damage, directly or indirectly, arising from the use of or reliance upon any information provided in this document.

ADDITIONAL INFORMATION FOR PERSONS IN NEW ZEALAND

This document is being distributed only to, and is directed only at, persons who are "wholesale investors" for the purposes of the Financial Markets Conduct Act 2013 and the Financial Advisers Act 2008.

Hong Kong Exchanges and Clearing Limited

8/F, Two Exchange Square, 8 Connaught Place, Central, Hong Kong
info@hkex.com.hk (t) +852 2522 1122 | (f) +852 2295 3106 hkexgroup.com | hkex.com.hk

