

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

## 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><b>Investment level</b></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><b>Fund level</b></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><b>Investor level</b></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 Thailand investors
Hong Kong	\$76
Ireland	\$64
Luxembourg	\$64
US	\$64
Thailand	\$72

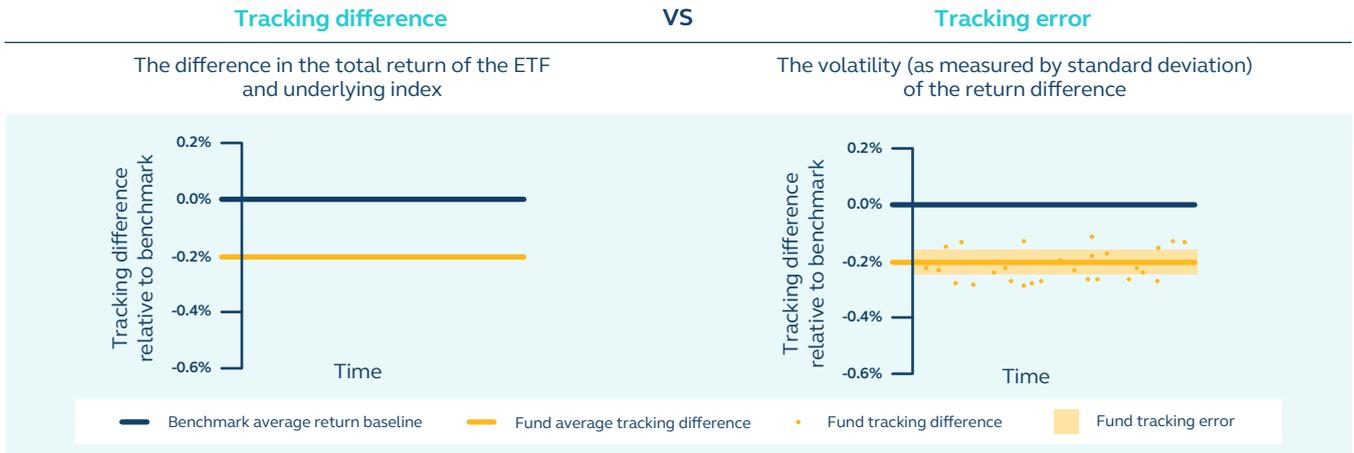
Source: EY report

Example: For Thailand investors, by investing in MSCI India Index through a Hong Kong ETF, the after tax return from ETF distribution should be 76% of the ETF distribution before three tier taxation, versus 64% using a US ETF.

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

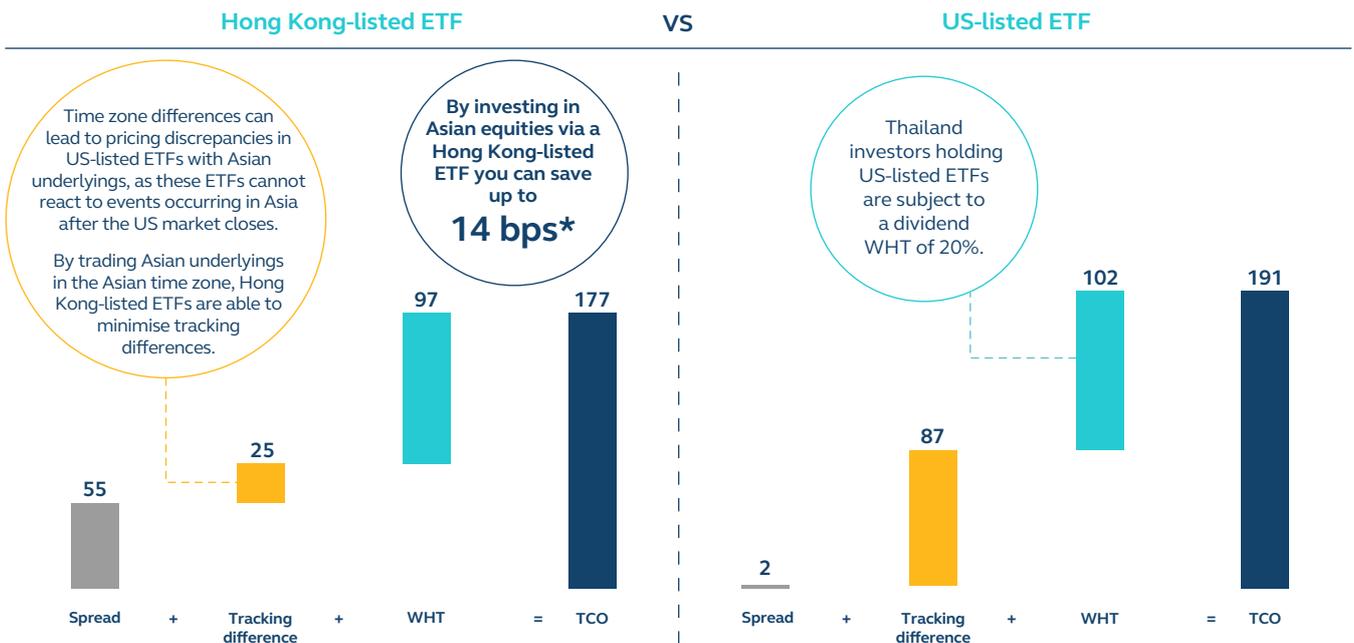
# Tracking difference vs tracking error

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 ETF vs US 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 Taiwan ETF (3074 HK); US ETF: iShares MSCI Taiwan ETF (EWT US)
- Tracking difference is measured over a period of 12 months as of 31 August 2022. Data sourced from BlackRock.
- Spread represents the median spread from 1 September 2021 to 31 August 2022. Data sourced from Bloomberg.
- Dividend yield based on dividend payments in the 12 months up to 31 August 2022. Data sourced from Bloomberg.

### 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 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 THAILAND

The information herein is provided to you solely at your request and is not intended to be solicitation or invitation for you to use any of our services or trade in any particular product.

### 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

