BALANCING ACT: ETF SHARE CREATION & REDEMPTION
Why Have Investors Embraced ETFs?

In large part, it’s because of their tax efficiency, transparency and intraday trading. A process that takes place behind the scenes without any buyer or seller involvement—ETF share creation and redemption—is the key to unlocking these benefits.

Below, we describe how this mechanism works and the market participants involved in the process.

ETF CREATION:
When Demand Exceeds Supply

1. Investor places a trade for ETF shares on exchange through broker
2. To create additional supply, the PD purchases the underlying securities of the ETF basket and delivers them to the ETF sponsor
3. The ETF sponsor issues new shares of ETF to the PD to meet investor demand

THE MARKET PARTICIPANTS

Individual Investor
Buys and sells ETF shares on an exchange through a brokerage account

ETF Sponsor
Generally, a financial institution that creates and administers an exchange-traded fund

Participating Dealers (PDs)
Most often, a broker-dealer that enters into a contract with the ETF sponsor to create and redeem shares

Designated Brokers (DBs)
Normally, a financial firm that actively trades ETFs and provides markets (both bids and offers) on the stock exchange
3 KEY BENEFITS OF ETFs

Here is why the share creation and redemption mechanism is important to investors:

- **Tax efficiency**—During a redemption, the PDs deliver ETF shares to the ETF sponsor in exchange for the underlying basket of securities. This in-kind exchange is not taxable as it does not require the portfolio manager to sell securities to raise the cash to meet redemption requests.

- **Transparency**—ETF sponsors publish the complete basket of securities daily for each fund so that PDs have the information they need to create and redeem shares as well as accurately price in real-time the value of the ETF.

- **Intraday trading**—Investors have the option to trade an ETF at any point when the markets are open. The creation and redemption process helps to keep the price of the ETF in line with the value of the underlying basket of securities (also known as ETF arbitrage).

While it’s not crucial to understand these inner workings, we hope this overview has provided some insight into how the share creation and redemption process works and how it helps make ETFs an attractive investment vehicle.

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ETF REDEMPTION:
When Supply Exceeds Demand

1. Investor offers ETF shares for sale on exchange through a broker
2. To remove excess supply from the market, the PD delivers ETF shares to ETF sponsor
3. The ETF sponsor delivers underlying securities to the PD, who will sell them in the market
Call On Capital Markets

When you're ready to trade, your financial advisor can reach out to our capital markets experts. These professionals have up-to-the-minute intelligence on market trends, communicate regularly with Designated Brokers (DBs) and Participating Dealers (PDs), can connect you with liquidity providers and provide guidance on limit orders—all to help you achieve the best possible executions.

Franklin LibertyShares is a new series of strategic beta and active ETFs designed to help investors seek better outcomes.

Our difference? The Human Factor. Because when it comes to investing, we put our stock in the most intelligent factor of all.

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IMPORTANT LEGAL INFORMATION

All investments involve risks, including possible loss of principal.

ETF units may be bought or sold throughout the day at their market price on the exchange on which they are listed. However, there can be no guarantee that an active trading market for ETF units will develop or be maintained, or that their listing will continue or remain unchanged. While the units of ETFs are tradable on secondary markets, they may not readily trade in all market conditions and may trade at significant discounts in periods of market stress.

The trading prices of an ETF units in the secondary market generally differ from the ETF’s daily NAV and are affected by market forces such as supply and demand, economic conditions and other factors.

ETFs trade like stocks, fluctuate in market value and may trade at prices above or below the ETFs net asset value. Brokerage commissions and ETF expenses will reduce returns.

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