Welcome to the ninth edition of our quarterly BNY Mellon ETF Services Newsletter. The purpose of this Newsletter is to keep our ETF Services clients up to date on information about how we do business, and in particular, how we are providing services to you.

Market Commentary

At the end of May 2014, the global ETF industry had 3,749 ETFs, with 8,015 listings and total assets of $2.40 trillion. The global ETF asset growth YTD 2014 through the end of May is 6.6%. This is from a total of 192 ETF providers on 57 exchanges.

Global inflows into ETFs in 2014 through the end of May was $88.74 billion.

Source: ETFGI, May 2014

U.S. Market Commentary

As of the end of May 2014, the US ETF industry had 1,314 ETFs/listings and total assets of $1.71 trillion. The US ETF asset growth YTD 2014 through the end of May is 6.2% from a total of 42 providers on 3 exchanges. In 2014 through the end of May, there have been 74 new ETFs launched by 18 providers, while 19 ETFs have delisted.

US inflows into ETFs in 2014 through the end of May was $47.84 billion, representing 53.9 of the global ETF inflows. YTD, Vanguard, iShares and First Trust have garnered the most inflows, while US SPDR ETFs, WisdomTree and Invesco PowerShares have experienced the most outflows. For US Equity ETFs; European, Global (ex-US), and North American exposed ETFs have garnered the most inflows, while Emerging Markets,and Asia Pacific exposed ETFs experienced net outflows. For US fixed income ETFs, Government, Broad/Aggregate and Corporate exposed products saw the most inflows, while Inflation exposed products saw net outflows. Commodities based ETFs have seen overall outflows YTD 2014 as an asset class, but Precious Metals, Industrial Metals, and Livestock exposed products experienced net inflows with the outflows led by Agriculture, Energy and broad-based exposed products.

Source: ETFGI, May 2014

ETF News in the US

BNY Mellon Awarded Best ETF Service Provider In The Americas for Eighth Year in Row

BNY Mellon, the global leader in investment management and investment services, has been named as the 2013 "Best Service Provider - The Americas" at the 10th annual Global ETF Awards, which is sponsored by exchangetradedfunds.com. This is the eighth consecutive year that BNY Mellon has been honored as the top service provider to ETFs.

"This recognition from our clients and key industry participants reflects our unwavering commitment to deliver the highest quality customer service and industry-leading technology," said Joseph F. Keenan, managing director for BNY Mellon Asset Servicing and head of its global ETF services business. "Our recent introduction of an automated system for calculating collateral requirements in the ETF marketplace is another example of our technological leadership."

Canadian Market Commentary

Assets in Exchange Traded Funds (ETFs) in Canada have hit all-time high of $68.5 billion as of the end of May 2014 (Canadian ETF Association - CETFA). For 2014 year-to-date, assets have grown 8.7% (as of May 31, 2014; CETFA). Net-new creations into ETFs through May 2014 are $1.5 billion (CETFA). Year-to-date 2014, Canada has seen 23 new ETFs launched by seven providers, while 13 ETFs were delisted (in calendar Q2 as per TMX as at June 23, 2014). There are now 325 ETFs listed on the TSX.

Source: TMX, June 23, 2014

Regulatory News of Interest to the ETF Segment

- April 2, 2014 -The Investment Industry Regulatory Organization of Canada (IIROC) recently proposed amendments that would expand the Universal Market Integrity Rules (UMIR) definition of Basis Order to explicitly include Exempt Exchange-traded Funds (ETF). IIROC would like stakeholders to submit their comments by June 25, 2014.
- April 11, 2014 -The Canadian Securities Administrators (CSA) recently announced a request for proposals (RFP) to conduct research on Canada's mutual fund fee structure. This call for third party research comes on the heels of a CSA Discussion Paper published in December 2012 that identified potential investor protection issues arising from Canada's current mutual fund fee structure.
- April 29, 2014 -The Investment Industry Regulatory Organization of Canada (IIROC) recently announced that it has selected two project teams of academics to evaluate the impact of high frequency trading (HFT) and associated activity on Canadian equity markets as part of the final phase of its HFT Study. IIROC anticipates that this third and final phase of its study will be concluded by the end of 2014.
- May 30, 2014 -The Investment Industry Regulatory Organization of Canada (IIROC) recently announced the selection of a third project team to review the impact of high frequency trading (HFT) on Canadian equity markets as part of the third and final phase of its HFT study. According to IIROC, the study will help contribute empirical data and objective study to the addressing of regulatory concerns pertaining to HFT. IIROC anticipates that the study will lead to a better understanding of HFT's impact on market integrity, quality and overall investor confidence.
- June 19, 2014 - Modernization of Investment Fund Product Regulation (Phase 2) - Final Amendments. The Phase 2 amendments include several new regulations for mutual funds, which ETFs are in Canada, including a new prohibition against investing in closed-end funds, changes to securities lending requirements, and new sales communication requirements following conversion from a closed-end fund. The Phase 2 amendments will also, have far-reaching effects on how closed-end funds are managed, including new investment restrictions, unit holder approval requirements, and rules relating to subsequent offerings (including a prohibition against issuing warrants). The Phase 2 amendments are expected to come into effect on September

22, 2014, though several changes will have longer transition periods.

Asia Market Commentary

MSCI decided not to admit China A-Shares to its global emerging market indices in view of the mainland's quota restrictions for overseas investors; an uncertain tax regime and capital controls. FTSE Group launched the new FTSE Global R/QFII Index Series allowing investors to add China A-Shares to their customized indices based on their own QFII/RQFII allocation. The flexibility allows investors to prepare for the eventual inclusion of China A-Shares in global benchmarks.

China Universal Asset Management launched the first two RQFII sector-based ETFs in Hong Kong in May, namely, C-Shares CSI Consumer Staple Index ETF and C-Shares CSI Healthcare Index ETF, tracking the respective sectors under the broad CSI 800 Index which includes the big-cap CSI 300 Index as well as the medium and small-cap CSI 500 Index. China Universal in China submitted in July 2013 its application for its inverse ETF to CSRC and is still waiting for the Chinese regulator's decision.

In June, Vanguard launched three new ETFs in Hong Kong, including the market's first with European equities exposure. The three new ETFs are the FTSE Developed Europe Index ETF, FTSE Asia ex-Japan High Dividend Yield Index ETF and the FTSE Japan Index ETF.

Taiwan's Yuanta Securities Investment Trust plans to launch the country's first commodity-focused ETFs this year. Yuanta is aiming to list a gold ETF and a crude oil ETF this year tracking the S&P GSCI gold and crude oil indices respectively, using gold and oil futures to replicate the indices, after the FSC relaxed the rules in February to allow asset managers to launch ETFs that invest in futures contracts. Taiwanese fund houses previously found it difficult to launch commodity ETFs because they and the market makers could not hold physical commodities.

Taiwan's FSC has also published consultation in June to gather local investor's feedback to allow local fund managers to launch leveraged ETFs and inverse ETFs. In March, the FSC gave the nod for local fund managers to launch ETFs that track futures indices.

Malaysia's only asset manager offering Islamic ETFs, i-VCAP Management, plans to launch its first product this year containing Shariah-compliant equities in the Association of Southeast Asian Nations (ASEAN) region, tracking a regional index. Currently, there are six listed ETFs on Malaysia's stock exchange, and only the two offered by i-VCAP are Shariah-compliant. I-VCAP who seeks more retail investment, has submitted proposal to regulators to allow retail subscribers to purchase ETF shares of its next ETF online and via automated teller machines.

In March, Krung Thai Asset Management in Thailand listed its KTAM SET50 ETF Tracker (ESET50) on the SET which offered the lowest management fee among ETFs in several other markets tracking the SET50 index, according to SET.

Also in March, India launched a public sector ETF, the Central Public Sector Enterprise ETF (CPSE ETF), as part of the government's disinvestment programme, according to SEBI. The ETF tracks the CPSE Index with equities listed on the NSE and having more than 55% shares held by the government. It was the country's largest equity fund since 2008, having raised $500 million at IPO. The ETF has a tap facility for the government to continue divestment from the 10 companies until it hits its minimum 51% holding in each. There is still potential for the ETF to grow, the government has announced plans to divest $5 billion in state-owned firms over five years. The ETF is also in compliance with the provisions of the Rajiv Gandhi Equity Savings Scheme (RGESS) aimed at attracting first time investors to mutual funds in India. Meanwhile, gold ETFs which were previously popular among retail investors in India have suffered account closures and continuous net outflows as the demand for gold is on the decline and the earlier ban on gold imports in India also impacted gold ETFs.

ETF News in Asia

Asia-Pacific ETF Assets Under Management Could Reach US$250 Billion by 2016, says BNY Mellon

With 'mutual recognition' of investment products between Hong Kong S.A.R and the People's Republic of China set to transform these markets, regulators and market participants need to consider the conditions that will allow the benefits of this impending policy to take full effect for the region's growing exchange traded funds market. Rex Wong, Managing Director within BNY Mellon's Asia Asset Servicing business, describes the market infrastructure, product developments and aspects of investor education that are needed to bring about the full potential of mutual recognition for exchange-traded funds (ETFs).

"There's great potential for mutual recognition to make life easier for ETF promoters and drive product design and development as they expand their footprint in the Asia-Pacific region. But success in building the ETF market in China and sustaining product development also requires changes in local market infrastructure and, most importantly, regulatory reforms.

"Today, Hong Kong and China together account for around 35% of total ETF assets under management (AUM) in the region, with Japan accounting for approximately 45%. The Asia-Pacific ETF market as a whole is seeing growth of 15%-20% annually. Once the right structures are in place, we expect the ETF market in Hong Kong and China to outpace the growth of the broader Asia-Pacific region. Mutual recognition may accelerate the growth, leading to AUM in Asia-Pacific's ETF market to grow by as much as 50% to reach US $250 billion by 2016 from its base of roughly US $165 billion today.

"We start from the premise that mutual recognition cannot be viewed in a vacuum. It will exist as part of - and because of - the success of other efforts that the Chinese government has put in place to liberalize its financial sector and facilitate cross-border capital flows. The pillars of this system include the expansion of the Renminbi Qualified Foreign Institutional Investor (RQFII) program, raising investment quotas for RQFII holders, opening new asset classes to foreign investors, such as interbank debt, and free trade zones.

"All of these programs need time to develop in order to create the right environment for ETF promoters to take full advantage of mutual recognition. In the interim, mutual recognition will mostly benefit mutual funds, as the market infrastructure requirements are less complex than for ETFs.

"However, I believe we will see some ETF developments in the early days of mutual recognition, especially in the area of China A-share ETF products listed in China thanks to the continued interest of Asian investors in the country's domestic market. In the medium term, investors will also be able to access more diverse asset classes including international equities, bonds and commodities. That will give them an exchange-listed option to gain exposure to global markets and other asset classes that do not currently exist today in their home market.

"But these are modest developments, essentially low hanging fruit. New market infrastructure is needed in order for China's ETF market to reach a stage of development that resembles the big ETF markets in Asia-Pacific, which are Japan, Hong Kong and Korea."

Promoting ETF liquidity and enhancing the ease of currency transfers

"First, we need to see more broker-dealers act as ETF market-makers and their active participation to provide liquidity is essential to the survival of ETFs. The ETF market making business in China is relatively new. However, many global broker-dealers already have a presence in Hong Kong, and can step into this role if regulation so permits it. They can bring their global trading platforms and expertise, and promote the development of this sector in

China.

"Second, an ETF that uses multiple active market makers that can access multiple liquid alternative hedges in addition to its basket would make it easier for the ETF to attract assets and to survive in the ETF space. There needs to be a diverse range of futures and options and a liquid derivatives market for ETFs. This will be an important inducement to market-makers as it allows them to hedge their exposure for the products in which they are providing liquidity.

"Third, removing restrictions on short-selling of ETFs would lower the cost that market-makers face and improve their ability to provide liquidity in the market.

"Finally, there needs to be a more streamlined process for transferring RMB across borders to make it more of a real-time process. This point is crucial. Restrictions on and delays in RMB transfers can prevent fund managers from investing in the underlying index shares. This introduces the risk that ETFs will suffer 'tracking error,' which can undermine their appeal, especially to institutional investors. A system for real-time RMB transfers or enhancement to the existing cross-border transfer process will alleviate this pain point and really allow the industry to take full advantage of mutual recognition."

Achieving the full benefits of mutual recognition

"Once the regulatory and infrastructural foundations are in place, the market will be able to support a greater number of ETFs and investment styles covering a variety of industry sectors, asset classes and investment strategies.

"We are seeing some innovative products today, like fixed income, sector, style, gold, cross-exchange and cross-border ETFs in China, but enhanced infrastructure, on the back of regulatory reforms, will really allow the market to develop further. Korea has been very progressive and has seen products such as inverse and leveraged ETFs come to market and we have seen Japan follow suit. Nevertheless, unless the current regulation is relaxed, we will not see the same level of innovation in China or Hong Kong.

"While regulatory reforms remain the key to the development of Asia's ETF market, investor education will play a vital role. The ETF promoters can foster wider and deeper usage of ETFs by showing how they facilitate asset allocation and portfolio building. And with trading in China's domestic markets dominated by retail investors, fund sponsors need to encourage institutions to see ETFs as instruments that can be used both tactically and strategically. Institutional and retail participation will be critical for the ETF market's growth."

BNY Mellon Named Best in Asset Servicing, Best in Securities Lending and Best in Collateral Management in Asia Awards

BNY Mellon received top recognition at The Asset Triple A Asset Servicing Awards 2014 in Hong Kong last week, scooping five accolades including Best in Asset Servicing, Best in Securities Lending and Best in Collateral Management in Asia. The company also won two awards for Best Custody Mandate and Best Corporate Trust mandate.

"The needs of our clients across Asia-Pacific continue to evolve, partly influenced by the shifting regulatory landscape, and partly driven by ongoing globalization and diversification as clients seek new sources of alpha and new avenues of raising capital," observed BNY Mellon's Eleni Wang, Asia-Pacific Head of Investment Services.

"Our clients rely on us to listen, understand and develop solutions which ensure they are successful and meet their changing needs. These accolades suggest they feel we are exceeding their expectations on doing just this. We are delighted to be recognized for our achievements and thank the judges for these honors."

Europe Market Commentary

Year to date ETF assets have increased by 10.1% to USD 434 billion, as of the end of May 2014. There is continued growth in the number of products in Europe with 50 new ETFs launched year to date (through end of May) across 12 providers, bringing the total number of ETF listings to 4,976 from 44 providers across 24 exchanges.

Source: ETFGI

From April 2014, the UK Government terminated Stamp Duty and Stamp Duty Reserve Tax (SDRT) charges on the purchase of units in ETFs to encourage the UK as a domicile of choice by ETF Issuers.

July 2014 is a key date for AIFMD and FATCA implementation, therefore there has been a strong focus in EMEA in preparation of both. A regulatory update is expected in Ireland in July regarding the introduction of a new legal structure, Irish Collective Asset-management Vehicle ("ICAV"). It is currently anticipated that a large number of locally domiciled ETFs, as well as mutual funds, will adopt this structure. In tandem, ETF issuers are turning their attention to the harmonization of European markets to T+2 settlement. The majority of European markets will transition in October 2014 which will also impact the trading of ETFs in these markets.

BNY Mellon Capital Markets

BNY Mellon Capital Markets continues to see an uptick in the institutional market place for ETFs, both for strategic as well as tactical purposes. Over the quarter BNY Mellon Capital Markets have traded well over $2bln of ETFs. Highlight trades include blocks of $200mm and $185mm in Japanese Equities and Emerging Market Equities, respectively. The sales/trading team has been fielding questions routinely from Institutional clients including Insurance Companies and Pension Plans on the merits of ETF investing, trading strategies, the mechanics behind the trades and the changes in regulatory environment. In addition, BNY Mellon Capital Markets has taken the opportunity, when commercial, to introduce interested clients with our relationships at various Investment Management firms to provide a deeper dive into specific products and strategies.

BNY Mellon ETF Symposium

Please save the date for the upcoming 3rd Annual BNY Mellon ETF Symposium. This will be held at the St. Regis Monarch Beach in Dana Point, California on December 2-4, 2014. This premier event brings together the various components of the ETF ecosystem with retail and institutional buyers of ETFs. The educational, value-added agenda will include the following topics: State of the ETF Industry, ETF Trading and Execution, Emerging Types of Actively Managed ETFs, Asset Allocation and Global Access, Smart Beta ETFs, Fixed Income, Managed Portfolio Strategies, Liquid Alternative ETFs, Currency and Hedging ETF Products. The sessions and agenda are in the process of being finalized shortly. This year, there will be a closing bell ringing live from the conference from NASDAQ OMX.

There are several exhibiting and sponsorship opportunities available. Please contact Brian Brennan for additional information at 212-635-8303 or brian.brennan@bnymellon.com.

SAVE THE DATE

BNY MELLON ETF SYMPOSIUM, DECEMBER 2 - 4, 2014
St. Regis Monarch Beach Resort,
Dana Point CA

Join us for the 3rd annual ETF Symposium, a dynamic forum on best practices and insights bringing together ETF sponsors, RIAs institutional investors and investment professionals.

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