

Investor Update: STW June 2019 Franking Credits

18 July 2019

For the first time in its history of operation, the SPDR S&P/ASX 200 Fund (“STW”) did not distribute franking credits with its year-end distribution. The following provides an explanation of the factors that have contributed to this.

What happened?

STW normally includes franking credits with its quarterly distribution. The June 2019 quarter distribution did not include any franking credits.

Why were no franking credits distributed?

Over the 2018/19 financial year, STW received franked dividends from its holdings in S&P/ASX 200 stocks at very close to index levels. However, like any other managed investment scheme, the Fund cannot automatically pass these franking credits on to its investors. It must first pass the “holding period” test in the tax law. There are two alternatives to passing that test. The first alternative is the “45 day rule”. Under this test, broadly if a fund has held a share for at least 45 days within a specified period around the ex-dividend date it can distribute any franking credits attached to that dividend.

The second alternative is the “benchmark rule”. The ATO publishes a “benchmark” level of franking and the fund tests its franking credits against this “benchmark”. The fund can distribute this “benchmark” level of franking credits plus an extra 20% without any other restrictions applying. Taking account of the factors noted below, this is the test STW elected to apply many years ago, even though that election cannot be revoked unless the ATO allows.

STW included franking credits in its September 2018, December 2018 and March 2019 distributions. The June 2019 testing showed that the franking credits already distributed exceeded the franking credits permitted under the “benchmark rule”. As a result, STW was unable to distribute franking credits for the June quarter.

To be clear, it is not that STW did not receive franked dividends. Rather, under the “benchmark rule”, STW is not permitted to pass all its franking credits through to investors for the 2018/19 income year or carry them forwards to future years.

Why did STW choose the “benchmark rule”?

Managed investment schemes have always faced the risk of receiving franking credits that they cannot pass on to investors under either the “45 day rule” or “benchmark rule”.

It is not uncommon for ETFs to experience both large inflows and large outflows from institutional investors. The “benchmark rule” was selected for STW many years ago because it reduced the risk of losing franking credits in this environment.

Take the following example; a large application by an investor one month is followed by a large redemption by a different investor the next month. Under the “45 day rule” there is a risk that franking credits earned in the interim will be denied. The “benchmark rule” avoids this risk and this is why it was selected for STW.

Why have franking credits been denied under the “benchmark rule”?

STW holds S&P/ASX 200 securities at very close to their benchmark weights, and so it is reasonable to expect that all franking credits received by the fund could be distributed to investors under a broadly based benchmark rule.

We are still actively investigating why this was not the case for the June 2019 year for STW. We are continuing to pursue this issue with our tax advisors and will advise investors as more information becomes available.

What about my tax statement for the 2019 financial year?

We are due to release investor tax statements next week. If there is any immediate prospect of a change to the position discussed above for STW for the June 2019 quarter we may delay the release of STW tax statements.

Are other SPDR ETFs impacted?

All SPDR ETFs with Australian equity exposure face the risk of receiving franking credits that they cannot pass on to investors. This is not only true for all other ETFs issued in Australia, it is also true for managed investment funds generally.

STW is the only SPDR ETF that uses the “benchmark rule”. All other SPDR ETFs use the “45 day rule”. According to the June 2019 testing, none of the other SPDR ETFs faced any material reduction in the franking credits passed through to investors under the “45 day rule”.

Will future dividends from STW have franking credits denied?

We expect to resolve this issue well before the next financial year end in June 2020. Accordingly we expect STW to be able to distribute franking credits as per normal in the future. However, like all ETFs listed in Australia, the possibility of future franking credits being denied cannot be completely removed.

Important Risk Information:

Issued by State Street Global Advisors, Australia Services Limited (AFSL Number 274900, ABN 16 108 671 441) (“SSGA, ASL”). Registered office: Level 17, 420 George Street, Sydney, NSW 2000, Australia · Telephone: 612 9240-7600 · Web: www.ssga.com.

SSGA, ASL is the issuer of interests and the Responsible Entity for the ETFs which are Australian registered managed investment schemes quoted on the AQUA market of the ASX or listed on the ASX.

This material is general information only and does not take into account your individual objectives, financial situation or needs and you should consider whether it is appropriate for you. You should seek professional advice and consider the product disclosure document, available at www.spdrs.com.au, before deciding whether to acquire or continue to hold units in an ETF. This material should not be considered a solicitation to buy or sell a security.

ETFs trade like stocks, are subject to investment risk, fluctuate in market value and may trade at prices above or below the ETF's net asset value. ETFs typically invest by sampling an index, holding a

range of securities that, in the aggregate, approximates the full index in terms of key risk factors and other characteristics. This may cause the fund to experience tracking errors relative to performance of the index.

Investing involves risk including the risk of loss of principal.

Diversification does not ensure a profit or guarantee against loss.

SPDR and Standard & Poor's® S&P® indices are trademarks of Standard & Poor's Financial Services LLC and have been licensed for use by State Street Corporation. ASX®, a registered trademark of ASX Operations Pty Limited, has been licensed for use by SSGA, ASL. SPDR products are not sponsored, endorsed, sold or promoted by any of these entities and none of these entities bear any liability with respect to the ETFs or make any representation, warranty or condition regarding the advisability of buying, selling or holding units in the ETFs issued by SSGA, ASL.

The whole or any part of this work may not be reproduced, copied or transmitted or any of its contents disclosed to third parties without SSGA, ASL's express written consent.