Making Sense of Unit Trusts

Produced by

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ABS THE ASSOCIATION OF BANKS IN SINGAPORE

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Contents

1 Introduction

What is a unit trust?

2 What are the benefits of investing in a unit trust?

3 What are some of the drawbacks of investing in a unit trust?

4 What should I think about before investing in a unit trust?

6 Are all unit trusts equally risky?

7 What information should my financial adviser disclose to me when recommending a unit trust?

8 What is a prospectus and what should I look out for in this document?

10 What fees and charges do I have to pay?

11 What is the Total Expense Ratio?

12 How are unit trusts priced?

15 What is a trust deed and what is the role of a trustee?

16 How do I check whether a unit trust is approved for offer to the public?

Who can distribute unit trusts?

17 Can I invest in unit trusts that are set up overseas?

Does MAS approval mean that the unit trust will be profitable and is a safe bet?

18 How are "capital protected funds" different from "capital guaranteed funds"?

19 What is the difference between a "closed-end" fund and an "open-end" fund?

20 What happens if I change my mind after I have bought a unit trust?

21 What reports can I expect to receive for my unit trust investment? How frequently will the reports be sent to me?

22 What will happen to my investment if the unit trust is terminated?

Quick guide to investing in unit trusts

Introduction

Making Sense of Unit Trusts

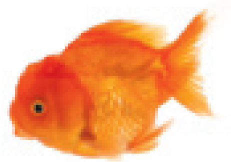
The purpose of this Guide is to help you understand what unit trusts are and what you should consider before investing in them. It highlights the benefits and risks of investing in unit trusts, what you should look out for in the prospectus and other important information you should know to make sense of your unit trust investment.

What is a unit trust?

A unit trust (also known as a collective investment scheme) is a pool of money managed collectively by a fund manager. You invest in a unit trust by buying units in a trust. Your money will be pooled with that of other investors and invested in a portfolio of assets to achieve the investment objective of the unit trust.

When a unit trust is first launched for sale, the price of each unit is usually fixed. If you invest in an existing unit trust, the price of each unit will be based on the market value of the underlying assets that the unit trust has invested in. The number of units you will receive depends on the amount of your investment less the sales charge you have to pay.

As unit trusts are generally considered medium to long-term investments, you should have the financial resources to stay invested in them for a reasonable period of time so as to gain the full benefits. If you need to convert your investments to cash in the short-term to meet specific needs, a unit trust may not be suitable for you.

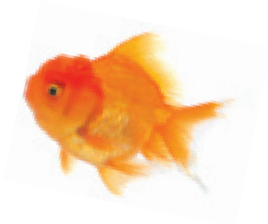


What are the benefits of investing in a unit trust?

- **Professional Management**
  Unit trusts are managed by professional fund managers with expertise and experience in investments. They will monitor your investments on a day-to-day basis, and make decisions based on research and analytical tools that you may not have access to.

- **More Investment Opportunities**
  By investing in a unit trust, you are pooling your money with that of other investors. As such, the fund manager is able to invest in a wider range of assets. Some assets such as bonds require a minimum investment of around $100,000, which may be difficult for individuals to access directly. You will also be able to tap overseas markets with less hassle, and as the size of the assets under management is large, you will benefit from lower transaction costs.

- **Diversification**
  As a unit trust invests in a wider range of assets, you can better spread your risks. This means that poor performance of any one asset in the unit trust is not likely to have a major adverse impact on your investment as a whole.

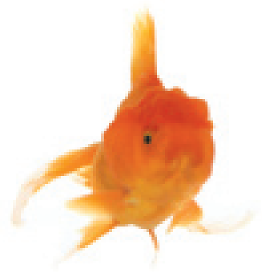


What are some of the drawbacks of investing in a unit trust?

- **No control over individual investments purchased by the fund**
  By investing in a unit trust, you give up control over the choice of individual bonds, shares and other assets that go into the fund, as the fund manager will make these decisions for you.

- **Fees and Charges**
  You would usually have to pay a one-time initial sales charge (sometimes known as a "front-end load") when you buy a unit trust. There may be other costs, such as trustee fees, management fees and redemption fees (fees charged when you sell your units in the fund).

- **Risks**
  Just like any other investment, there is always an element of risk investing in unit trusts. Although investing in unit trusts helps to diversify some of your risks, it does not eliminate all risks entirely. As such, be prepared for fluctuations in the market price of your unit trust.



What should I think about before investing in a unit trust?

Unit trusts differ in terms of investment objectives, strategies, risks and costs. Think about whether you want the unit trust to provide regular income or for your initial capital to grow. Choose one that matches your investment objectives and risk profile. When choosing a unit trust, consider the following:

- **Risk Profile**
  Your risk profile is determined by how much risk you are willing to bear. It will differ, depending on your age, financial situation and investment objective.

- **Investment Objective**
  Some unit trusts focus on certain asset classes, geographical regions or industry sectors.

- **Investment Strategy**
  Even unit trusts with the same investment objective may use different investment strategies to achieve the same goal. Some fund managers choose companies that offer good "value", while others choose companies for their "growth" potential. Make sure that the fund's investment strategies are in line with your own investment objectives.

- **Foreign Exchange Risks**
  Unit trusts that invest in foreign currency-denominated assets while being priced in Singapore dollars will be exposed to foreign exchange risks. This is also true for unit trusts that are priced in foreign currencies. Depending on the direction of exchange rate movements, you may be subject to foreign exchange gains or losses when you invest in such funds.

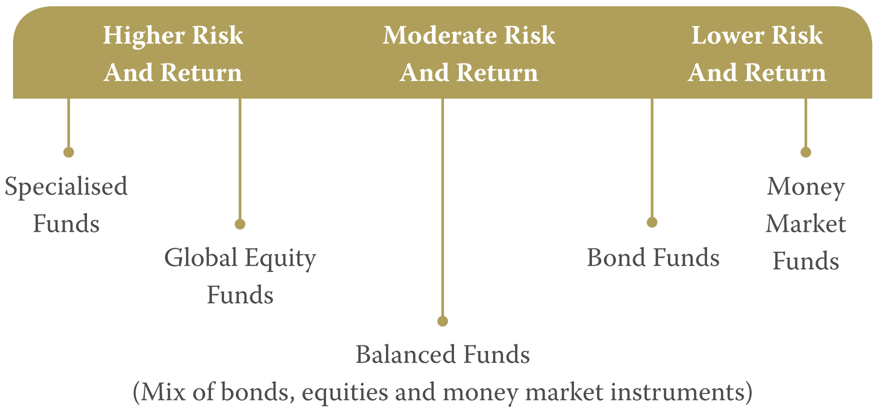
- **Time Horizon**
  Your investment time horizon is the time period that you stay invested until your expected withdrawal. The younger you are, the longer would be your investment time horizon. It is a critical factor in determining what types of investments are right for you. Investments that offer higher potential returns also involve greater risk of price fluctuation and therefore require a longer time horizon.

- **Fund Manager**
  As the fund manager is the one looking after your unit trust, you should be comfortable that the firm and its staff have the necessary resources, experience and skills to manage your investment.

Are all unit trusts equally risky?

Unit trusts differ in the type of assets they invest in and the strategies used by the fund manager. Some unit trusts aim to deliver higher returns but this is almost always accompanied by higher risks. Choose a unit trust that meets your investment objective and risk profile. The diagram below shows the risk/return profile of different types of unit trusts:

Risk/Return Profile



What information should my financial adviser disclose to me when recommending a unit trust?

When recommending a unit trust, your financial adviser is required to disclose to you the key features of the product including the following:

- Nature and aim of the product
- Benefits of the product
- Risks of the product
- Details about the fund manager
- Fees and charges to be borne by you
- Share of fees and commissions due to the financial adviser
- Warnings, exclusions and disclaimers

For more information on how to deal with a financial adviser, refer to the MoneySENSE guide "Dealing With A Financial Adviser: What To Look Out For?" available at www.moneysense.gov.sg.

What is a prospectus and what should I look out for in this document?

Every unit trust that is sold to the public must be accompanied by a legal document called a prospectus. You can obtain the prospectus from your fund manager or financial adviser. Read it carefully as it contains important information that you should know before investing in a unit trust. These include the fund's investment objective, strategy, risks, fees, historical performance and other important information. Speak to your fund manager or financial adviser if you are unclear about the information in the prospectus.

The following are some of the key items to look out for in the prospectus:

- **Investment Objective, Focus and Approach** - Check whether the fund's investment objective, focus and approach match your own investment goals.

- **Risks** - Find out what are the risks of investing in the unit trust and check whether they match your risk profile. The value of a unit trust's investment in listed shares, for example, may be affected by the economic and political conditions of the country where the listed company operates. In addition, where the trading volume in certain developing markets is thin, the purchase or sale of securities by the fund may be done at unfavourable prices. Where a Singapore dollar denominated unit trust invests in securities denominated in foreign currencies, any change in the exchange rate between the Singapore dollar and these foreign currencies may also affect the return of the unit trust.

- **Performance** - Although the past performance of a fund is not indicative of its future performance, it is useful to compare the fund's performance to its benchmark and other funds with similar investment objectives. Information about the performance of various unit trusts and investment linked products can be found at www.fundsingapore.com.

- **Fees and Charges** - Check what you need to pay and compare them with similar funds.

- **Subscription, Redemption and Switching of Units** - The procedures for subscribing to the unit trust, redeeming your investment and switching to another unit trust are described in the prospectus. Read these carefully.

What fees and charges do I have to pay?

There are two broad categories of fees: those to be paid by you and those to be paid by the fund. Some of the more common fees and charges are:

(a) **Fees and charges to be paid by you** - These represent one-time fees that you pay to invest in a unit trust.

(i) *Initial sales charge* (also known as the "front end load") - This fee is charged when you buy a unit trust, and is typically 1.5% - 5% of your investment. Funds with an initial sales charge would usually not charge a redemption fee.

(ii) *Redemption or realisation charge* (also known as the "back end load") - This fee is usually set at 1% - 5% of your investment, and is charged whenever you sell or redeem the fund. Some unit trusts progressively reduce the redemption fee if you hold your investment over a longer period of time. Funds that charge a redemption fee typically would not have an initial sales charge.

(iii) *Switching fee* - Some unit trusts allow investors to switch or change to another fund managed by the same fund manager. A switching fee of about 1% would usually be charged. There may also be free switching facilities available - check with your fund manager or financial adviser.

(b) Fees and charges to be paid by the unit trust - These are fees that the fund manager, trustee and other parties charge to the unit trust. While you do not pay these fees out of your own pocket, they are nevertheless paid for by the unit trust, which will reduce the return you get on your investment.

(i) *Management fee* - This is an annual fee charged by the fund manager for the management of the fund. It is typically 0.5 - 2% per annum of the Net Asset Value (NAV) of the fund. The NAV of a unit trust is the value of the fund's assets less its liabilities.

(ii) *Trustee fee* - This is the annual fee charged by the trustee for the provision of custody services for the fund's assets. It is usually set at 0.1 - 0.15% per annum of the NAV of the fund.

When reading the prospectus, pay attention to the maximum amount that the unit trust can levy for each charge. Take note that although some unit trusts do not currently levy certain charges, they may do so in future. Ask your fund manager or financial adviser to provide a clear breakdown of all the fees and charges that you have to pay for your unit trust investment.

What is the Total Expense Ratio?

This is the operating expenses of the fund expressed as a percentage of the fund's assets. The ratio, of which the management fees and trustee fees form a large component, is calculated to ensure that investors are properly informed of all relevant costs of having their funds managed. It also enables meaningful comparison among fund managers with different cost structures.

How are unit trusts priced?

Unit trusts are priced either by the "bid and offer pricing" method or the "single pricing" method. The fees and charges built into the pricing structure will determine the number of units you get upon subscription and the amount you will receive upon redemption. You can find details of the pricing method in the prospectus. We illustrate both pricing methods with two examples below.

Bid and Offer Pricing

A unit trust's offer price is the price at which investors buy units; while the bid price is that which investors sell their units. The difference between the bid and offer prices of a unit trust reflects the subscription (sales charges) and the redemption charges (if any). In the "bid and offer pricing" method, the subscription charge is added to the NAV per unit, while the redemption charge is deducted from the NAV per unit.

In the following example, Unit Trust A is assumed to have a bid and offer price structure, and both subscription and redemption charges.

When buying Unit Trust A:

Assuming that
(i) the NAV of Unit Trust A is $1.00 per unit; and
(ii) the initial sales charge upon subscription is 5% of NAV,

The offer price to you would be $1.05 per unit [NAV of $1.00 + initial sales charge of 5%].

In effect, you will have to pay $1.05 for 1 unit of Unit Trust A, which is valued at $1.00.

An investment of $1,000 in Unit Trust A would purchase 952.38 units ($1,000 divided by the offer price of $1.05). At the NAV of $1.00 per unit, your 952.38 units are valued at $952.38.

When selling Unit Trust A:

Once you have invested in a unit trust, you would be concerned with its bid price as this is the price per unit you would receive at redemption (when selling your unit trust).

Assuming that
(i) Unit Trust A has a redemption charge of 1%; and
(ii) the NAV of one unit has increased to $1.10,

The bid price to you would be $1.089 per unit [NAV of $1.10 - redemption charge of 1%].

This means that you will only get back $1.089 if you sell 1 unit of Unit Trust A, even though its NAV is $1.10.

If you sold your original investment of 952.38 units, you would receive $1,037.14 ($1.089 X 952.38 units), even though the units are valued at $1,047.62 ($1.10 X 952.38 units).

How are unit trusts priced? (Cont'd)

Single Pricing

Alternatively, a unit trust may be priced using the single pricing method. Unit trusts quoted in this manner would provide a single quote that reflects the NAV per unit of the fund. For unit trusts that are priced using this method, the subscription charges would first be deducted from the invested capital before the units are allocated. Any redemption charge would also be deducted from the redemption proceeds. In the following example, Unit Trust B is assumed to have a single pricing structure, and both subscription and redemption charges.

When buying Unit Trust B:

Assuming that
(i) the NAV of Unit Trust B is $1.00 per unit; and
(ii) the sales charge upon subscription is 5%,

The sales charge of 5% would be deducted from the amount of your investment and the remainder of your investment would purchase units at the price of $1.00.

An investment of $1,000 in Unit Trust B would purchase 950 units [($1,000 less sales charge of 5%) divided by the offer price of $1.00]. Your investment of 950 units would be valued at $950.

When selling Unit Trust B:

Assuming that
(i) Unit Trust B has a redemption charge of 1%; and
(ii) the NAV of one unit has increased to $1.10 at the point of redemption,

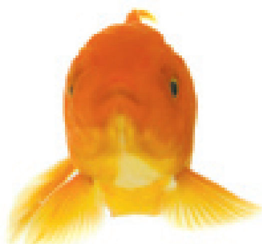
If you sold the 950 units, you would receive $1,034.55 [(950 units multiplied by the NAV of $1.10) multiplied by (100% - redemption charge of 1%)] even though the 950 units are valued at $1,045.

As the pricing structure may differ from one unit trust to another, check with your fund manager or financial adviser on how your unit trust is priced.

What is a trust deed and what is the role of a trustee?

In Singapore, unit trusts are established by a trust deed. The trust deed is a legal document that sets out the working arrangement between investors, the fund manager and the trustee. It spells out the investment objectives of the unit trust, and the responsibilities of the fund manager and trustee.

The trustee must be independent of the fund manager. It acts as the custodian of the fund assets and ensures that the unit trust is managed according to the guidelines laid out in the trust deed to minimise the risk of mismanagement by the fund manager.

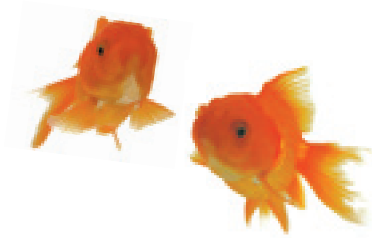


How do I check whether a unit trust is approved for offer to the public?

The list of unit trusts approved for sale to the public is available on the Monetary Authority of Singapore (MAS) website at www.mas.gov.sg. You can access the information via OPERA, the electronic repository for public offers of investments.

Who can distribute unit trusts?

Distributors of unit trusts would need to hold a financial adviser's licence or be an exempt financial adviser. The list of financial advisers regulated by MAS is available on the MAS website at www.mas.gov.sg under "Financial Institutions Directory".



Can I invest in unit trusts that are set up overseas?

MAS allows unit trusts set up overseas to be offered in Singapore. Foreign unit trusts approved for offer by MAS are known as "recognised funds". You can visit OPERA on the MAS website to check whether a foreign fund is recognised for offer to retail investors in Singapore.

Does MAS approval mean that the unit trust will be profitable and is a safe bet?

MAS sets rules and regulations that, among other things, require fund managers to ensure that their investments are sufficiently liquid and diversified. The regulations relating to disclosures in prospectuses also require fund managers to give true and adequate information about the unit trust to enable investors to make an informed decision about the merits and risks of the unit trust. Approval by MAS **does not guarantee** the quality or profitability of the fund. Investors must do their own homework and assess for themselves the merits and risks of the unit trust before investing.

How are "capital protected funds" different from "capital guaranteed funds"?

A capital guaranteed fund is designed to preserve your capital through an explicit legal guarantee. This guarantee on the capital applies only if you hold the investment until maturity. The manager of a capital guaranteed fund normally invests in a portfolio of low-risk assets such as bonds. You will be paid the guaranteed amount, even if any of the bond issuers default. Although there is an explicit guarantee, be aware that the fund is still subject to the risk that the guarantor may default. The guarantee on most capital guaranteed funds does not cover the sales charge. For example, if the sales charge is 3% of your investment, the guarantee may only cover 97% of your capital.

Like capital guaranteed funds, the protection for capital protected funds is provided by a portfolio of bonds chosen by the fund managers. However, unlike capital guaranteed funds, capital protected funds do not guarantee the full repayment of your capital.

What is the difference between a "closed-end" fund and an "open-end" fund?

Closed-end funds have a fixed number of issued shares traded on an exchange. They generally do not issue new shares after the close of the subscription period. Because the supply of shares is limited, the traded price of the closed-end fund will rise and fall depending on supply and demand, just like shares of other companies traded on an exchange. Closed-end funds often trade at a discount to their NAV. As these funds may have higher borrowings, they are generally riskier than open-end funds.

Open-end funds are allowed to issue new units and existing units can be realised or redeemed on demand. As there is no limit to the fund size, the price of the units does not rise and fall in response to demand, but is dependent on the value of the fund's underlying assets. In Singapore, most unit trusts are open-end funds.

What happens if I change my mind after I have bought a unit trust?

You can change your mind about your unit trust purchase within seven calendar days. There will not be any administrative penalty for cancelling your purchase but you may suffer a loss if the unit trust has fallen in market value after you bought it. If the market value of the unit trust has risen, you will get a full refund of what you paid for the unit trust, but you will not be entitled to the gain. This is to protect the existing unitholders of the fund. In either case, the sales charge will be refunded to you.

Note that the right to cancel is not available if you are making additional investments in a unit trust that you already own. It also does not apply to investors who purchase recognised funds or funds listed on the Singapore Exchange.

What reports can I expect to receive for my unit trust investment? How frequently will the reports be sent to me?

The annual reports, annual accounts and auditor's report will be prepared and sent to all investors within three months of the unit trust's financial year-end. The semi-annual accounts and reports will similarly be sent to investors within two months of the financial half-year end. Check with your fund manager or financial adviser if you do not receive these reports.

Some fund managers may also publish monthly or quarterly updates on their funds. Take time to read these to keep track of how your unit trust is doing.

There are also other ways to get information on the performance of your unit trust. These include:

- The financial section of local newspapers.
- Semi-annual reports, annual reports and performance statements from the fund manager.
- Monthly or quarterly fund factsheets
- The websites of financial advisers and fund managers.
- The Fund Information Service at www.fundsingapore.com - this provides information about unit trusts and investment-linked life insurance products available in Singapore.

What will happen to my investment if the unit trust is terminated?

A unit trust is terminated when the fund manager has made a business decision to wind up the fund. This may occur when the fund manager ceases operations or when the fund size has become so small that it is not economically viable to continue managing the fund.

When terminating a unit trust, the fund manager must provide you with information on how to get a refund on your investment or otherwise make arrangements for you to transfer your investment to another fund. The fund manager must give you notice of the termination no later than one month before the fund is terminated. Details on fund termination are set out in the fund trust deed. A copy of the trust deed is usually available for inspection at the fund manager's office.

MoneySENSE - A National Financial Education Programme

In October 2003, the Singapore Government launched a national financial education programme called MoneySENSE. MoneySENSE is a long-term programme that brings together industry and public sector initiatives to enhance the basic financial literacy of consumers. It is a collaboration among the following government agencies - the Monetary Authority of Singapore, Ministry of Community Development, Youth and Sports, Ministry of Education, Ministry of Manpower, Central Provident Fund Board and People's Association - and other private sector bodies and community organisations. For more tips and educational resources on personal financial matters, visit the MoneySENSE website at www.moneysense.gov.sg.

About The Association of Banks in Singapore

The Association of Banks in Singapore (ABS) plays an active role in promoting and representing the interests of the banking community in Singapore. In doing so, the ABS works closely with the relevant government authorities towards the development of a sound financial system in Singapore. Since its establishment in 1973, the ABS has promoted common understanding among its members and projected a unifying voice on banking issues. It has brought its members closer together through various guidelines and banking practices as well as the support of projects of mutual benefit to face the challenges of the financial and banking community in Singapore. As of April 2005, ABS has a membership of 114 local and foreign banks. Further information on ABS is available on the website: www.abs.org.sg.

The Association of Banks in Singapore
Email: banks@abs.org.sg
Website: www.abs.org.sg

About Investment Management Association of Singapore

The Investment Management Association of Singapore (IMAS) was established on 22nd September 1997. IMAS currently has over 100 members. Its membership roll includes all the major investment management firms in Singapore.

IMAS' objective is to contribute towards the development and growth of the investment management industry in Singapore. It aims to do this by fostering high standards of professionalism and promoting exemplary practice among its members, providing a forum for its members to discuss industry related issues, servicing as a collective voice where representation is needed on behalf of the industry, facilitating training for its members, and contributing towards investor education.

For more information about IMAS, please visit the IMAS website at www.imas.org.sg.

Investment Management Association of Singapore
Email: enquiries@imas.org.sg
Website: www.imas.org.sg

Quick Guide
to Investing in Unit Trusts

1. Do not choose a unit trust simply because it aims to deliver a high return. Higher returns are almost always accompanied by higher risks.

2. Before investing in a unit trust, develop an overall financial plan and be clear about your investment objectives, investment time horizon and risk profile.

3. Do sufficient research to choose the right fund manager. Be comfortable that the fund manager has the resources, expertise and skills to manage the unit trust.

4. Check that you are buying an approved unit trust managed by an authorised fund manager. This information can be found on the MAS website (www.mas.gov.sg).

5. Read the prospectus carefully as it contains important information about the unit trust.

6. Check what fees and charges you have to pay when buying, selling or switching a unit trust, as these will affect your returns.

7. Monitor your investment regularly. Read the financial statements and annual reports sent to you to check how your unit trust is performing.