

SECURITIES AND EXCHANGE
COMMISSION



Getting
started
with ...

**UNIT
TRUSTS
&
MUTUAL
FUNDS**

What you
should know

Introduction

What are Collective Investment Schemes?

Collective investment schemes are pools of funds that are managed on behalf of investors by a professional money manager. The manager uses the money to buy stocks, bonds, or other securities according to specific investment objectives that have been established for the scheme. In return for putting money into these funds, the investor receives shares or units that represent his/her pro-rata share of the pool of fund assets. In return for administering the fund and managing its investment portfolio, the fund manager charges a fee based on the value of the fund's assets.

Collective investment schemes in Ghana take the form of either a Mutual Fund or a Unit Trust. The characteristics of collective investment schemes in Ghana are provided for in the Securities Industry (Amendment) Law 2000, Act 590 and are not necessarily the same as those of other jurisdictions.

It is worth noting that variations exist in collective investment schemes from jurisdiction to jurisdiction. The definitions in this brochure are based on the current Securities Industry Law of Ghana.

1. What is a Mutual Fund?

A mutual fund is a public or external company incorporated solely to hold and manage securities or other financial assets. The company accepts funds from investors and uses those funds to buy a portfolio of securities and other financial assets and employs a professional fund manager to manage the investment. The company issues shares which represent pro-rata share of the pool of fund assets to investors.

A mutual fund in Ghana may either be open-ended or closed-ended.

2. Open-ended funds

These are funds which stand ready to repurchase their shares from the holders in any quantity and whenever the holder should desire. In addition they sell shares in any quantity to prospective investors at whatever time the investors determine. In other words, open-ended funds stand ready to issue new shares or redeem outstanding shares on a continuous basis.

The number of shares of the fund, therefore, fluctuates as investors purchase or redeem shares. The price of a share in an open-ended fund is determined by the net asset value per share of the fund, where net asset value per share refers to the total value of the assets in the fund's portfolio, less any fund liabilities, divided by the number of shares outstanding.

3. Closed-ended funds

These are funds which issue a fixed number of shares and do not stand ready to repurchase their shares from their shareholders when they decide to sell them. The

Securities Industry (Amendment)t Law requires that closed ended funds be listed on an organized exchange in order to provide liquidity to the shareholders.

These shares are traded at prices determined by the laws of supply and demand.

4. Who are Parties to a Mutual Fund?

The main parties involved in the organisation and operation of a mutual fund are:

- (i) **The Mutual Fund Company**
The company established to operate as a mutual fund company
- (ii) **The Manager**
The professional fund manager appointed by the Mutual Fund Company to manage the fund's investments. The manager must be a body corporate licensed by the Securities and Exchange Commission (SEC) as an Investment Advisor.
- (iii) **The Custodian**
A company appointed by the Mutual Fund Company to keep custody of all the securities owned by the fund. The custodian must either be a bank, an insurance company or a financial institution or a wholly owned subsidiary of any of them approved by the SEC.

5. What Relationship should exist among the Parties to a Mutual Fund?

The manager and the custodian must be independent of the mutual fund company. Independent, means that the mutual fund company should not be a substantial shareholder of the manager or the custodian.

A substantial shareholder means a shareholder entitled to exercise or control the exercise of 30% or more of the voting power at general meetings of the company or one who is in a position to control the composition of a majority of the board of directors of a company.

6. What is a Unit Trust?

A unit trust is an arrangement whereby investors' funds are pooled together and used to invest in a portfolio of securities and other financial assets, with the beneficial interest in the assets of the trust divided into units. The funds are managed by a professional manager. A unit trust is constituted by a document known as the trust deed. Under the Securities Industry (Amendment) law, Act 590, unit trusts are open-ended funds and their managers stand ready to issue new units or redeem outstanding units on a continuous basis.

7. Who are Parties to a Unit Trust?

The parties to a Unit Trust are:

i) The Manager

The company that establishes the unit trust. The law requires the company seeking to establish a unit trust to be the manager of the Trust. The manager must be a body corporate licensed by the SEC as an Investment Advisor prior to the establishment of the unit trust.

ii) The Trustee

A company appointed by the Manager to take into its custody or under its control the property of the unit trust and hold it in trust for the investors.

The trustee must either be a bank, an insurance company or a financial institution or a wholly owned subsidiary of any of them approved by the SEC.

The trust deed of the unit trust is made under seal between the manager and the trustee.

8. What Relationship should exist among the Parties to a Unit Trust?

The manager appoints the trustee but the manager and the trustee must be independent of each other. Independent here means that the manager is not a substantial shareholder of the trustee, and the trustee is not a substantial shareholder of the manager.

A substantial shareholder means a shareholder entitled to exercise or control the exercise of 30% or more of the voting power at general meetings of the company or one who is in a position to control the composition of a majority of the board of directors of a company.

9. Do we have Collective Investment Schemes in Ghana?

Currently there are 2 unit trust schemes in the country. They are the HFC Unit Trust and the HFC Real Estate Investment Trust (HFC REIT). These 2 schemes were established by the Home Finance Company Limited. The first one, HFC Unit Trust was established by Legislative Instrument L.I. 1516 of 1991 and the second one, HFC REIT approved by the Bank of Ghana acting for the SEC in 1995.

10. What are the Common Types of Funds?

Mutual Funds and Unit Trusts are generally categorised according to their investment objectives and their investment policies. Some mutual funds focus on stocks, others on bonds, money market instruments, or other securities. On the international scene some funds invest primarily in their countries, others invest internationally, and some specialise in specific countries.

11. Common types of funds are:

a) Money Market Funds

These funds invest in short-term (less than one year to maturity) corporate and government debt securities such as treasury bills, and corporate notes. Some money market funds specialise in or invest only in Treasury Bills. These are generally very low-risk funds offering moderate returns.

b) Fixed Income Funds

These funds invest in debt securities like bonds, debentures, and mortgages that pay regular interest, or in corporate preferred shares that pay regular dividends. The goal, typically, is to provide investors a regular income stream with low risk.

c) Growth or Equity Funds

These are funds which invest primarily in common shares (equities) of local or foreign companies (if allowed), but may hold other assets as well. The goal is typically long-term growth through capital appreciation of the assets held. Some growth funds focus on large 'blue-chip' companies, while others invest in smaller or riskier companies. Performance will be affected by the success or failure of specific investments and by the performance of the stock markets.

d) Balanced Funds

These are funds which invest in a 'balanced' portfolio of equities, long-term debt securities and money market instruments with the objective of providing reasonable returns with low to moderate risk.

e) Global and Foreign Funds

These are funds which may be fixed income, growth, or balanced funds that invest in foreign securities. These funds can offer investors international diversification and exposure to foreign companies, but are subject to risk associated with investing in foreign countries and foreign currencies.

f) Specialty Funds

These are funds which invest primarily in a specific geographical area (e.g. Africa) or in a specific industry (e.g. high-technology companies). As a result, specialty funds are subject to a certain risk-level related to the market in which it specializes. Types of risks speciality funds face include foreign exchange, political, geographical or sectoral (industry) risk.

g) Index Funds

These are funds which invest in a portfolio of securities selected to represent a specified target index or benchmark, such as the GSE All-Share Index and Databank Stock Index. The associated risk is directly related to the risk of the market that the index is measuring, such as the stock market.

12. What are the Potential Advantages of Investing in Collective Investment Schemes?

There are many advantages for investing in Collective Investment Schemes.

?? **Diversification**

Investing in a number of different securities helps reduce the risk of investing. When the investor buys a share/unit in a fund, he/she buys an interest in a portfolio of dozens of different securities, giving him/her instant diversification, at least within the type of securities held by the fund. For example, a portfolio made up of shares from various companies is a good example of diversification.

?? **Affordability**

With many funds, the investor can begin buying shares/units with a relatively small amount of money (e.g. about ₦20,000 for the initial purchase). Some funds allow investors to buy more shares on a regular basis with even smaller monthly installments.

?? **Professional Management**

Mutual funds/Unit trusts are managed by professionals who are experienced in investing money and who have the skills and resources to research many different investment opportunities. Investors in these funds, therefore, get access to the professional management of their funds.

?? **Liquidity**

Shares of open-ended mutual funds can be redeemed at any time at the Net Asset Value Per Share (NAVPS) of the fund.

?? **Flexibility**

Many fund management companies administer several different funds. (e.g. money market, fixed-income, growth, balanced and international funds) and allow the investor to switch between funds within their 'fund family' at little or no charge. This can enable the investor change the balance of his portfolio as his personal needs or market conditions change.

?? **Performance Monitoring**

The Net Asset Value Per Share (NAVPS) or the bid and offer prices of open ended funds are reported in the press and on many internet sites as pertains in other markets, allowing the investor to continually monitor the performance of his/her investment.

13. What Returns does the Investor get from Investing in Collective Investment Schemes?

The mutual fund/unit trust investor earns a return on his investment from:

- ?? any distribution to him/her of the interest, dividends, or capital gains earned by the fund; and
- ?? any net increase in the Net Asset Value Per Share (NAVPS) of his/her fund shares/units.

14. Are there any Tax Advantages for Investing in Collective Investment Schemes?

Under current tax laws, Collective Investment Schemes do not pay taxes on their incomes. Again, investors in these schemes do not pay taxes on incomes received from these schemes. These tax incentives have been designed to encourage the pooling of investors' resources together for investments to develop the economy

15. What are the Licensing Requirements for Operating a Mutual Fund?

For a mutual fund the first step is the incorporation of a Mutual Fund Company under the Companies Code 1963 (Act 197) as a public limited liability company with the sole aim of holding and managing portfolio of securities and other financial assets.

After the incorporation of the company, an application is made by the company to the Securities and Exchange Commission (SEC) for a license to operate the fund.

The Securities and Exchange Commission requires the following documents to be submitted to it for its review for the issue of a licence to operate a mutual fund.

- ?? Company Regulation
- ?? Management Agreement
- ?? Custodial Agreement
- ?? Prospectus (offering document)

16. What are the Licensing Requirements for Operating a Unit Trust?

For a unit trust, an application is made to the Securities and Exchange Commission (SEC) by a company licensed by the Commission as an investment adviser for a licence to establish a unit trust. The SEC requires the following documents to be submitted to it for its review for the issue of a licence to operate a unit trust.

- ?? Management Agreement
- ?? Trust Deed
- ?? Prospectus (offering document)

17. How are Collective Investment Schemes Regulated?

All securities in Ghana are subject to securities laws that are administered and enforced by the Securities and Exchange Commission (SEC). The securities laws regulate collective investment schemes in four basic ways:

Through Licensing Requirements

Every person who establishes a scheme or manages the investment portfolio of a scheme must be registered (licensed) by the Commission. Those who sell the shares/units are registered as dealers. Those who make investment decisions for collective investment schemes are registered as advisers. The registration requirements enable the Commission

to ensure that each operator, dealer, or adviser has the basic qualifications required to act on behalf of investors.

Registration is a continuous process, and thus subject to periodic renewal in order to ascertain the continued suitability of registrants.

Through Prospectus Requirements

Every scheme that intends to sell securities to the public must first file a prospectus with the Commission and must give a summary disclosure document to each purchaser. The information contained in these documents is intended to allow investors and their financial advisers to make prudent and informed investment decisions. The mutual fund company or the unit trust manager is accountable under the law for the statements made in the prospectus. Once a fund has filed a prospectus it is also obliged to provide investors with financial statements and other important information on a regular basis.

Through Regulations on Fund Operations and Sales Conduct

The Securities and Exchange Commission has also established regulations that govern investment and marketing practices, the way in which fund assets must be held and the types of incentives that can be paid to those who manage or sell the funds.

Many dealers who will sell shares/units of funds will also be members of the Ghana Stock Exchange (GSE) which is the industry's Self-Regulatory Organisation (SRO) and both they and their employees are subject to the rules, by-laws and policies that are established by the GSE.

Through Surveillance and Monitoring

The Commission controls and supervises the activities of registrants in collective investment schemes with a view of ensuring that they maintain proper standards of conduct and acceptable practices.

Licensed operators are obliged to submit financial and operational reports periodically to the Commission. These reports are reviewed alongside set standards and criteria to ensure that licensed operators continue to remain compliant over the period of operation and not only at the time of first application of licence/registration or at the time of renewal of their licence/registration.

18. How is a Mutual Fund/Unit Trust Investment Protected?

It is important to remember that mutual funds/unit trusts like any other investments have varying levels of risks associated with them. While certain types of funds are low-risk (such as money market or T-bill funds), others (such as equity and bond funds) can change significantly in price in response to the ups and downs of the economy, interest rates, foreign exchange rates, and other economic variables. These fluctuations can cause

the value of your investment to decline, particularly over the short term. This is known as market risk, and no regulator can protect you from this.

However, regulations have been established to help ensure that the money you invest in these funds is handled carefully and professionally. For example, the mutual funds/unit trusts assets must be held separately by a custodian/trustee. Again an independent auditor reviews and reports on the finances and practices of the funds each year.

The dealers who handle mutual fund/unit trust transactions for clients are also subject to detailed rules governing their conduct to ensure that clients are dealt with fairly and honestly