MUTUAL FUNDS

AUTORITÉ
DES MARCHÉS
FINANCIERS

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Note: In this brochure, the masculine form may refer to both women and men.

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Introduction

Autorité des marchés financiers

The *Autorité des marchés financiers* (AMF) is the body mandated by the government of Québec to regulate Québec's financial sector and to offer assistance to consumers of financial products and services.

Its mission is to protect the public by applying the laws and regulations governing the following areas of activity: insurance, securities, deposit institutions (other than banks) and distribution of financial products and services.

Purpose of the brochure

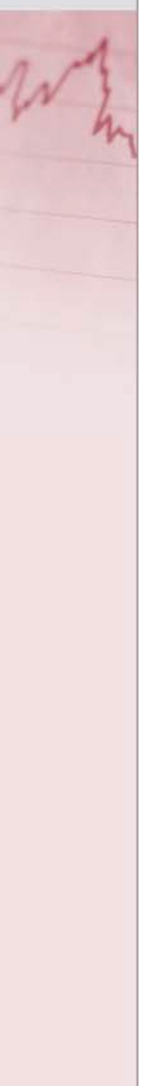
The purpose of this brochure is to help you become more familiar with mutual funds so you can determine whether this type of investment is suitable for you.

This AMF brochure is provided for your information. It does not offer any advice on the purchase or use of specific financial products and services.

More and more Canadians are investing in mutual funds. In Canada, mutual fund assets have risen from $25 billion in 1990 to over $500 billion in 2005.[1]

Given their popularity and convenience, many investors consider mutual funds to be suitable investments for them, but is this really the case?

In the following pages, you will learn more about mutual funds to help you determine whether this type of investment is right for you.



CONTEXT

Monique *is looking for other investment opportunities...*

Monique has $5,000 in her savings account. She has noticed that her financial institution is only giving her $0.15 in interest per month on this amount. She is seriously thinking about investing her money elsewhere, but where?

Monique has vaguely heard about mutual funds and would like to find out more.

1 WHAT IS A MUTUAL FUND?

A mutual fund is made up of money that is pooled by investors and managed on their behalf by a portfolio manager who uses the money to purchase securities such as shares and bonds based on its objectives.

In consideration of the money you place into the mutual fund, you receive units or shares that represent your share of the mutual fund's assets. Ownership is in the form of shares if the mutual fund is set up as a business corporation, in which case it is referred to as an *open-ended investment company*. Ownership is in the form of units if the mutual fund is set up as a trust.[2] For the sake of convenience, only the term "units" will be used in this brochure.

In general, mutual funds offer units continually, which means that new investors can purchase them. Generally, existing investors can ask for their units to be redeemed at any time, and obtain the proceeds quickly. When you ask for your units to be redeemed, the amount you receive is based on their value, less any redemption fee.

1. Sources: Department of Finance Canada and the Investment Funds Institute of Canada.

2. A trust is the most common form. It is sometimes called an "open-end fund."

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HOW IS THE MUTUAL FUND INDUSTRY REGULATED?

In Canada, the securities industry is governed by provincial and territorial securities laws. This is the case for mutual funds. In Québec, the *Autorité des marchés financiers* (the AMF) regulates this matter.

Securities laws regulate the mutual fund industry in three ways:

By requiring registration

Every firm or person who sells mutual fund units or who manages a portfolio of securities held by a mutual fund must be registered in each jurisdiction in which the firm or person carries on business. In Québec, the registration requirement allows the AMF to ensure that, among other things, representatives fulfill the qualification criteria and firms are financially sound as required by law.

Representatives who are registered to exclusively sell mutual fund units are known as group savings representatives. They work for securities dealers or firms,[3] or independently. To ensure that dealers, firms or representatives are registered with the AMF, you can contact an information officer at the AMF's Information Centre or visit its website. You will find the contact information at the end of this brochure.

CONTEXT

Monique
makes an appointment...

Monique made an appointment with a group savings representative attached to her financial institution. Before being registered with the AMF, a representative must successfully complete a recognized course.

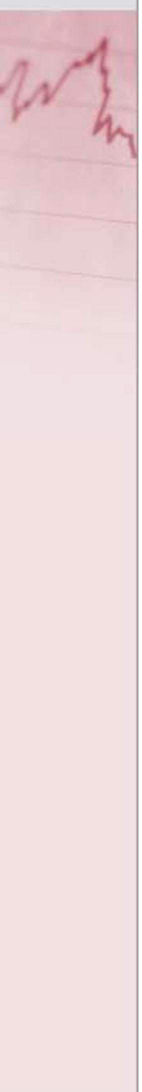
By requiring a prospectus

A prospectus is a detailed information document that an issuer, such as a mutual fund, must generally prepare to issue securities to the general public. Before offering units in a province or territory, a mutual fund must hold a receipt for a prospectus approved by the regulatory agency for its jurisdiction. In Québec, this is provided by the AMF. Among other things, a prospectus outlines the risks related to an investment in the units of a mutual fund, the fees and the investment objectives. The information contained in this document must allow investors to make sound investment decisions. The mutual fund, the management company and the mutual fund distributor are legally responsible for the information presented in the prospectus. They are also required to regularly provide investors who request them with financial statements and other important information about the mutual fund. For further details, see our brochure *Prospectuses made clear*.

3. Certain firms are attached to financial institutions.

By applying rules and policies concerning the operation of a mutual fund and its sales practices

The AMF has also set up rules and policies that govern marketing and investment practices. These rules also determine how a mutual fund's assets must be invested and held, and the various ways of remunerating people who sell mutual fund units.



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HOW DOES A MUTUAL FUND OPERATE?

Several people are involved in the organization and operation of a mutual fund. They include:

Trustee

In the case of a mutual fund set up as a trust, the trustee represents the entity acting on behalf of unit holders. The trustee is generally responsible for all the fund's activities. It holds the investments of each mutual fund in trust on behalf of unit holders. The trustee often delegates its responsibilities to a management company.

Management company (or manager)

It sets up one or more mutual funds, handles marketing activities and manages the funds on a daily basis.

Portfolio manager (securities adviser)

The portfolio manager is appointed by the management company. It makes investment decisions on behalf of the mutual fund. It purchases and sells securities held in the mutual fund portfolio and interacts with dealers. The management company sometimes acts as the portfolio manager.

Principal distributor (underwriter)

It co-ordinates the sale of mutual fund units to investors, either directly or through branches of a financial institution or a network of registered dealers, firms or representatives.

Depositary (securities custodian)

This is the bank or trust company appointed by the management company for safekeeping the securities that belong to the mutual fund.

Auditor

This is the independent firm of chartered accountants hired by the management company. Every year it audits the financial statements of the mutual fund and prepares an auditor's report.

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CAN YOU CHANGE YOUR MIND ONCE YOU SUBSCRIBE FOR MUTUAL FUND UNITS?

Anyone who subscribes for mutual fund units may cancel the contract unilaterally and receive full reimbursement by sending a notice to such effect to the dealer or firm within two business days of receiving the prospectus.

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HOW IS THE UNIT VALUE CALCULATED?

A mutual fund first adds up the value of all the securities and assets it holds. Fees are deducted from this amount to determine the *net asset value*. By dividing the net asset value by the number of units outstanding, the *net asset value per unit* is obtained. An investor can find out the value of his investment by multiplying the net asset value per unit by the number of units owned.

The net asset value per unit is calculated at the end of every business day, generally at 4:00 p.m.

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WHAT ARE THE MAIN CATEGORIES OF MUTUAL FUNDS?

As a general rule, mutual funds are classified based on their investment objectives and the assets they hold. Some of them target low-risk investments, whereas others hold more risky securities.[4] If you decide to invest in mutual funds, it is important to identify those with investment objectives that are suitable for you. You should also take into account the risks, fees and other features. For further details on investment objectives, see the brochure entitled *Choose the investments that suit you*.

4. Risk is defined as the degree of uncertainty related to the expected return of an investment, including the possibility that all or part of the investment will be lost.

The main categories of mutual funds are indicated in the following table.

Main categories of mutual funds

CATEGORIES	FEATURES	RISK AND RETURN
Money market	The managers of these mutual funds invest in short-term debt securities issued by large corporations or governments, such as short-term bonds and Treasury bills.	They are generally very low-risk funds that offer modest but stable returns. These mutual funds aim for safety of principal.
Fixed income	The managers of these mutual funds invest in debt securities such as bonds, debentures and mortgages that generate regular interest income, or in preferred shares of companies that pay a regular dividend.	As a general rule, these funds aim to provide investors with regular income with low to moderate risk. Their value will fluctuate to a certain extent, especially in response to interest rate variations.
Equity	The managers of these mutual funds invest primarily in common shares of Canadian and foreign companies. These funds generally aim for long-term growth through asset appreciation. Some mutual funds focus on the securities of large, well-established companies. Others, on the contrary, focus on securities of smaller but often riskier companies.	The return depends on the merits of the strategy adopted by the manager and by his choice of securities. In general, the movement of stock markets also has an impact on returns.
Balanced or asset allocation	The managers of these mutual funds invest in a balanced portfolio of shares, debt securities and money market instruments.	These funds aim to give investors the best return possible with low to moderate risk.
International	The managers of these mutual funds invest in foreign securities. These funds offer investors international diversification.	The return will depend on the type of mutual fund. These funds include risks associated with investing in foreign currencies and markets.

Main categories of mutual funds (continued)

CATEGORIES	FEATURES	RISK AND RETURN
Specialized	The managers of these mutual funds may invest primarily in a specific geographic area, such as Asia, or in a specific industry, such as high tech.	The return will depend on the type of mutual fund. These funds carry a certain level of market-related risk, such as currency risk and political risk, or risk related to a lack of geographic or sector diversification.
Index	The managers of these mutual funds invest in a basket of securities intended to represent a target or reference index, such as a stock exchange index.	The risk and return will reflect that of the selected index.
Ethical (socially conscious)	The managers of these mutual funds take into consideration environmental or moral criteria in selecting securities.	The risk and return will depend on the choice of securities and market conditions.

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HOW CAN YOU EARN (OR LOSE) MONEY BY INVESTING IN A MUTUAL FUND?

You may earn a return from:

- your share in interest income, dividends or capital gains generated by the securities held by the mutual fund;
- any increase in the value of the units caused by the rise in the value of securities held in the mutual fund portfolio.

On the other hand, the value of the units held could be lower if the value of the securities held by the mutual fund declines.

For example, if you invest in a fixed income mutual fund, you can expect a significant portion of the return on your investment to be based on accrued interest or dividends. This income will either be paid to you directly or reinvested in other units of the mutual fund in your name. You can also expect a certain fluctuation, either up or down, of the value of your units based on movement in the bond market. The value of fixed income securities moves in the opposite direction of interest rates. If the current interest rate increases, the value of your fixed income mutual fund portfolio could fall.

If you invest in an equity mutual fund, your return will more closely be tied to the performance of the stock markets. Thus, you could obtain a return on distributions of dividends or capital gains generated by the securities held by the mutual fund. Your profits or losses could also result to a great extent from fluctuations in the value of the mutual fund portfolio. If the price of the shares held by the mutual fund rises, so will the value of your units. On the other hand, if the price of the shares drops, the value of your units will also drop.

For some mutual funds, the return will depend to a certain extent on the manager's skill in selecting securities.

8 WHAT ARE THE RISKS OF INVESTING IN MUTUAL FUNDS?

Every mutual fund carries a certain level of risk based on its objectives and the securities it holds. The value of securities may vary from day to day, reflecting changing interest rates, markets and corporate situations, as well as economic conditions. Also, nothing guarantees that you will recover the full amount of your investment.

For further details about risk, see the brochure entitled *Choose the investments that suit you.*

- MUTUAL FUND UNITS ARE NOT GUARANTEED BY DEPOSIT INSURANCE, UNLIKE SAVINGS ACCOUNTS AND GICS (GUARANTEED INVESTMENT CERTIFICATES).

9 WHAT ARE THE ADVANTAGES OF INVESTING IN A MUTUAL FUND?

Diversification

Investing in different securities helps reduce the risk related to investments. When you invest in a mutual fund, you buy an interest in a portfolio made up of a multitude of different securities. This gives you instant diversification, at least within the type of securities held by the mutual fund.

When certain conditions are met, diversification considerably reduces the risk, even if the investments may be risky individually.

Accessibility

For many mutual funds, you can begin to buy units with a relatively small sum, such as $500 for the initial purchase. Certain mutual funds also allow you to purchase units regularly through even smaller instalments, such as $50 per month.

Portfolio management

Investors seldom have the time and resources to conduct research on securities. The task of managers consists of identifying the best opportunities and diversifying investments, according to the objectives of the mutual fund.

Liquidity

The vast majority of securities held in the portfolio of a mutual fund must be easily traded so that the units can be redeemed at any time. The proceeds of redemption are therefore generally payable on very short notice.

Flexibility

Many mutual fund management companies handle several different mutual funds. It is sometimes possible to make transfers free of charge between mutual funds of the same family. For example, a family of mutual funds could offer money market, fixed income, equity, balanced and international mutual funds.

It may also be possible to automatically reinvest income and capital gains for the purchase of additional units.

Monitoring of return

The value of most mutual funds is published daily in the financial press and on many websites. This allows you to regularly monitor the return on your investment.

Administration

Administrative duties, including bookkeeping, the preparation of tax information and the reinvestment of distributions (income from various sources and capital gains earned), are performed by the mutual fund manager or entrusted to a third party.

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WHAT ARE THE DISADVANTAGES OF INVESTING IN A MUTUAL FUND?

Most mutual funds focus on long-term investments. They are not suitable for investors who are looking for a short-term return and who want to trade often. In addition, as we will see in the following section, some mutual funds charge fees on every transaction.

It is not recommended that mutual funds be used as a source of emergency funds. An investor could have to ask for units to be redeemed during a market downturn and thus incur a loss.

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WHAT FEES ARE INVOLVED WITH MUTUAL FUNDS?

There are two main types of fees for mutual funds: management and operating fees, and purchase (or redemption) fees (“loads”). Management and operating fees are generally paid by the mutual fund, but they indirectly reduce the value of your investment. Purchase or redemption fees are paid directly by the investor.

Management and operating fees

They cover expenses related to the development and administration of the mutual fund and are taken out of the mutual fund assets. They therefore rarely appear on the statement of account that an investor receives. Some mutual funds offer discounts that reduce the amount of fees charged to investors if the account value is higher than a pre-determined amount.

Management fees are generally calculated based on a set percentage of the mutual fund assets under management. Operating fees are variable (auditor’s fees, legal fees, printing costs, remuneration paid to the depositary, etc.).

The management expense ratio (MER) corresponds to the management expenses as a percentage of the average net assets of the mutual fund. For example, if a mutual fund with average net assets of $100 million has fees of $2 million per year, its MER is 2%. The higher the MER, the greater its impact on the earnings of the mutual fund and on the return obtained by participants. As well, such expenses are applicable to the mutual fund regardless of whether or not it generated positive returns.

Purchase (or redemption) fees

When you purchase mutual fund units, you may have to pay a purchase (“front load”) fee. Also, when you sell your units, a redemption (“back load”) fee may apply. When a redemption fee is charged, it may decrease progressively based on the number of years the units were held. Some mutual funds allow the redemption of an annual pre-established percentage of units at no charge.

An increasing number of mutual funds are sold without front-load or back-load fees. However, you should also consider the management and operating fees, and in particular ensure that the mutual fund is suitable for you.

Note that other fees may also be charged. Some mutual funds charge penalties for excessive trading, for example for buying and then redeeming or substituting a large number of units within 30 days. Excessive trading increases operating costs and adversely affects returns for other investors.

Fees can impact your return and vary considerably from one mutual fund to the next. Higher fees are not necessarily synonymous with better returns. Check and compare fees before investing. Remember, every dollar paid in fees is a dollar less in returns.

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WHERE CAN YOU FIND INFORMATION ABOUT A PARTICULAR MUTUAL FUND?

CONTEXT

Monique
wants to find out more...

Before meeting with a group savings representative, Monique wants to find out about mutual funds. At the suggestion of a co-worker, she plans to read certain documents on-line.

Simplified prospectus

A simplified prospectus constitutes a fundamental source of information on a mutual fund. A prospectus presents all the important facts about a mutual fund, its management, the nature of the securities it holds, its investment objectives, its risk profile and its fees. When you buy mutual fund units, you will receive a simplified prospectus and financial information. For further details on prospectuses, see our brochure entitled *Prospectuses made clear*.

Annual information form

You can also obtain additional information about a mutual fund by asking for its annual information form, which provides the information required by law that does not appear in the prospectus. This includes details on investment restrictions, the redemption of units and the responsibilities of the various participants in the mutual fund's activities, such as the portfolio managers.

Other sources of information

Due to the popularity of mutual funds, there is a multitude of other sources of information. Speak to your representative about them, go to the library, read financial newspapers or visit some of the many websites on the matter, including www.sedar.com or www.ific.ca.

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HOW DO YOU KNOW IF MUTUAL FUNDS ARE SUITABLE FOR YOU?

For most investors, choosing a representative and a firm constitutes the first step in any investment program. For further details, see the brochure entitled *Choosing a securities firm and representative*. With the help of your representative, you can establish your investment objectives, assess your risk tolerance and develop a personal investment strategy.

Ask your representative whether mutual funds are an appropriate investment for you. Discuss the type of mutual fund that best meets your personal investment strategy and then ask for some suggestions.

Once you have identified a few mutual funds that seem to meet your needs, read the prospectus for each of them. Pay special attention to the following points:

Investment objectives

Are the mutual fund's investment objectives compatible with yours? Can the mutual fund give you the level of regular income you need? Does it provide you with the type of diversification you are seeking?

Risk

Do you feel at ease with the degree of risk associated with the mutual fund? If you hold other investments, will the mutual fund have the effect of increasing or reducing your general exposure to risk? As mentioned, mutual funds are not insured by deposit insurance. The value of most mutual funds fluctuates. You could therefore incur losses depending on market conditions.

Time horizon

Does the investment fit into the time horizon you have planned for your investments? For example, if you invest for a relatively short period, will the front load and back load fees (if any) cancel out your potential gains? Could the value of the mutual fund have dropped when you need to redeem your units?

Expected return

Is the mutual fund able to provide the return that will enable you to reach your goals? The past performance of a mutual fund will give you information about historical fluctuations and could be compared with competing mutual funds. However, this is not a reliable indicator of future returns. The return you expect to earn from a mutual fund is closely linked to any associated risk. The lower the risk associated with a mutual fund, the lower the expected return. Make sure your expectations are realistic.

Flexibility

Will you have the right to transfer your investment to other mutual funds belonging to the same "family"? Can you afford to make the minimum initial investment? Does the mutual fund offer other advantages, such as a regular monthly subscription or redemption plan you might be interested in?

Tax consequences

If you invest in a mutual fund outside a registered plan, are you aware of the tax related to the fund's distribution of income or capital gains? As a general rule, a mutual fund will distribute enough of its income and capital gains each year to avoid being taxed on its profits. This means that you will have to pay tax on the income allocated to you. When you ask for your mutual fund units to be redeemed, you will have to declare any capital gain (or loss).

If you hold your investment through a registered plan, the income or capital gains attributed to you are generally not taxable, provided they are held in your registered plan, but as soon as you redeem units or cash distributions from your registered plan, you are taxed at the applicable tax rate, as you would be for any income.

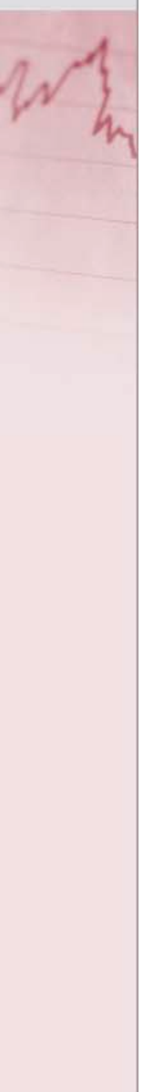
If necessary, ask your representative about the tax consequences of investing in a mutual fund. Carefully read any information provided by the mutual fund in this respect.

CONTEXT

Monique
has made a choice...

With the help of the group savings representative, Monique found mutual funds that meet her objectives. She has read the materials and asked questions for additional information.

During their meeting, the representative took the time to caution Monique. Contrary to her savings account, which is covered by deposit insurance, the mutual funds she would buy through the financial institution would not be covered.



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WHAT SHOULD YOU DO IF YOU ARE CONCERNED ABOUT YOUR MUTUAL FUND OR THE CONDUCT OF YOUR REPRESENTATIVE?

If you are concerned about the conduct of your representative, see the suggestions made in the brochure entitled *Choosing a securities firm and representative*.

If the conduct of the mutual fund is what concerns you, first contact your representative or his firm. If you do not receive a satisfactory response, contact the mutual fund's management company. If you still have concerns, contact the AMF.

As a general rule, you should not authorize your dealer to carry out transactions without specific instructions from you. Never issue a cheque in the name of the representative—make it payable to the firm the individual represents.

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OTHER TYPES OF FUNDS

In addition to mutual funds, other investment possibilities are available if you want to invest your money in a fund managed on your behalf, such as exchange-traded funds and segregated funds. Consult the *Short Investment Glossary* for a comparison of the main types of investment.

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TEST YOUR KNOWLEDGE OF MUTUAL FUNDS

True or false?

1. A mutual fund is made up of money pooled by investors and managed on their behalf by a portfolio manager.
2. A mutual fund that plans to offer units in Québec must hold a receipt for a prospectus approved by the AMF.
3. Investing in different securities helps reduce investment-related risk.
4. A prospectus constitutes the best source of information about a mutual fund.
5. Mutual funds are not covered by deposit insurance.

6. Mutual funds must be sold through registered representatives who work for securities dealers or firms that are also registered with the AMF.
7. Information about mutual funds can be found on the SEDAR website.
8. If you hold your investment through a registered plan, the income or capital gains attributed to you are generally not taxable, provided they are held in your registered plan.
9. Money market mutual funds are generally not very risky.
10. The value of bond mutual fund units moves in the opposite direction of interest rates.

Answer: All the above statements are true!

Questions?

If you want to find out more about mutual funds or investments in general, contact your representative.

Notes

TO CONTACT THE *AUTORITÉ DES MARCHÉS FINANCIERS*

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You can also visit the website of the *Autorité des marchés financiers* at www.lautorite.qc.ca

Brochures to help you with your investments

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