Investment Solutions
with confidence

Understanding Unit Trusts

Unit trusts, or mutual funds, as they are referred to internationally, are collective investment schemes constituted under trust deeds and regulated by the Collective Investment Scheme Control Act (CISCA) No. 45 of 2002. They are created for investors with similar investment objectives, enabling them to pool their funds with economies of scale and to invest in aggregation with a stated objective or investment goal.

Each investor or unitholder has the right to claim a share of the total fund. The value of the claim depends on the amount invested through the purchase of equal portions, or units, in the unit trust. Each unit has a price, or net asset value (NAV). The unit trust is priced daily and is a function of the underlying securities held in the unit trust, which are also priced daily. Unit prices are published daily in most newspapers, allowing investors to frequently monitor the investment performance. Unit trusts also offer investors transparency as a summary of the underlying investments and other information is provided in monthly fund fact sheets.

Each unit trust has an appointed portfolio manager who invests the pool of money in underlying securities with the objective of meeting some predefined investment objective. By investing in a unit trust, investors can diversify their investment as unit trusts invest in a combination of uncorrelated and unrelated securities. This spreads investment risk, and may also increase the probability of meeting the investment objective as there is no reliance on a single financial institution or security to deliver the required investment return.

Unit trusts offer sufficient liquidity to all investors as units can be converted to cash for withdrawal at any time. The Investment Solutions Superior Yield and Enhanced Income unit trusts offer daily liquidity and investors can access and withdraw their money within 24 hours or even on the same day if redemption instructions are received before 11am. Daily liquidity is offered, as these unit trusts have sufficient size and primarily invest in underlying securities that also have daily liquidity, but is subject to regulatory requirements as specified in the respective trust deeds.

Unit trusts are not taxed, although any taxable income earned as part of the underlying investment strategy will be taxed at individual investor level. In some cases, when units are either sold or transferred from one person or legal entity to another, capital gains tax (CGT) may be payable. With both income tax and CGT, certain exemptions may apply. Unit trusts must withhold, report on and pay any dividend-withholding tax as a regulated intermediary.

PROTECTION OFFERED BY UNIT TRUSTS

Unit trusts offer unique protection to investors. The ownership of the assets of the unit trust vests in a trustee, independent from the management company, which holds the assets for the benefit of the unit holders. The trustee is usually a financial institution or bank unrelated to the company that manages the unit trust. The implication of this is that any investor in the unit trust does not take any risk on Investment Solutions' creditworthiness as the unit trust company and all assets invested in the unit trust will remain unaffected in the unlikely event that Investment Solutions is liquidated or sequestrated. Unit trusts are also managed in accordance with specific rules and regulations as determined in the investment mandate or legal contract agreed between the unit trust management company and the unit trust. It is the responsibility of the trustee to ensure such rules and obligations are adhered to at all times. In terms of legislation, a unit trust can only invest in prescribed securities within certain limits. This limits exposure to any single security, which provides additional protection to investors.

Investors, and specifically corporate institutions, are often concerned with the credit rating of an investment as part of their internal risk-management process or credit policies. This especially applies to cash deposits, which are seen as nothing more than a loan to the deposit-taking institution that inherently has some level of credit or default risk. Similarly, credit risk is taken on the issuer when any interest-bearing security is bought from the issuer. In return for taking credit or default risk, the borrower or issuer pays interest to the lender or investor. This is set at an appropriate interest rate to compensate for the credit or default risk, among other factors, and the issuer undertakes to repay the principal or amount invested or borrowed at some future date, subject to pre-specified conditions. Here credit-rating agencies play an important role as they usually rate deposit-taking institutions or issuers of interest-bearing securities based on their estimated credit or default risk to give investors an indication of the risk taken.

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