What you should know about

Mutual funds and collective investment

Information Guide

This CNMV guide is for investors. It explains the essential terms, helps you to ask the right questions, sets out the information that an investor must request and tells you what to do if you have doubts.

CNMV
COMISIÓN NACIONAL DEL MERCADO DE VALORES

Mutual funds and collective investment

Information Guide

This is a CNMV document

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COMISIÓN NACIONAL DEL MERCADO DE VALORES

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introduction

Mutual funds made their first appearance in Spain during the 1980s. Since then they have become a firm favourite with Spanish investors. The figures are eloquent: eight and a half million unitholders and assets under management at the 2005 close summing nearly 30% of GDP. Funds have conserved their attraction for household savers through the thick and thin of market fluctuations and successive tax reforms, and now constitute a mature market ready to take on fresh challenges.

This coming of age is acknowledged in recent changes in collective investment scheme legislation, which signify the opening up of the Spanish funds market to new investment opportunities, in an increasingly sophisticated and global financial landscape. Specifically, the implementing regulations to the 2003 law, passed in the closing months of 2005, authorise new fund modalities already operating in other countries, like exchange-traded funds or the alternative investment funds generally known as hedge funds.

The result is an extraordinarily varied choice of products to suit every investor profile, from the most conservative to the most adventurous. This diversity is undoubtedly a good thing for savers wishing to enter the securities markets; however, many of these products will be new to them, which means distributors must be scrupulous in complying with the mandatory rules of conduct. In particular, the advice and information that intermediaries give their clients must respect two basic principles: it must be tailored to the investor's individual needs and cover all the main characteristics of the product plus the associated risks.

The growing complexity of markets places added responsibilities on sector professionals but also on investors, who must take active steps to select the fund that best matches their expectations. Before buying units in a given fund, they must weigh up all the factors that need to be considered in making an investment decision, such as the time horizon of the investment, the liquidity of the product and the potential loss involved. It is advisable therefore to make a habit of consulting the official documentation, especially the fund prospectus and periodic reports. In the case of hedge funds, they should take time to read carefully through the consent form, remembering that by signing it they expressly acknowledge their familiarity with the workings of the product and its specific risks.

As part of its commitment to investor protection and education, the Comisión Nacional del Mercado de Valores wishes, through this guide and other publications to follow, to clear up some of the doubts still surrounding these products, despite their undeniable popularity.

Mutual funds are an excellent vehicle for individual investors to explore the complex but rewarding world of securities markets. Get to know them better!

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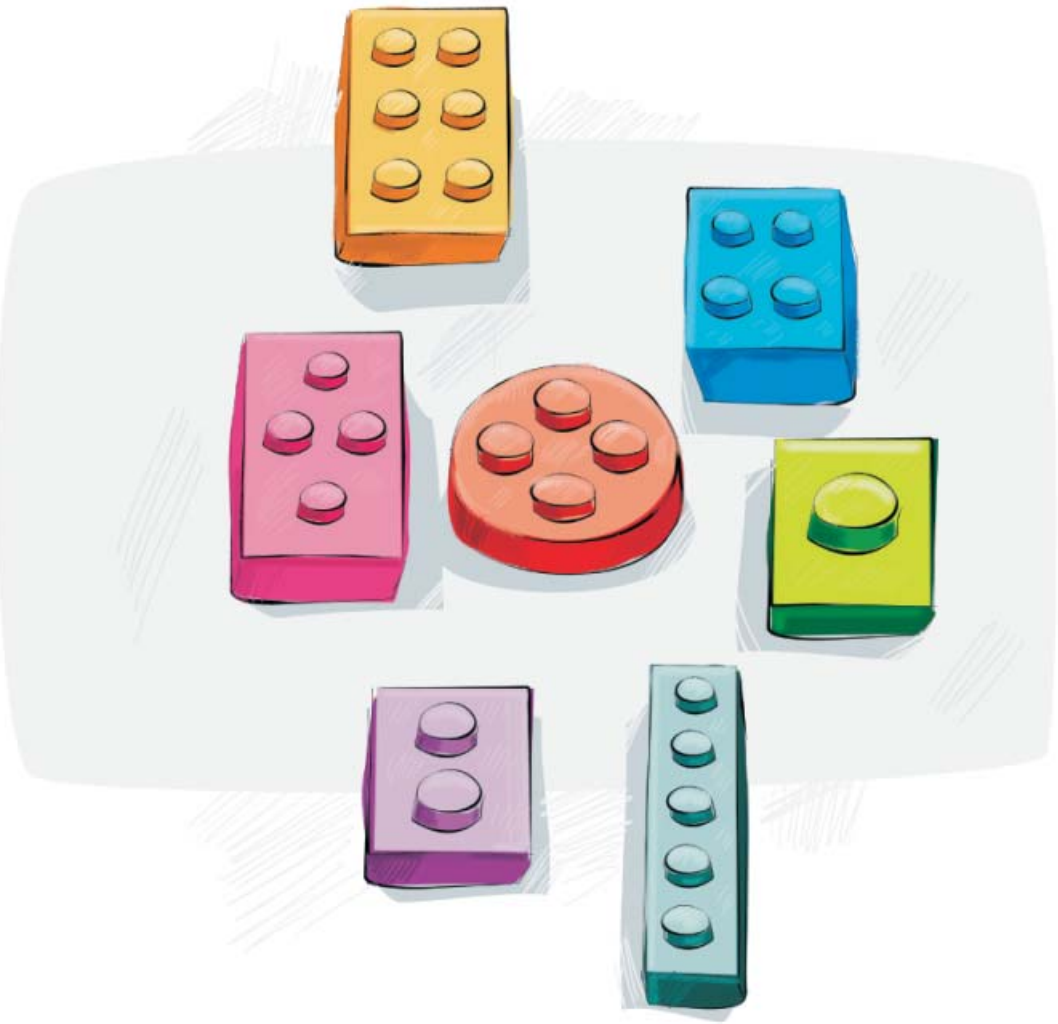


01 Some key points about mutual funds

Mutual funds are collective investment schemes, meaning the income corresponding to each individual depends on the return obtained by a collection of investors.

In reality, a mutual fund is a pooling of assets without legal personality. This pool is made up from the individual contributions of a variable number of people (unitholders).

The lack of legal personality means that mutual funds have to "interact" with their environment (unitholders, intermediaries, markets) through a management company and a custodian entity. The functions of both are clearly defined:

- The **management company** takes the investment decisions and exercises all administrative and representative duties relating to the fund. It is accordingly the management company that invests the capital entrusted by savers (unitholders) in the financial assets making up the fund's portfolio: fixed-income securities, equities, derivative products, bank deposits... Among its obligations is to draw up a **prospectus** setting out the fund's characteristics; a document that we will deal with at length later in this guide.

Mutual funds are collective investment schemes.

The assets of a fund are made up from the individual contributions of a variable number of people.

- The **custodian** is entrusted with the safekeeping of the fund's assets (securities, cash), and with overseeing some aspects of the manager's activity on behalf of unitholders.

The basic investment measure is the **unit**. And its price or market value is net asset value, arrived at by dividing the fund's total assets less expenses and fees by the number of units outstanding at a given time. The way these concepts work is dealt with in our next chapter: "Calculating fund returns".

Example 1. Mutual Fund XXX begins operations on 1 January with four unitholders: Mr. A, Mr. B, Ms. C and Ms. D. Each one pays in 100 euros, so the fund starts out with initial assets of 400 euros. In this case, each investor is the holder of a unit worth 100 euros. And the fund has 4 units outstanding.

Manager YYY, in charge of representing and managing the fund, invests these 400 euros in the securities markets such that the fund portfolio is made up as follows:

Fixed-income security 1	50 euros
Fixed-income security 2	100 euros
Equity security 3	125 euros
Equity security 4	100 euros
Cash	25 euros
TOTAL PORTFOLIO	**400 euros**

These securities are kept by the Custodian ZZZ.

The fund's assets can grow or decrease for two reasons:

1. The entry and exit of unitholders: mutual funds are open-ended, meaning investors can enter or withdraw at their own convenience by purchasing or selling units. Each purchase of units is known as a **subscription** and their sale as a **redemption**, which may be partial or total. Hence the number of units outstanding is constantly changing as investors join and leave the fold.

2. Changes in the market value of the assets making up the fund portfolio. It is these fluctuations in portfolio value that determine the gains or losses corresponding to the fund and, in consequence, to each of its unitholders.

Fund returns, whether gains or losses, are not passed on to investors until they redeem their units.

A key characteristic of mutual funds is their tax efficiency. Returns are not passed on to investors until they redeem their units, so gains, if any, will not be taxed before that point[1].

In exchange for the professional management of his or her investments, the unitholder pays a series of fees which vary from one fund to the next (and must be specified in the prospectus), within the ceiling levels set by law.

(1) The income obtained from mutual funds is treated as a capital gain or loss for tax purposes. As of end 2005, the capital gains obtained by resident individuals are subject to a 15% withholding tax. In other words, investors redeeming their units for more money than they put in will have 15% deducted from the proceeds. In most cases, capital gains raised over a period of one year or less are taxed at the going rate, i.e. from 15% to 45%, and those raised in more than one year at 15%.

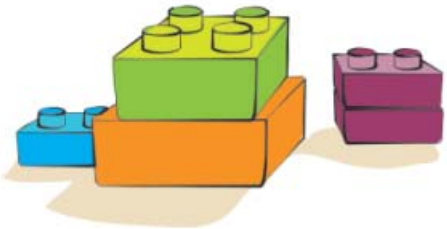
The manager and custodian debit the fund directly for management and custody fees, so these are already subtracted from the return that the fund and, therefore, the investor earns. Also, the management companies of certain funds may charge unitholders directly for buying and/or redeeming units.

Example 2. After one month of operation, the Fund XXX portfolio stands as follows:

	PREVIOUS MONTH	**CURRENT MONTH**
Fixed-income security 1	50 euros	55 euros
Fixed-income security 2	100 euros	100 euros
Equity security 3	125 euros	117 euros
Equity security 4	100 euros	115 euros
Cash	25 euros	24 euros
TOTAL PORTFOLIO	**400 euros**	**411 euros**

Although some securities have performed better than others, the portfolio as a whole has risen in value to 411 euros. However, to calculate the fund's assets we have to subtract the 2 euros management fee charged by Manager YYY plus the 1 euro due to the Custodian ZZZ for its securities administration services.

So the fund's assets actually stand at 408 euros. The price of each fund unit (net asset value) is therefore 102 euros. Meaning each unitholder has made a capital gain of 2 euros.



02 Calculating fund returns

As we explained in the previous chapter, mutual fund assets are divided into units. The term net asset value denotes the price of each unit at a given moment.

$$\text{Net asset value (NAV)} = \frac{\text{Fund assets}}{\text{No. of units outstanding}}$$

In traditional funds, this sum is worked out by the manager on a daily basis[2]. Managers must publish the net asset values of their funds on their websites or in stock exchange bulletins, whatever is specified in the prospectus; in most cases, they can also be consulted in the press or through economic news agencies like Bloomberg or Reuters.

Returns are stated as the percentage change in NAV between subscription and redemption dates.

$$\text{Return} = \frac{\text{Final NAV}^{3} - \text{Initial NAV}}{\text{Initial NAV}} \times 100$$

Returns are calculated as the percentage change in NAV between subscription and redemption dates.

(2) Later on, we will see how some collective investment schemes dealing in different kinds of assets may calculate net asset value at longer intervals: monthly, quarterly...

(3) Exceptionally, some funds may distribute part of their earnings among unitholders instead of retaining them within the fund. In such cases, returns will be the sum of the distributed earnings and final NAV.

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Example. Two years ago, the Gómez family took out 50 units of Fund AAA at a price of 1,000 euros per unit. At this moment, their net asset value is 1,025 euros. The Gómezes decide to cash in half their investment, so redeem 25 of the units held. Using the above formula, we get a return on this investment of 2.50%: they invested 25,000 euros and have received 25,625.

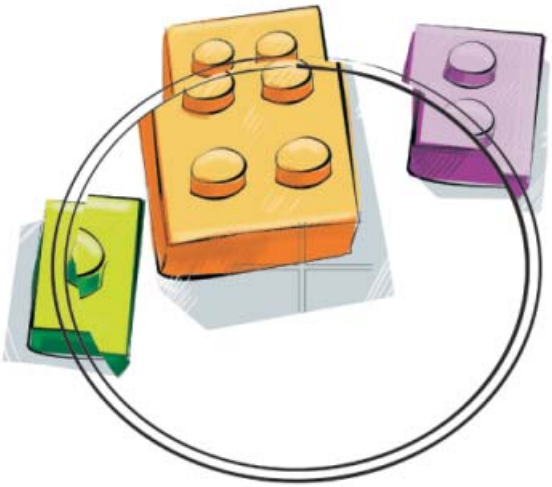
Two months later, they redeem the remainder of their units to meet an unforeseen expense. But the markets, meantime, have moved lower and NAV is now 985 euros. In this case, their investment has generated a negative return of –1.50%: they invested 25,000 euros and got back only 24,625.

This example shows how returns can be either positive or negative depending on movements in net asset value.

Note that this form of calculating returns gives us the variation in NAV over any period, not necessarily a year. In the first case, for instance, the investor made a gain of 2.50% in a period of 2 years. So to compare performance against other products expressing their returns as an annual interest rate, we need to annualise the return obtained (giving 1.24% in the example considered).

It is also important to remember that final returns may be minus the amount of subscription or redemption fees (specified, when applicable, in the fund prospectus). These and other costs are described in more detail in chapter 6 of this guide.

Fund returns can be either positive or negative depending on the performance of net asset value.



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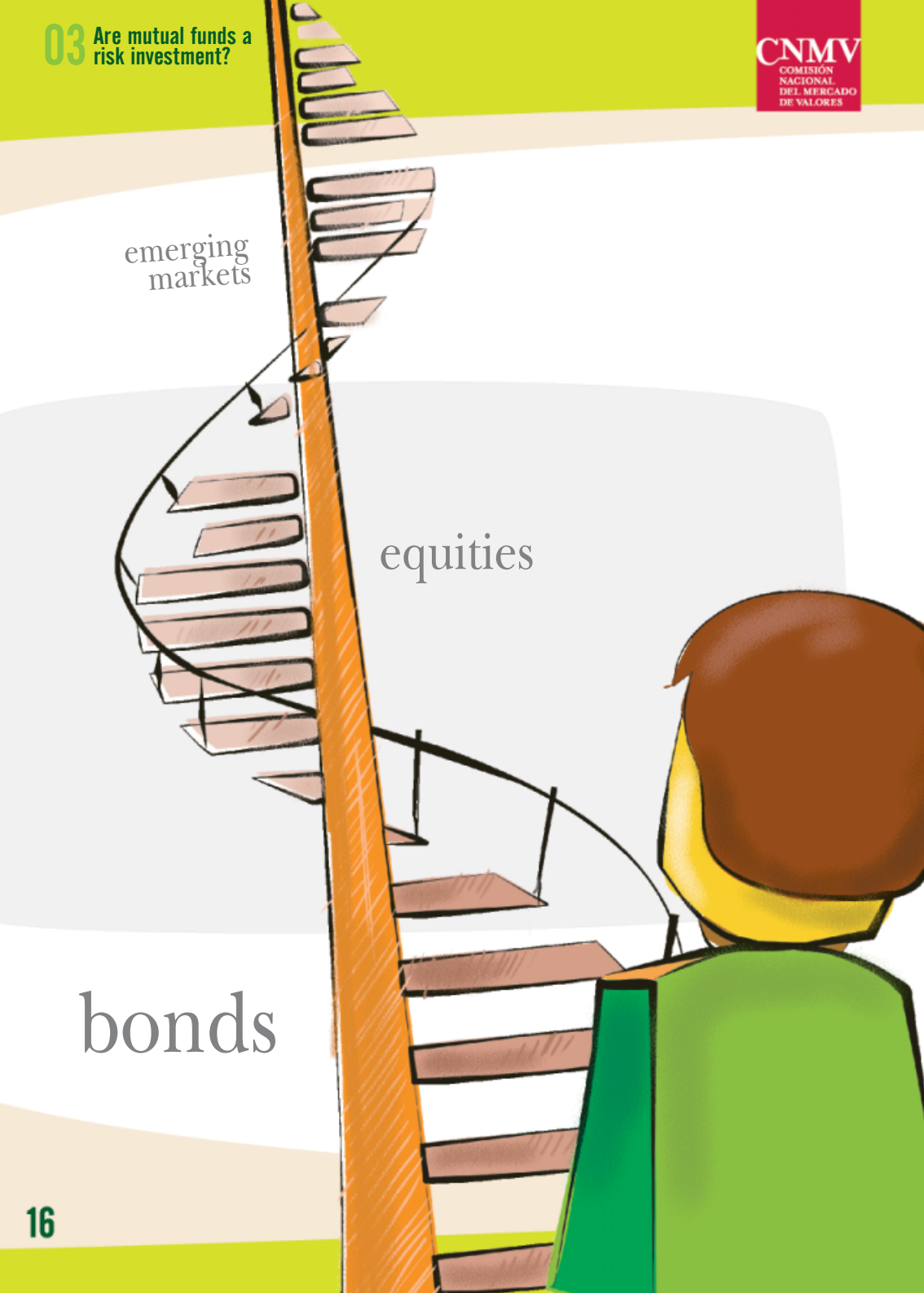

03 Are mutual funds a risk investment?

Mutual funds, like any other investment product, carry some degree of risk. Although they tend to be regarded as "safe", investors can still lose money if the markets do not perform as expected. The nature and extent of risk will depend on the type of fund, the conditions applying (defined in the prospectus) and the assets in which it invests.

To choose the fund that is right for you, decide first how much risk you can reasonably tolerate and how long you want to hold the investment (especially relevant in the case of guaranteed funds). Generally speaking, mutual funds help you control risk by means of portfolio diversification, so losses on some assets can be offset by gains on others. However, the possibility of suffering a loss can never be ruled out: after all, your capital is still invested in securities whose prices fluctuate according to market conditions.

Diversification can help control risk, but the possibility of suffering a loss can never be ruled out.

The first thing to decide, then, is whether you are ready to accept that your investment may be worth less when you redeem it than when you bought it.

Two variables can help elucidate the risk attached to a given mutual fund. These are: volatility and duration.

- **Volatility** tells us whether a fund's net asset value has fluctuated widely in the past or held more or less to a stable course. Greater volatility means

more risk, because it is harder to predict whether net asset value will rise or fall. On redemption, therefore, the unitholder could net a substantial gain but also a heavy loss.

Investors using volatility as a decision aid should note that it may be worked out and presented different ways (daily, monthly, annualised, non annualised...). The best solution is to choose a reliable source and stick to it, to ensure the data managed is consistent.

- **Duration** (or average maturity) gives us a handle on fixed income elasticity to variations in interest rates (interest rate risk). When rates rise, the fixed-income securities in a portfolio lose value, because market demand shifts to new-issued instruments incorporating the higher rate. And the reverse is true when rates fall.

This effect is less notable in shorter-term securities, because the money raised when they mature can be reinvested in assets paying current rates. The rule, then, is that the longer the duration of a portfolio, the greater its sensitivity and therefore risk.

Also, before subscribing to any fund, the investor should check out its investment policy (in the prospectus) and, if the fund has been running long enough, its portfolio composition at the last quarterly close (periodic unitholder reports). Both these documents can and should be requested from the fund distributor. They can also be consulted on its website or in the registers of the CNMV.

The fund's investment policy and the composition of its portfolio can tell investors a lot about the risk they are assuming, by way of the percentage invested in each asset class, in euros versus other currencies, in one or other geographical zone, etc. A few pointers:

- Equity investment, by its very nature, entails more risk than investment in fixed income, but the latter is not immured from losses and savers should invariably keep this in mind. Equities, as a rule, have more risk attached because share prices are more volatile.

• The investment policies of some funds mean they may carry securities incorporating a higher *credit or counterparty risk*: the possibility that the issuer (company, bank or government, among others) is unable to meet its payments or has to push them back in time. In these cases, it may be worth consulting the credit rating assigned to the issuer by international specialist agencies.

• Investing in emerging market securities brings another risk into play, known as *country risk*, whereby your investment is exposed to local circumstances and events of an economic, political or social nature.

• Holding assets denominated in currencies other than the euro exposes the investor to *exchange rate risk*.

• Funds investing in financial derivatives (futures, options, etc.) can, by their very nature, incorporate an added risk (e.g. leverage[4]). This means that while portfolio gains may be multiplied, so too may portfolio losses.

That said, many funds use derivatives primarily or exclusively to smooth out the risk of the spot portfolio (hedging); the investment policy statement contained in the prospectus must indicate whether derivatives will be used for investment or hedging purposes.

• Another point to remember is that a fund investing in unlisted securities is taking on the added risk implied by less control over issuing companies. The valuation of these assets is also complicated by the lack of an objective market price.

(4) Leverage is generally used to describe the effect of borrowings on profitability. In securities markets, however, the term refers to the technique whereby a small investment can be made to act like a far bigger one, with the effect of magnifying gains or losses. The best example is buying options or warrants: by paying just a small amount (the premium), the investor gets the chance to raise the same return as if he or she had bought or sold securities with a far greater market value. While waiting for the option to expire, the investor can obtain a return on funds which he or she has not yet had to disburse. Hence an investment in options can be much more profitable than an investment in the underlying asset, if market prices favour the derivative position; the risk, however, is also greater and the entire investment may be lost if the market goes against.

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04 Types of funds

The Spanish market offers a wide choice of mutual funds that we can classify using different criteria. Perhaps the best yardstick for individual investors is the fund's **investment policy** as defined in its prospectus, since the assets it invests in are what will ultimately determine the degree of risk assumed by unitholders. The investor will thus be equipped to choose the fund that bests matches his or her goals, financial situation and risk profile.

The alternatives available fall into the following broad categories:

- **Bond funds:** investing most of their assets in fixed-income assets (bonds, bills, commercial paper, etc.). A specific sub-group is *money-market funds* which invest in short-term fixed-income assets (less than 18 months to maturity) and may not be positioned in equities. This kind of fund carries less risk, but is also lower on potential returns. Returns, in fact, may even turn negative when interest rates are at lows.

The main feature that serves to classify funds is the investment policy defined in their prospectuses. The kind of assets a fund invests in is what determines its degree of risk.

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- **Balanced funds:** investing part of their assets in fixed-income securities and another part in equities.

- **Equity funds:** investing primarily in equity securities. Equity funds often operate sub-categories depending, for instance, on their target markets (Spain, Eurozone, USA...) or industries (technology, finance...).

- **Global funds:** do not have a precisely defined investment policy, so fit none of the above categories. They are under no requirement to maintain a set percentage of fixed-income or equity assets, or a predefined exposure to currencies or geographical markets. Some global funds are extremely high risk propositions.

- **Guaranteed funds:** lately the most popular product among Spanish investors, these schemes have specific characteristics which we explore in more detail in our next chapter.

The latest arrival to the Spanish market are the newly authorised **umbrella funds**. This format, widely used in neighbour countries, involves the opening of two or more sub-funds, each with its own investment policy, fees and expenses schedule, etc. Sub-funds, in turn, can issue different classes of unitholdings subject to different fees. The result is that each sub-fund and class of unit, as the case may be, will have a net asset value different to all others in the same fund, so logically their rates of return will also differ.

There are other types of funds, like hedge funds or exchange-traded funds, which tend to fall outside the general rules applying to the industry. These are explained separately in the chapter on “Other collective investment schemes”.

... knowing the investment policy equips investors to choose the fund that bests matches their goals, financial situation and risk profile.


12 October 2006
expiry date
27 March 2009
27 March 2009
expiry date
27 March 2009
27 January 2010
expiry date
27 March 2009

05 Guaranteed funds

Guaranteed funds assure unitholders at least the protection (total or partial) of their initial investment over a given time period.

They should not be confused with other types of funds **which aim to deliver a specified growth rate** or one linked to a given benchmark (Euribor...). The difference, precisely, is that in the latter case these returns are an objective and not a guarantee, so cannot be claimed by the investor as of right. What they are really offering is a **non guaranteed target return**.

Guaranteed funds have certain features that you should know about before subscribing, since their relative safety does not automatically mean they are right for all investors:

a) Guarantee conditions. Liquidity restrictions

b) What happens when the guarantee expires?

c) Taxation

d) Calculating returns

a) Guarantee conditions. Liquidity restrictions

Guaranteed funds have a recommended investment horizon coinciding with the term over which they guarantee the preservation of capital. You should therefore think twice about investing in a guaranteed fund if you may need the money before the guarantee expiry date (usually set between 1 and 6 years on, depending on the fund).

Unlike non guaranteed funds, they incorporate a series of features to dissuade investors from entering or leaving the pool during the guarantee period:

- Initial offer period, when you can contribute to the fund without paying subscription fees (often as high as 5% of the amount invested). When a given return is also specified, it will only be available to those who made their investment during this period.

- Only unitholders maintaining their investment up to the guarantee expiry date will be covered by its terms: **i.e., units redeemed before this date are not guaranteed.** Unitholders needing to withdraw their money before the guarantee matures will be paid the NAV corresponding to the redemption date, which may be more or less than the initial sum. As a rule, they will also have to pay a redemption fee (up to 5% of capital).

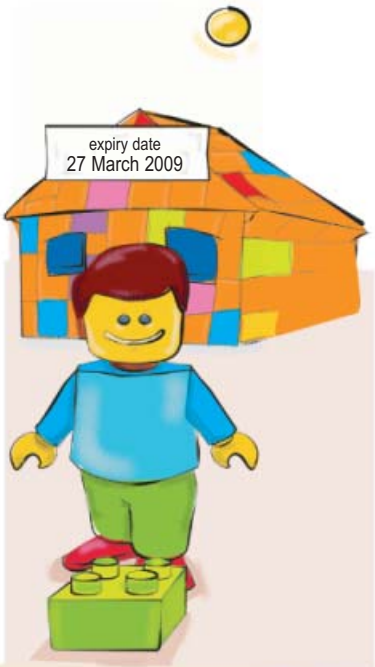
In short, unitholders entering the scheme after the offer period or who leave it before the guarantee expires could find their returns severely penalised and may even lose part of their initial investment.

Some guaranteed funds have what are known as **"exit windows".** These are preset dates on which unitholders can redeem all or some of their units without paying a fee, provided they comply with the notice period[5]. Exit windows are a big advantage for the investor since they alleviate one of the main shortcomings of this kind of product. However, unitholders must remember that the amount they receive will correspond to the NAV of the request date, i.e. they will not be protected by the guarantee and are at risk of losing some of their investment.

Some funds make **regular "payments" over the guarantee period**. These should not be confused with the coupons typical of fixed-income securities, since they are in fact compulsory partial redemptions liable for tax in the year they arise.

(5) This notice period usually runs from three days to one week, and is expressed in business days (generally, without counting Saturdays, Sundays and public holidays). The dates and notice periods of exit windows are given in the fund prospectus, which should also specify what is meant by a business day.

In general, redemptions made before or after the guarantee's expiry date are not protected by its terms. This means you could lose money.



b) What happens when the guarantee expires?

Guaranteed funds assure the preservation of the capital invested (or part of it) to a specified future date, namely the **guarantee expiry date**. Two things can happen when this expiry date arrives: the manager can opt to renew the guarantee under the market conditions of the moment, or leave the fund to function like any other, i.e. without a guarantee.

So when we talk about **"expiry dates" referring to mutual funds we mean the expiry of the guarantee, since the fund itself does not expire[6].**

As the guarantee expiry date approaches, the manager will send a letter to unitholders specifying the changes that will take place in the fund. **Unitholders who decide against staying on under the new conditions automatically have a free exit right**, meaning they can cash in their units without paying a redemption fee. Investors must be careful to read all the mail they receive from their dealer, because **no response will be taken to mean that they want to remain in the fund for the new guarantee period.**

Unitholders should also be aware that once a guarantee has expired and the free exit period has elapsed, any redemptions they make will be at market price, which may be lower than at the time of the guarantee's expiry.

(6) Although a manager may decide to wind up or merge a fund (for commercial or other reasons), mutual funds are established in principle with an indefinite duration.

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c) Taxation[7]

The fund guarantee is provided by a third party, and may be internal (any shortfall to the net asset value underwritten is paid to the fund) or external (it is paid direct to unitholders).

Each system implies a different tax treatment of unitholder proceeds. As the internal guarantee materialises as a payment to the fund itself, the investor receives it as part of the net asset value of his or her unitholdings (as a capital gain), meaning it has no immediate tax consequences[8]. In the case of external guarantees, however, unitholders are paid the difference between the fund's net asset value on the guarantee expiry date and the net asset value guaranteed, and this amount, conversely, is taxable the year it is received (as capital income).

d) Calculating returns

Guaranteed funds offer the total or partial preservation of the capital invested at the end of a preset period. However not all guarantee any added return. The guaranteed funds currently available in the Spanish market can be divided into two main groups:

- **Fixed-income guaranteed funds** generally assure a certain increase on your investment on the guarantee expiry date over and above the protected capital. To get a precise idea of the return on offer, look for the annual equivalent rate or AER (stated in the prospectus whenever it is possible to calculate).

- **Variable-income guaranteed funds** will generally only protect the initial capital invested, while offering the possibility of a return linked (totally or partially) to the price of shares, stock indices, currencies or other mutual funds. If the markets perform against expectations or certain prospectus assumptions are not fulfilled, the unitholder may receive no return at all on his or her investment.

(7) Tax treatment as of December 2005, and subject to possible future modifications.
(8) Capital gains are not taxed until unitholdings are redeemed.

Other guaranteed funds assure a minimum return on guarantee expiry (these may look tempting in multiannual terms but frequently give an AER below 1%), alongside prospective returns linked to shares or share indices. These are essentially a hybrid product in between the two big groups of guaranteed funds.

It is often extremely difficult for the unitholder to know what scale of return to realistically expect, when results hang on the performance of a number of underlying instruments. Remember also that the commercial material publicising these products may overstate the possible returns. However optimistic the forecasts for market performance, **we still need to know whether a guaranteed fund is in fact offering a guaranteed return.**

Guaranteed funds with target returns linked to the performance of share or mutual fund baskets, indices and other instruments use increasingly complex formulas to calculate the return available to unitholders. These may be described in detail in the fund prospectus, but only someone with specialist knowledge can understand them.

However "lay" investors can still learn to identify some of the main calculation mechanisms employed by this kind of fund. These formulas, almost without exception, place some constraint on the real returns (if any) that investors can hope for, even though the growth rates displayed may look highly succulent. This is because the unitholder, in most cases, will not see the same gains as the underlying instrument, but only a percentage which depends on the formula used.

It is wisest to only invest a sum that you can leave in the fund for the whole of the recommended time horizon.

The table that follows sets out some of the calculation methods used by these funds, and how they affect the real returns obtained by unitholders. We use the letter **R** for return, **fV** for the final value of the investment and **iV** for the initial value.

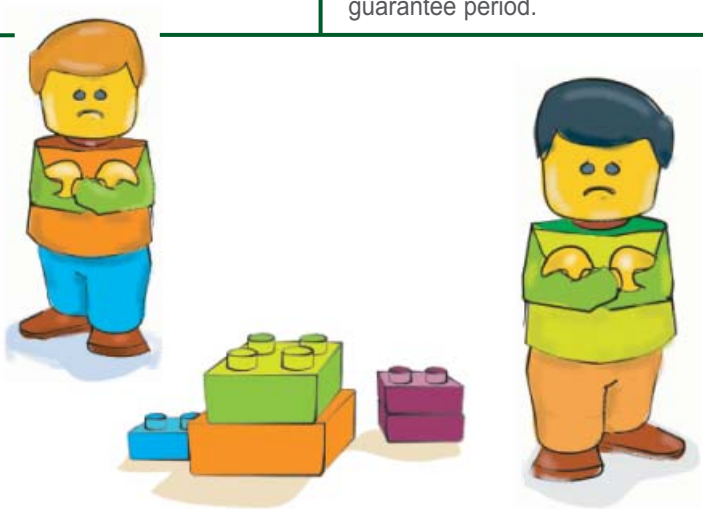
MOST COMMON GUARANTEED FUND STRUCTURES

TYPE OF RETURN	UNITHOLDER RETURN
Standard $R=\frac{(fV - iV)}{iV}$ Factoring only the initial and final values of the underlying asset.	The return is the same as if we invested directly in the underlier, and is therefore the best deal for the investor. However, this formula is barely ever used. And when it is, unitholders rarely get 100% of the difference but a smaller percentage (between 40% and 60%).
Based on final value $R=\frac{(fV - iV)}{fV}$	Returns will always be lower than with the previous method: the more the underlying asset appreciates, the higher the denominator, so returns will be less than if we divided by initial value.
Worst performing asset Returns are linked to the worst performing of all the assets included in the set or basket of securities.	Investor returns are largely determined by the make-up of the basket. If this comprises a large number of securities or a broad mix of sectors (i.e. with less likelihood of performing in line), there is more of a chance that one will do badly. And this is precisely the case that will be used to calculate his or her returns.

TYPE OF RETURN	UNITHOLDER RETURN
Limited or contingent returns	
Based on complex structures. Among the numerous variants we can single out:	
1. “Caps”. Even if the underlying asset records stronger growth, the cap marks the maximum gain used for calculating investor returns.	1. “Caps” are bad for investors, because they limit the maximum return that they can obtain.
2. “Barriers”. These can be of two types: activating and deactivating. In some cases, if the underlier exceeds a given level (the barrier), the unitholder is assured a fixed return (“knock in”). In others, when the barrier is reached, the investor loses the right to any gains (“knock out”).	2. The effects on the investor can be positive or negative depending on the structure they form part of.
3. Other formulas include “floors”, which place a backstop on losses or set the reference value of the underlier for calculating fund returns (if the value of the underlier falls below the “floor”, it is this last value that is factored).	3. The use of “floors” is generally more beneficial for the investor, because they eliminate the most negative data from fund return calculations.
“Caps”, “barriers” and “floors” can be used in tandem with remaining mechanisms and it is even possible to combine “caps” and “floors” in a single formula.	

TYPE OF RETURN	UNITHOLDER RETURN
Average of monthly observations The change in value of the underlying asset is worked out as the arithmetical average of its monthly values over a set period of time. This is one of the most popular formulas for guaranteed funds, which usually offer 100% of the growth of the underlier or an even higher percentage.	Overall, we can say that this formula harms investors in a bull market (as it smooths out gains) and helps them in a bear one or when the underlier enters losses at the end of the guarantee period (since it also smooths out falls). If the underlier is an index or basket of shares, its composition is the key factor determining returns. In the case of a broad mix of sectors or markets (with little co-directionality), losses in one place will tend to offset gains elsewhere, making it harder for the unitholder to obtain a substantial return.
Himalaya structure This formula is referenced to a basket of securities or indices. Fund returns are calculated as the arithmetical average of as many observations as there are subperiods (usually annual or six-monthly). The guarantee period is divided into the same number of subperiods as the number of securities or indices making up the basket. At the end of each, the security that has performed best since the start of the guarantee period is dropped from the calculations of successive subperiods. The security chosen in the first subperiod is recorded with its performance data for this first subperiod. The security chosen in the second subperiod, figures	The formula, as such, does not rest on the performance of all the underliers over the guarantee period, but on the performance of each component instrument over a distinct interval of time: the longest corresponding to the security that performed worst over the remaining subperiods. This fact plus the use of the arithmetical average of all observations delivers lower returns than would be got by using the straight change in value of the same underlier. Although investors may come out ahead on specific occasions, the most usual outcome will be a lower return.

TYPE OF RETURN	UNITHOLDER RETURN
with its performance data for the first two subperiods. And so on until we reach the final subperiod (ending with the expiry date of the guarantee), for which the data correspond to the performance over the whole period (including all subperiods) of the only security left undiscarded.	
Initial value corresponding to the highest price in a given period Other popular formulas take the top price of the underlying asset in a given period as the initial value for calculating target returns.	The longer the observation period used to calculate initial value, the greater the chance that it will be higher, meaning returns for the investor will be correspondingly less. This formula can be used in tandem with others, such as average monthly revaluation, with both exerting a significant influence, generally a downward one, on the returns earned by the investor at the end of the guarantee period.




MANAGER
mutual funds
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06 How to choose a mutual fund

Every mutual fund has its own characteristics and level of risk, so once you have settled on collective investment, you need to shop around to find the best product for your particular circumstances and expectations. This calls for two separate analyses:

- **Of your personal situation and objectives**. It is important to be clear about the scale of losses you are prepared to accept and how long you wish to maintain your investment. The answer to these questions will allow you to identify the kind of fund that best matches your investment goals.

- **Of the funds available**. To select one fund from the wide variety available in Spain, you need to look closely at certain characteristics which are set out in the fund prospectus. Studying this document, which you must be given before you subscribe (available on the website of the manager or distributor and from the CNMV) will help you make an informed decision about your investment.

The following checklist can serve as a guide:

a) Risk profile and investment policy

b) Recommended time horizon

c) Fees

d) Past performance

e) Advertising and commercial messages

In addition to the information you get from your manager or distributor, the Comisión Nacional del Mercado de Valores offers abundant information on mutual funds through its official registers (prospectuses, registered entities) and the Investor's Corner section of its website (www.cnmv.es): explanation of key concepts, comparison tools...

a) Risk profile and investment policy

The first thing to think about is your own attitude to risk. Risk profile[9] indicates the investor's ability and willingness to face up to potential losses. It is important to remember that there is normally a close relationship between risk and return. Thus investors looking for higher returns must accept a higher degree of risk.

For the mutual fund prospector, this means looking for funds with a risk level adapted to his or her profile (low, moderate or high risk). This information is disclosed in the prospectus along with the other general characteristics of the fund. In chapter 3 of this guide we saw how a fund's risk is closely bound in with its investment policy.

- Investors with a low risk profile have little tolerance of losses, and may be content with lower returns if they can be sure of preserving their capital. They will probably be best served by products like bond or money-market funds.

- Investors with a moderate or medium risk profile will be prepared to contemplate some degree of losses in exchange for the opportunity to earn a reasonable return. The best solution for this group could be some kind of balanced fund (bonds and equities).

- Investors with a high risk profile exhibit little aversion to risk. They set their sights on high returns and will accept considerable capital losses in exchange. This group can invest in any kind of fund including those which, a priori, carry a higher risk: equity funds specialising in certain sectors or countries (technology stocks, emerging markets...), hedge funds[10], etc.

Investors unsure about their particular risk profile should seek guidance from their financial intermediary. Most intermediaries have questionnaires to identify clients' risk profile available at their offices and websites.

(9) This concept is dealt with in a simplified way for reasons of instruction, though in fact many other factors intervene.

(10) Hedge funds are dealt with in detail in chapter 10 of this guide

b) Recommended time horizon

The nature of mutual funds and their tax treatment mean investors will benefit from keeping their money in for a certain length of time. The prospectus states the recommended time horizon for each product depending on its characteristics: guarantee, markets invested in, nature of investments... For example, more volatile funds call for longer horizons, since this gives the investor sufficient time to recover from market troughs.

It is important to keep the capital invested in the fund for at least the recommended time horizon. Otherwise, you may face a series of outlays that eat into returns:

- Redemption fees. Some funds specify redemption fees on a sliding scale, whereby the rate declines or even disappears the longer you hold the fund.

- It is advisable to stay in guaranteed funds up to the guarantee expiry date (usually between one and six years). By cashing in units before this date you not only incur the standard redemption fee but may also find yourself down on your initial investment (if that day's NAV is lower than when you subscribed).

It is wisest therefore to only invest a sum that you can do without in the short term and, in theory, will be able to leave in the fund for the whole of the recommended time. This means each investor should first draw up his or her own financial budget covering projected income and expenses and extraordinary outlays, and setting something aside for unforeseen commitments...

Before choosing a fund, you must be sure about the losses you are ready to assume and about the time you want to remain invested.

c) Fees

The fees charged by mutual funds are another important checkpoint for prospective investors, as they may significantly lower rates of return. Their amount and conditions are set out in full in the fund prospectus[11]. There are several types of fees:

- Management and custody fees: as charged by the manager and custodian respectively. These fees are implicit, that is, they are already subtracted from the NAVs that funds publish (since they are charged to the fund directly[12]).

  Management fees can be based on the fund's assets, performance or both at once (check the prospectus to see if fees vary, for example, according to how long you have held the fund). The maximum limits are: 2.25% if based on fund assets, 18% if charged on performance. In mixed formulas, the fees applied cannot exceed 1.35% of assets and 9% of returns.

(11) The prospectus should also list any additional expenses borne by the fund in respect of essential services other than management and custody.

(12) There is one case where management fees are not implicit: if the fund charges a performance fee on an individual basis, each unitholder will have to pay a percentage of his or her investment returns.

Custody fees are those charged by the custodian entity for the administration of fund securities. They may in no case exceed an annual 0.2% of the fund's assets.

- Subscription and redemption fees: these can be paid to the manager or to the fund itself. They are explicit, i.e., charged to the unitholder at the time of subscription or redemption as a percentage (up to 5%) of the amount being purchased or sold, and deducted from the same.

- A fee may also be charged in some cases from switching from one sub-fund to another.

But other expense items aside from fees can eat into final returns. One useful indicator which you can find in the prospectus if the fund has been running long enough is the **TER** or **total expenses ratio** (expressed as a percentage of the fund's total assets). Total expenses include management and custody fees, external expenses and other operating expenses. The lower this percentage, the more profit is left for the unitholder.

Mutual funds also apply different fees to the different unit classes issued. These depend on factors like distribution policy (whether the units are bought on the Internet, by phone or at a branch), size of investment (in general, the higher the amount the lower the fee) or the currency in which the fund is denominated.

For instance, a fund may have A class units with a high management fee but exempt from subscription and redemption charges, and B class shares with a low management fee but paying subscription and redemption fees. Investors can thus select the fee and expense structure that is most appropriate for their particular goals, like the time they want to remain invested or their intention to make regular purchases and sales.

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d) Past performance

A fund's track record can be another aid to decision making, provided you remember that past returns are not a reliable guide to future performance. Even though a fund retains the same management strategy, the economy as a whole is subject to multiple influences that can alter market trends or the progress of listed companies and, with them, the results obtained. Hence the standard warnings attached to information on fund performance to the effect that **"past returns are not indicative of future returns".**

Care should also be taken when analysing the data given by different sources (financial newspapers and journals, the websites of financial institutions and the CNMV, statistical publications, etc.):

- Rates of return should always refer to an explicit time period (quarter, six months, one, three or five years...). Comparisons between the returns of different funds should always be based on the *same time periods*.
- It is fairly common for funds to modify their investment policy, resulting in a parallel change in their category and risk level[13]. When looking at the past performance of a fund, remember that the results obtained with a now lapsed investment policy have little practical significance in the present. It is therefore important to know how long the current investment policy has been in place, disregarding any results obtained prior to that date.

e) Advertising and commercial messages

Financial intermediaries use advertising as a way to inform potential investors about their products and stimulate their interest. Logically enough, they try to present their products in as favourable a light as possible. This may mean playing down or omitting a product's disadvantages and limitations, or stating them in such a way that they go practically unnoticed. Also, some typical advertising devices can create unrealistic expectations if they are not accompanied by the necessary warning note.

(13) Such modifications must be notified to unitholders who, in most cases, will be entitled to leave the fund during a specified time without paying a redemption fee.

It is therefore important for investors to read them in a critical spirit. Remember commercial messages, by their very nature, cannot include all the information necessary to know if a product is really right for you. In consequence:

- Don't take any investment decision without first consulting the prospectus, which sets out all relevant details on the fund.
- The prospectus and other official documentation (periodic reports...) are available for consultation at the offices of financial intermediaries and the CNMV.

Ask your financial intermediary to explain any points you are unsure of regarding the characteristics and risks of the fund you are considering. Remember intermediaries will usually only have information on the funds they themselves distribute (often those of their own financial group), and especially those in the launch phase. Ultimately, you are the best judge of your own wants and needs. So make sure you are actively involved in the selection process, and analyse whether the products you are being offered are really right for your risk profile and the time you want to stay invested.

Anyone who considers that advertising material is insufficiently clear or contains potentially misleading elements can report this fact to the Comisión Nacional del Mercado de Valores through its Investor Assistance Office.

Aside from the information you should get from your financial intermediary, the Comisión Nacional del Mercado de Valores offers a wealth of data on mutual funds.

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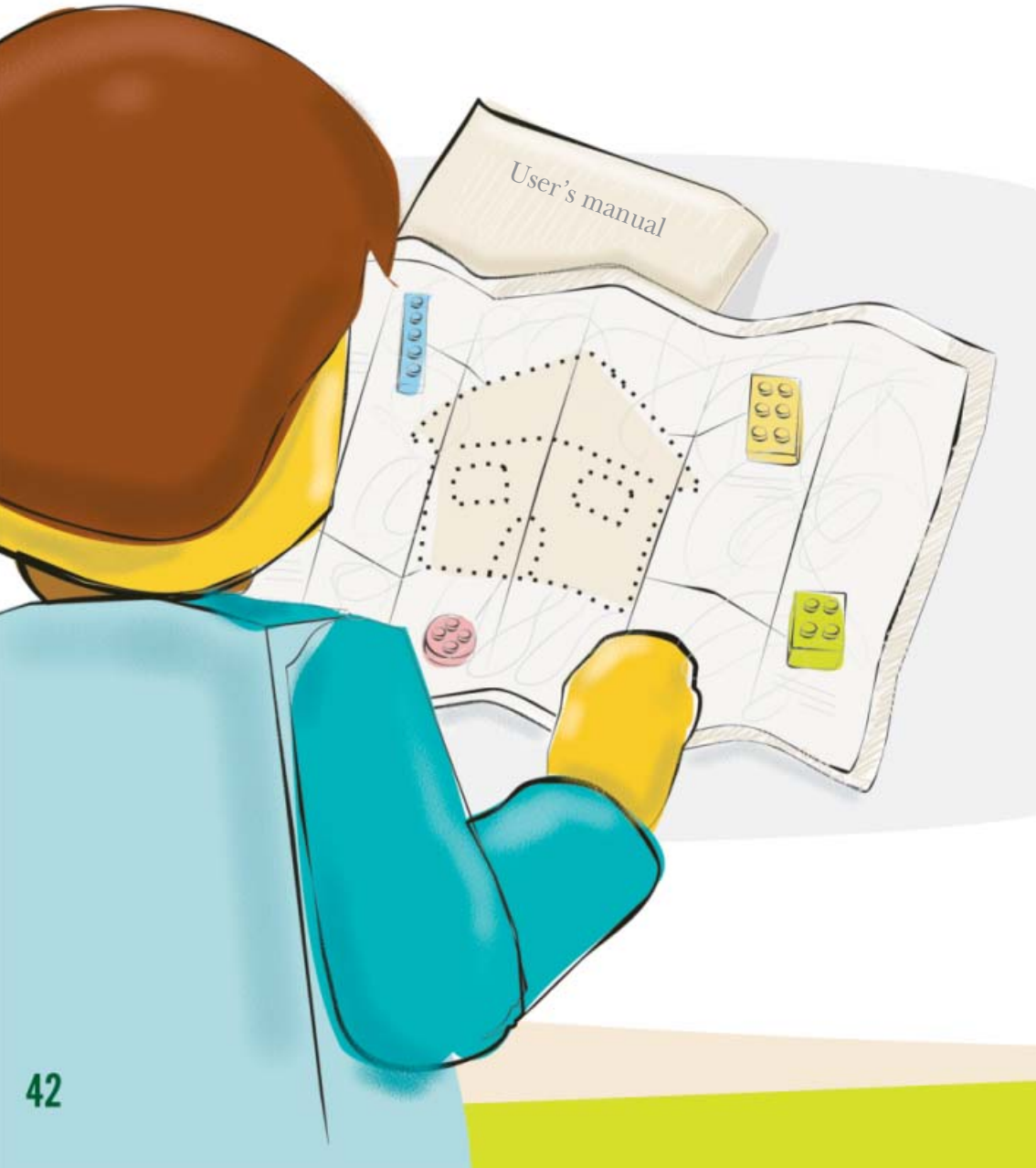


07 Subscriptions, redemptions and transfers

The way mutual funds work is fairly straightforward. However it is worth exploring some of the basic terms and procedures, so you know what options are available for purchasing or selling mutual fund units, the problems that can arise and how to deal with them[14].

a) Units subscription

b) Units redemption

c) Transfers

a) Units subscription

The way to invest in a fund is by purchasing units: managers issue as many units as are necessary to meet subscriber demand. Each investor receives a number of units worked out by dividing the amount invested by the net asset value applying to the transaction.

The applicable NAV may be that of the request date (as disclosed the following day) or that of the day after the request date (as disclosed two days later), whichever is specified in the fund prospectus.

Remember finally that some funds charge a subscription fee which can run to 5% of the sum invested.

The fund prospectus will tell you which NAV is applied to subscriptions and redemptions, depending on the request date.

(14) Our chapter on guaranteed funds gives detailed information on the subscription and redemption peculiarities of this kind of product and their possible consequences for the investor.

Example. Ms. Gómez decides to invest 1,000 euros in Fund AAA. The fund prospectus states that the NAV applicable is that of the day following the request. There is a subscription fee of 5%.

Ms. Gómez signs a subscription form in her bank on 3 October. In this case, therefore, the purchase will go through at the NAV corresponding to the 4th of October, as disclosed on the 5th.

On the manager's calculations, the NAV of 4 October is 10 euros: each unit acquired that day costs 10 euros. So Ms. Gómez's money will get her 100 units.

NUMBER OF UNITS = AMOUNT INVESTED / NET ASSET VALUE

But the subscription fee (1,000 x 5% = 50 euros) cuts the amount available for investment to 950 euros, so finally Ms. Gómez gets 95 units (950 / 10).

Set out below are some practical pointers on buying into a mutual fund:

- **Distributors**. Mutual fund units can be purchased through financial intermediaries like banks, savings banks, broker-dealers, etc. In theory, management companies can also market their own funds either directly or via agents or representatives; but this is usually left to the abovementioned intermediaries (credit institutions and investment firms). Intermediaries frequently sell funds run by a variety of managers, not all of them belonging to their own financial group.

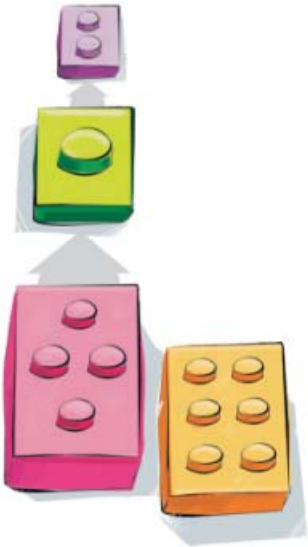
- **Sales channels**. Mutual fund units can be purchased at the offices of financial intermediaries, by telephone or online, and also at times by agents acting on the intermediary's behalf. In this last case you should never hand the agent cash or make a cheque out to his or her name: any order should be made direct to the fund's account in the designated custodian entity.

Distributors must provide you with a copy of the fund prospectus before you make a purchase.

- **Need for a current account**. Financial institutions often require investors to open a current account (a securities account is unnecessary in the case of mutual funds) to register the movements arising from unit subscriptions and redemptions. This is an aid to operating efficiency but not a legal obligation, so the holders of such accounts should not be charged opening, maintenance or cancellation fees unless they are also using them for non fund business.

- **Minimum initial investment**. Some funds will not take investments below a certain amount (stated in the prospectus). These thresholds can be quite high and are especially relevant when a purchase follows on from a transfer, because if the transfer is ordered for a sum below the minimum investment, the subscription leg will not go through, with possible tax consequence for the unitholder.

- **Mandatory documentation**. Fund distributors are obliged to give clients a free copy of the simplified fund prospectus along with the latest semiannual report[15], before they subscribe and whatever channel they have purchased through (face to face, telephone, Internet...). Our next chapter explains the main information you will find in the prospectus, which you should read through carefully to check that the investment is right for you.



(15) They must also provide clients on request with the latest annual and quarterly reports and the full version of the prospectus.

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b) Unit redemptions

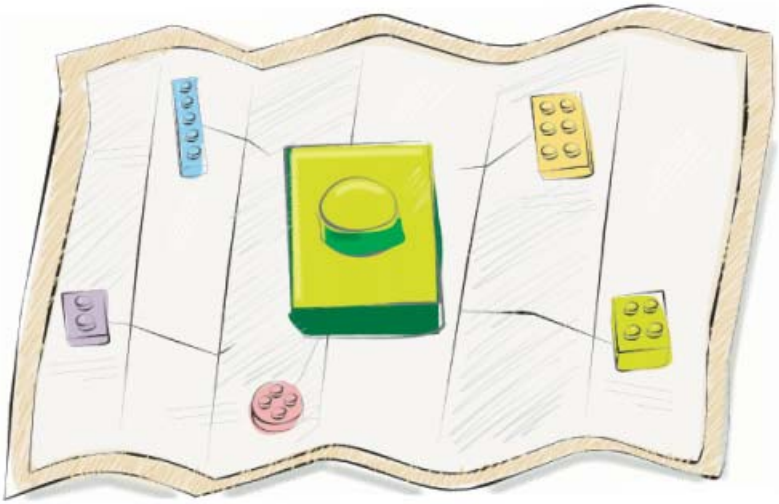
To undo a mutual fund investment, the investor has to redeem the units he or she holds at a given net asset value.

The NAV applicable is worked out in the same way as for subscriptions: and will correspond either to the day of the request or the following day (as specified in the prospectus).

Prospectuses generally stipulate a cut-off time: requests received after this time will be deemed to have been received the next day for the purposes of calculating applicable NAV.

As a rule, the custodian will pay the investor the redeemed amount within three business days from the date of the applicable NAV. This period may in exceptional circumstances be extended to five business days.

Redemption fees, if any, will be based on the total amount of the operation and subtracted from the same. These fees may run to 5% of the redeemed amount.



Example. Continuing with our previous example, let's suppose that after six months' time, on 3 April at 13:15, Ms. Gómez redeems her 950 units. The fund prospectus stipulates a cut-off time of 12:00 hours. Since the redemption request was made after the cut-off time, it will be presumed to have been received the following day, i.e. 4 April, for the purposes of transaction NAV.

The applicable NAV is 11 euros, so the amount Ms. Gómez receives back will be 1,045 euros (950 x 11).

NUMBER OF UNITS X NET ASSET VALUE = AMOUNT REDEEMED

However the Fund AAA prospectus states that any redemptions in a unitholder's first year will carry a fee of 5% (in this case 52.25 euros = 1,045 x 5%).

So the amount due to Ms. Gómez before withholding tax is finally 992.75 euros and not 1,045.

It is important to remember the following points when redeeming mutual fund units:

- **Minimum maintenance investment**. Funds sometimes specify a minimum "maintenance investment" for staying on as a unitholder. This information, which you will also find in the prospectus, is worth taking note of. Imagine that you decide to make a partial redemption or transfer and, as a result, the value of your investment or the number of units remaining drop below the maintenance threshold. In this situation, the manager could opt to redeem your fund holdings in their entirety.

- **Notice periods**. Managers may stipulate up to 10 days' notice for redemption requests involving more than 300,000 euros.

Some funds specify a minimum "maintenance" investment.

c) Transfers

A transfer is simply redeeming an investment in one mutual fund and immediately subscribing to another, while conserving the age of the first investment for tax purposes. This means capital gains are not taxed until such time as the units in question are finally redeemed.

Transfers can be between funds run by the same manager or by different managers.

The first case is the simplest. The delivering and receiving entity are one and the same, meaning checks are far easier to complete. The unitholder approaches the entity to request a transfer between two mutual funds, specifying the amount or number of units to be transferred. The investment in the receiving fund should be made effective within a maximum of three business days.

When the funds are run by different managers, the procedure is rather more complex, and in normal circumstances could take around eight business days. The steps to take are as follows:

- The client should first approach the manager of the receiving fund, specifying the fund to be withdrawn from and the amount or number of units to be transferred. A good way to avoid mistakes being made is to give the manager one of your statements, as this will contain all the necessary information to identify the delivering fund.

- The receiving entity has one business day to send the transfer application to the delivering entity.

- The delivering entity then has two business days at most to run the corresponding checks.

- Once the delivering entity has confirmed that the request is in order, it will make the withdrawal from the delivering fund. It has a maximum of three business days to complete this operation.

- The delivering entity then makes a bank transfer of the amount redeemed to the receiving entity, along with the unitholder's tax data. In practice this step usually takes a further two business days at most.

- Once the capital has arrived in the receiving entity, the subscription of the new fund units goes through automatically.

There is no specific fee for inter-fund transfers. However a transfer, we must remember, involves both a subscription and a redemption, and the investor may have to pay the corresponding fees if the scheme prospectuses so dictate.

Although transfers are usually between securities investment funds, they may also involve other types of collective investment schemes: foreign funds subject to EU legislation (most of those filed with the CNMV for distribution in Spain), real estate investment funds, open-ended investment companies... The characteristics of the schemes involved can affect the cost and terms of the transfer transaction. For instance, whether subscriptions and redemptions are confined to certain dates (as with real estate funds), or the flow of capital and information is between countries (entities not having a registered office in Spain).

08 Why you should check the fund prospectus

The prospectus is the fund's official document setting out all its conditions and characteristics. Its contents are prescribed by law and copies must be filed with the Comisión Nacional del Mercado de Valores. **Distributors are obliged to provide clients with the simplified version before they make a purchase**, whatever the sales channel used (face to face, telephone, Internet, etc.). Investors can also obtain the prospectus of all the funds they hold at the offices or websites of the manager or distributor or from the CNMV.

In earlier chapters we have made frequent references to the information contained in mutual fund prospectuses. Reading them is the best way to reach a properly informed decision and to avoid the pitfall of making an investment that is ill suited to your personal goals and circumstances.

Although some sections of the prospectus may seem daunting, future investors should have no difficulty finding the key information they require. If you have any doubts about the text's contents or scope, consult your intermediary or the CNMV.

The prospectus contains all the information you require to be sure that a fund fits well with your needs and expectations.

Listed below are the essential points to look for, as reflected in the chapters of the present guide:

- **General characteristics of the fund**
  - Risk profile
  - Minimum initial investment
  - Minimum maintenance investment
  - Recommended minimum duration of investment
  - Offer period (guaranteed funds)
- **Subscriptions and redemptions**
  - Net asset value applicable to subscriptions and redemptions
  - Cut-off time
  - Notice period (for redemptions)
  - Frequency of NAV calculations
  - Places where NAV is published
- **Investment policy**
  - Fund category, type of assets in which it intends to invest
  - Management goal (guarantee, non guaranteed target return...)
  - In guaranteed funds, the key characteristics of the guarantee
- **Guaranteed return (guaranteed funds only)**
  - Scope and limiting conditions of the guarantee
  - Guarantee expiry date
  - Calculation formulas for investor returns
  - Guaranteed AER, where this can be calculated
- **Fees**
  - Fees applied
  - Basis on which fees are calculated (assets, performance...)
  - Other fee related conditions (sliding scales, exit windows...)
  - Fee ceilings (for each sub-fund and unit class)

In the case of funds that have been running for some time, the prospectus will include an Annexe providing information on past performance and the fund's total expenses ratio (TER).

Prospectus contents must be kept permanently up to date. When any changes made substantially alter the fund's characteristics, the manager must grant unitholders an **exit right** (the option of leaving the fund without paying a redemption fee). Among the events that can trigger this exit right are a change in the fund's investment policy, the introduction or raising of fees, changes in the guarantee conditions...

If changes affect only one or several sub-funds, the exit right will be confined to unitholders in these compartments.

The prospectus must be updated in the event of any substantial change in the fund. Such changes will also generate an exit right for unitholders.

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09 Monitoring your mutual fund investment

There are two main ways to keep track of your investment:

- The documentation sent out by the management company or the custodian. Unitholders are legally entitled to receive certain regular information about the progress of their investments.

- Financial media. Mutual fund data (returns, volatility, fees, etc.) can commonly be found in newspapers, Internet portals and other financial information media. Some also offer fund tables organised under diverse criteria.

Of the documentation provided by the manager or custodian, we can single out:

- Periodic reports: annual, semiannual and quarterly. These include information on portfolio composition and performance, the distribution of fund assets, etc.

  The latest semiannual report must be delivered to investors before they subscribe, along with the fund prospectus. The former must be sent to each unitholder's home address every six months. The annual report must also be mailed out. Investors wishing to receive more regular information can ask to have quarterly reports sent to them free of charge. They can also opt to receive all the above information by e-mail.

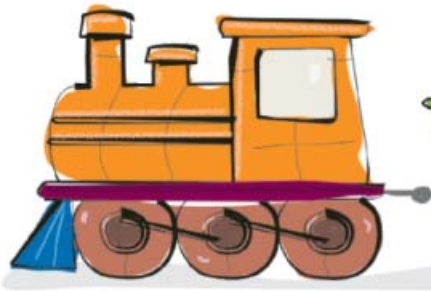
Both reports (annual, semiannual and quarterly) and prospectuses (simplified and full) are available to the public at the offices and websites of fund managers, financial intermediaries and the CNMV.

- Fund account statement. The manager or custodian must send each unitholder a statement setting out their fund position on a specified date. Statements will be monthly, at least, in the event of intervening subscriptions and redemptions, and at the end of the year in all other cases. Unitholders can also ask to have their statements sent by e-mail.

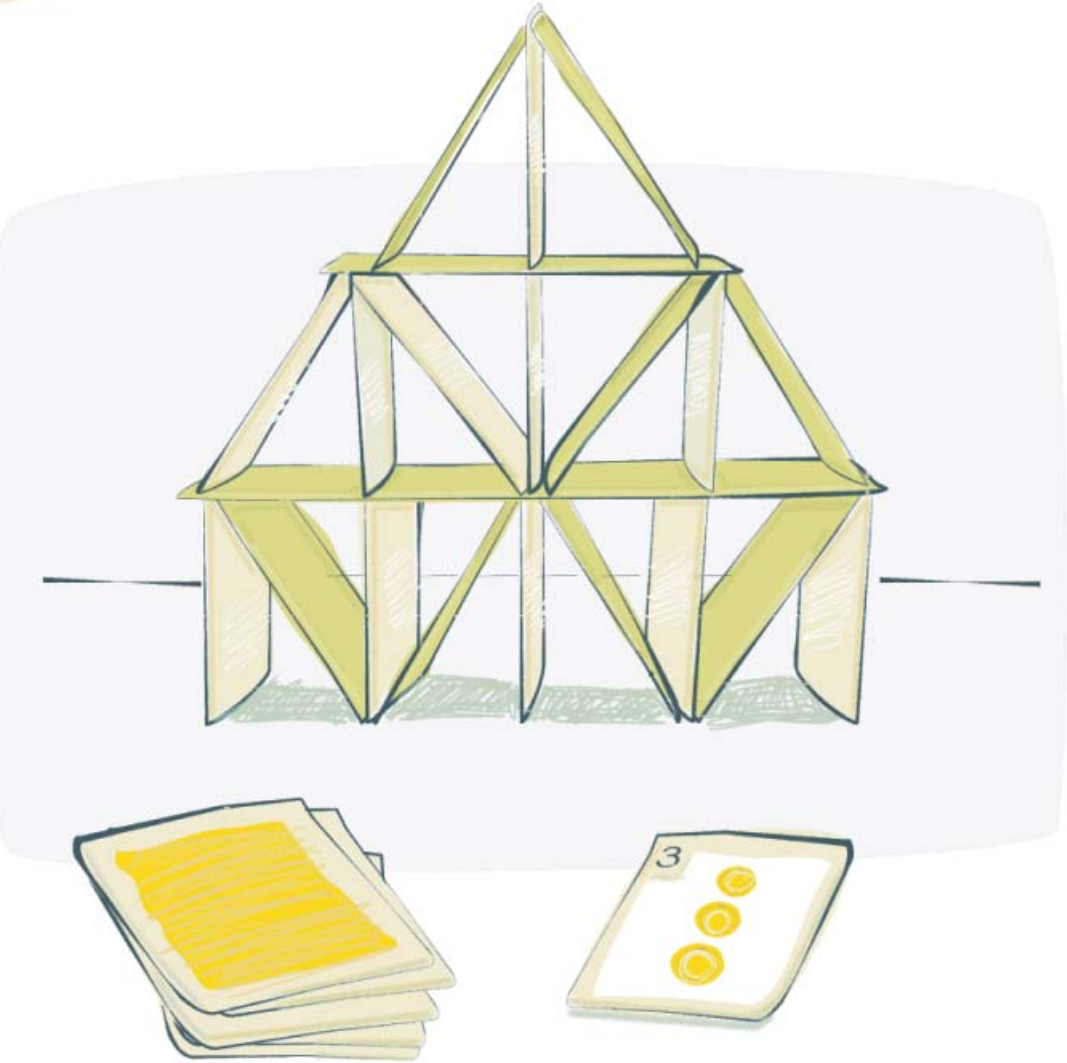
If no transactions have taken place, the statement will show the number of units held and their NAV on the reference date. Otherwise, it will list the corresponding transaction data (date, number of units purchased or redeemed, NAV applied, gross amount, amount after fees, the number and value of units held after the transaction, and the percentage they represent in the fund's assets).

- Notice of significant changes and exit rights. The manager must send all unitholders a letter to inform them of any changes modifying key fund characteristics. This document will also publicise the corresponding exit right and the term over which it may be exercised (normally a month). This right can be exercised as the investor chooses: via the redemption or transfer, total or partial, of his or her units without incurring a redemption fee or any other charges.

It is vital for investors to read all the information they are sent, because if the deadline passes without them stating their wishes they will lose their exit rights, and will have to stay on in the fund under the new conditions or else redeem their units paying the applicable fees.



Unitholders must be sure to read all the information they are sent by their financial intermediary about the performance of the fund and any changes planned.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10 Other collective investment schemes

The collective investment schemes authorised under Spanish law can be classified in different ways. Legal form is what separates a fund from a company; while the nature of its investments determines whether a scheme is financial or non financial... To date we have been talking exclusively about securities investment funds, as these are the most popular product with individual investors.

But there are other kinds of collective investment scheme which are organised differently to the ones described in previous chapters:

a) Real estate investment funds
b) Open-ended investment companies (SICAV)
c) Exchange-traded funds
d) Hedge funds
e) Funds of hedge funds
f) Foreign collective investment schemes

a) Real estate investment funds

Real estate investment funds purchase properties (housing blocks, residential complexes, buildings under construction, old people's or student residences...) which they then lease out. Their returns, as such, come from both the rents they receive from their tenants and the evolution of property prices. Those with a corporate form are called real estate investment companies.

These products are less liquid than securities investment funds, as they need only allow subscriptions and redemptions once a year, and calculate NAV at monthly intervals. However many of the real estate investment funds in today's market permit subscriptions every month and redemptions every three, four or six months, depending.

They also tend to charge hefty redemption fees (up to a maximum of 4%), which decrease with time and may disappear entirely after the third or fourth year. This circumstance, plus their lower liquidity, make them best suited for those working to a long-term investment horizon.

b) Open-ended investment companies (SICAVs)

These differ from mutual funds in that the latter are simply a pool of assets in which each saver holds units, while SICAVs are public limited companies and the savers investing in them have the status of shareholders. SICAVs can be self-managed or may entrust their running to a management company.

Like mutual funds, SICAVs may also have sub-funds with differing investment policies, and issue various share series with their own fee schedules. They are frequently the investment vehicle of choice in private banking, i.e. targeted on high net worth individuals. SICAV shares can be traded on stock exchanges or bought and sold via subscriptions and redemptions in a similar way to mutual fund units.

c) Exchange-traded funds

This is a common format in other countries, but, despite being authorised by law, there are no such funds currently operating in Spain. Exchange-traded funds or ETFs issue shares for trading on stock markets. Their investment policy is to replicate the performance of a stock or bond index or, at times, that of selected listed companies.

As shares are market traded, the holder has immediate knowledge of their net asset value at any given time. They can accordingly change hands at different prices in a single session, depending on the performance of the share or index they are tracking. In short, trading ETFs is similar to buying or selling shares on the stock market with the resulting advantages of liquidity, transparency and immediate transactability.

The high initial redemption fees and lesser liquidity of real estate investment funds make them best suited for long-term investment.

d) Hedge funds

Also known as alternative investment funds, these products are mainly aimed at qualified investors (institutional investors or large fortunes). Spanish legislation stipulates an initial investment of 50,000 euros.

Funds are free to invest in any kind of financial assets, and do not have to meet the investment concentration limits imposed by law on other collective investment schemes. They can also borrow up to five times their total assets.

Net asset value is calculated at least every quarter, although this interval can be extended to six months when investments so warrant. Investors, therefore, can only subscribe or redeem units every three or six months (although funds may opt to offer more frequent liquidity, monthly for example). Likewise, these schemes are not bound by the fee ceilings applicable to remaining mutual funds. Reporting requirements are also significantly less stringent.

Despite the **many differences between hedge funds**, their total freedom in choosing investments, lesser liquidity and transparency and leverage possibilities means they are **generally riskier than other collective investment products**. So much so that investors have to sign a document stating that they are aware of the risks involved.

e) Funds of hedge funds

These are mutual funds with at least 60% of their assets invested in hedge funds, subject to an upper limit of 10% in any single scheme.

In theory, their diversification plus the fact that investee funds are selected and monitored by a management company permits a tighter rein on risks. These, however, must be adequately publicised in the fund prospectus and any advertising material. Investors must also sign a document stating that know the risks attached to this type of fund.

As with hedge funds themselves, net asset value can be calculated on a quarterly or semiannual basis (so unitholders can only subscribe or redeem every three or six months), making them less liquid than "traditional" schemes. They are not subject to the fee ceilings applied to other mutual funds.

f) Foreign collective investment schemes

Foreign mutual funds and investment companies are also marketed in Spain. These foreign schemes divide into those subject to European Union legislation (harmonised) and others (non harmonised).

Authorised financial intermediaries can market harmonised schemes in Spain unrestrictedly (provided both the scheme and distributor figure on the CNMV registers), making them an alternative choice of collective investment for the Spanish saver.

Non harmonised schemes can also be sold in Spain but only with the express prior consent of the CNMV, and after filing the relevant documentation with the supervisory authority. However this kind of product has only a small presence in the Spanish market.

Many foreign schemes calculate net asset value at fortnightly or monthly intervals or even longer. In these cases, the subscription and redemption NAV applicable will be the first reported after the order is placed.

Mutual funds are joined by other types of collective investment schemes with their own characteristics.

11 Checklist for mutual fund investment

- Funds are investment products so invariably carry some type of risk. The chance of suffering losses will be greater or smaller depending on the fund's investment policy, but can never entirely be lost sight of.

- Guaranteed funds have certain characteristics to watch for, as they may not be right for all investors:

  - Only unitholders who keep their money in the fund up to the guarantee expiry date are assured the preservation of their capital. Units redeemed before or after this moment are not guaranteed, and you may suffer losses. As far as possible, try to make your investment horizon coincide with the term over which the guarantee is effective.

  - In guaranteed funds with "exit windows", investors can redeem units on specified dates without paying a redemption fee, though also without being covered by the guarantee. Remember also that investors wishing to take advantage of exit windows may have to give notice of their intention within a specified period.

Not all guaranteed funds assure you a return on your investment.

- Before the guarantee expiry date, the manager must send unitholders a letter apprising them of this fact and of the changes to take place in the fund. Investors not wishing to remain in the fund under the new conditions have a period when they can redeem units at no fee (free exit right). Although this notification is mandatory, unitholders should keep the guarantee expiry date firmly in mind so they can plan ahead.

- It is important to remember that not all guaranteed funds also assure you a return on your investment. We have to distinguish between those that guarantee the capital invested plus a preset return (fixed-income guaranteed funds) and those that only guarantee the preservation of capital but offer the **possibility** of returns (the so-called variable-income guaranteed funds).

- Commercial and advertising materials cannot carry all the details you need to really know a fund, so do not make any decision without also consulting the fund's prospectus, where you will find a description of all its main characteristics.

- Distributors must provide clients free of charge with the simplified prospectus and last semiannual report before they purchase fund units. They can also obtain these documents at any time from the offices or website of the fund manager or distributor or from the CNMV.

- If a fund is being purchased through a financial agent, remember never to hand over cash or make a cheque out to that person's name.

- If a financial institution requires that you open a current account for your mutual fund movements, it may not charge you opening, maintenance or cancellation fees unless you also want to use it for other business.

- Take note if a fund specifies a minimum initial investment, especially if you are thinking of making a transfer: if this involves a sum below the investment threshold, your subscription will not go through while the redeemed amount may have a tax impact.

- The existence of a minimum maintenance investment should also be noted: if you order the partial redemption or transfer of fund units with the result that your investment falls below the maintenance threshold, the manager may opt to redeem your holding in its entirety.

- There are no fees as such for transferring between mutual funds, but the unitholder will be liable for any redemption and subscription fees stipulated in the fund prospectuses.

- In Spain, individual investors can buy into hedge funds through funds of hedge funds. Remember these funds have characteristics (broad freedom in choosing which assets to invest in, possibility of leverage, lower liquidity) that demand a specific investor profile and knowledge of the risks involved.

Do not select a mutual fund without first consulting the prospectus.

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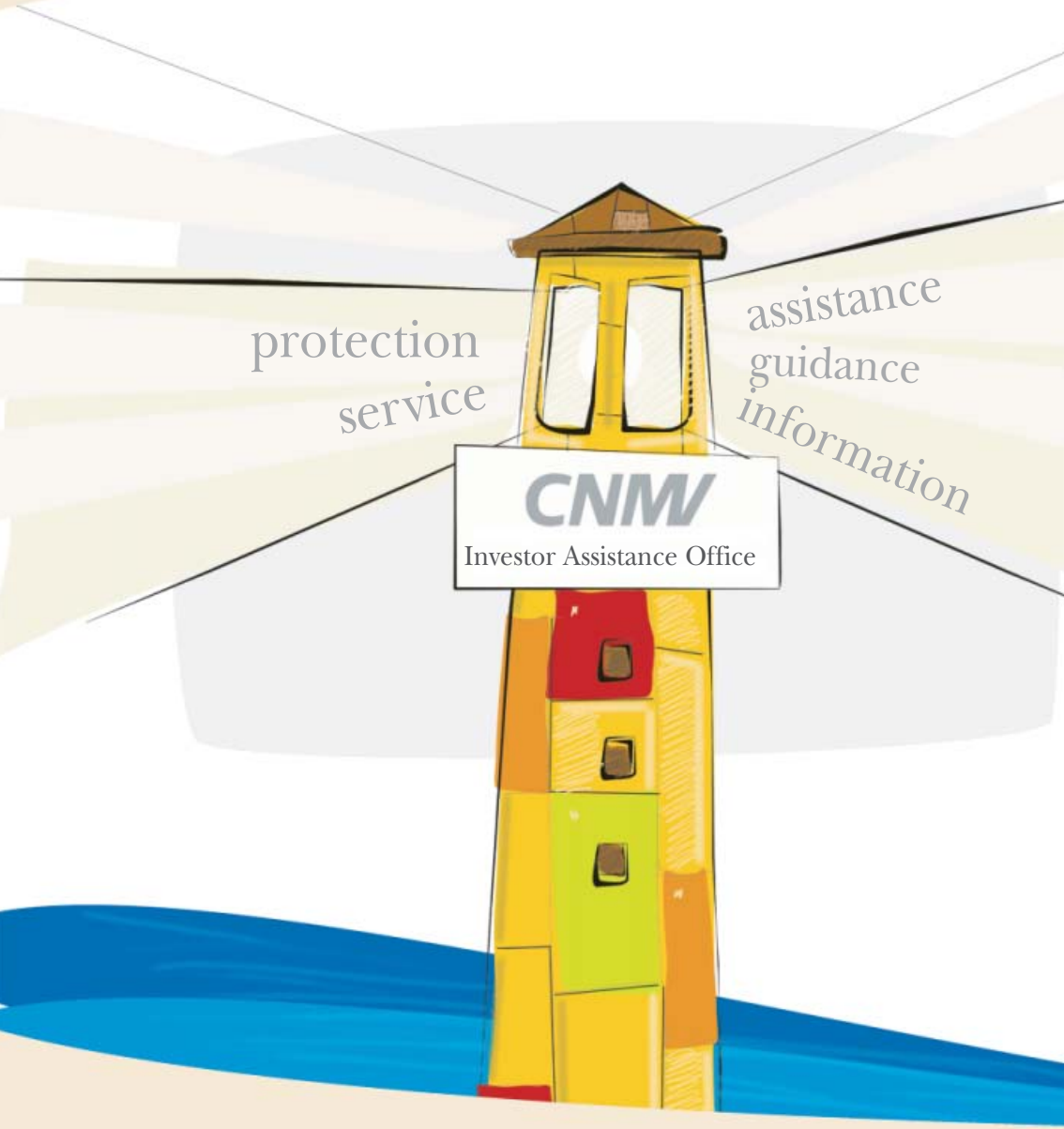

12 Where can I get information if I have doubts? Where can I complain?

For any **doubts or enquiries** about mutual funds, contact the Investor Assistance Office of the CNMV.

If you are unhappy about the conduct of a fund manager, distributor or custodian, you should first lodge a claim or complaint with the Customer Service Department or Customer's Ombudsman of the institution in question.

If you receive no answer within two months or are in disagreement with the response, you can approach the CNMV Complaints Service through the Investor Assistance Office.

The CNMV's experience is that most complaints about mutual funds concern failure to deliver the fund prospectus, and misleading or misunderstood explanations about the product. Aside from the fact that the prospectus and last semiannual report must be given to investors before they subscribe, remember that verbal information may be incorrect, insufficient or misinterpreted and create unrealistic expectations in the minds of investors.

Be sure to settle all your doubts before you subscribe.

Other common causes of complaint are transfers between mutual funds, NAV calculations, the start of a new guarantee period for guaranteed funds without the client having received the information in time to exercise his or her exit right (or being unaware of having received it), etc.

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