Exchange funds

Wealth Management

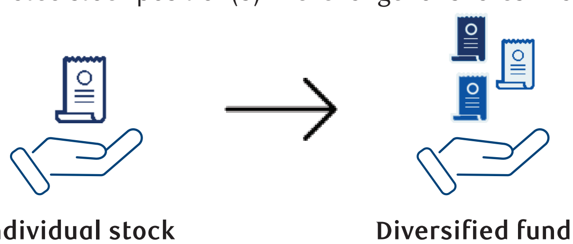
What is an exchange fund?

An exchange fund groups shares from different companies, allowing investors to exchange a significant holding of a single stock for units from the exchange's larger portfolio.

An exchange fund can provide diversification to holders of concentrated stock positions that cannot be sold because
1. Shares are restricted for regular market sale
2. The position has appreciated enough to create a large tax burden if it were sold

Features of an exchange fund

- Investors contribute their concentrated stock position(s) in exchange for shares in a diversified exchange fund



- Since securities are delivered in-kind to the fund , contributions are generally not taxable under current federal tax law
- Investors typically must be a qualified purchaser (investable assets of >$5 million; see SEC guidelines for full requirements)

Considerations of an exchange fund

Pros

- Diversification reduces or eliminates specific company risk
- Potentially significant tax benefits versus selling position and investing after-tax proceeds of sales

Cons

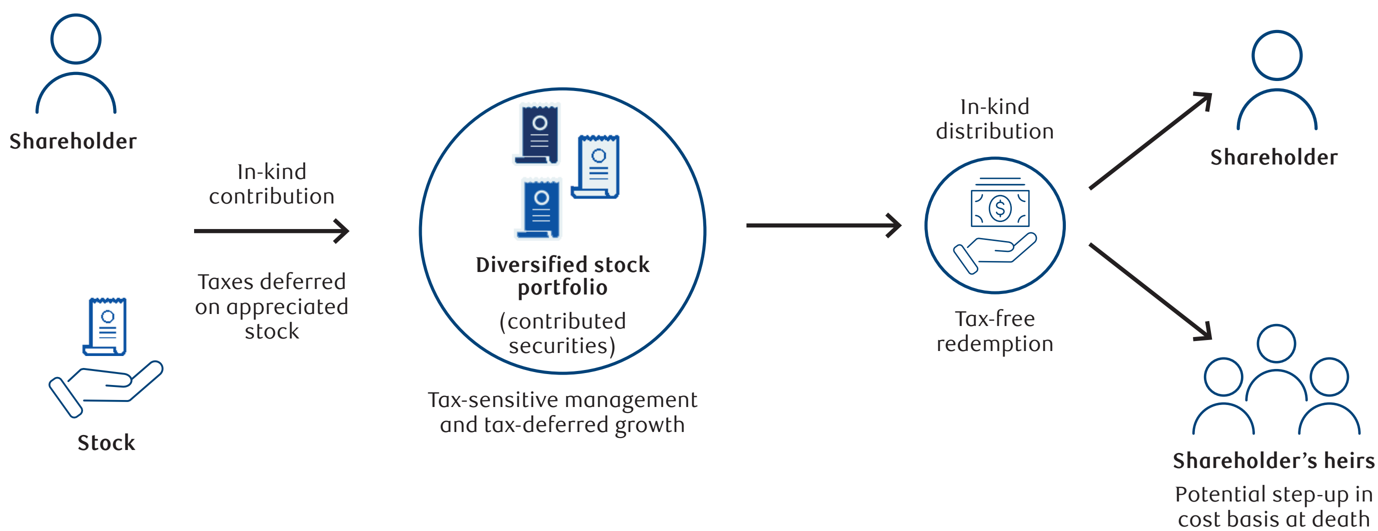
- A seven-year holding period is required to take advantage of the tax benefits
- Investors exchange the upside of their stock position to align with the diversified fund

Life cycle of a fund investment

As illustrated in the chart below, an exchange fund allows investors to participate in the larger ecosystem of an exchange fund, benefitting both from a diversified stock portfolio and tax-deferred growth.

Furthermore:

- A concentrated stock position is exchanged for fund shares
- Shares offer diversification and tax-deferral if held for seven years
- Fund shares can be distributed in-kind, but when the shares are sold taxes are calculated according to the original cost basis



Tax treatment of exchange fund investments

- No gain or loss recognized on contributions of securities
- Fund assumes that the shareholder's cost basis in contributed securities and the shareholder's initial basis in fund shares equals the cost basis of contributed securities
- Taxes incurred when distributed securities are sold
- Distributions of cash and securities to shareholders are generally not taxable (which reduces the aggregate cost basis)
- In a complete redemption, a shareholder's adjusted cost basis in fund shares, less any distributed cash, is allocated among the securities distributed
- Potential step-up in cost basis upon death

Shareholder redemption options

For redemptions made **before** 7 years:

In order to continue deferring taxes, investors are required to have their contributed stock returned to them. The value of their redemption will be based on the prevailing NAV of the fund.

*1% redemption fee in the first three years

$1 million stock contribution

Scenario 1		**Redemption**	
Fund outperforms the contributed stock		Contributed stock	$0.8 million
Contributed stock declines 20%	= $0.8 million	Filler stock	$0.4 million
Fund grows 20%	**=$1.2 million**		$1.2 million

Scenario 2			
Fund underperforms the contributed stock			
Contributed stock grows 20%	=$1.2 million	Contributed stock	$0.8 million
Fund declines 20%	**=$0.8 million**		

These scenarios are for illustrative purposes only and are not intended to be representative of any specific investment vehicle or individual client experience.

For redemptions made **after** 7 years:

It is no longer required that the originally contributed stock be returned to the investor. The value of their redemption will be based on the prevailing NAV of the fund. Redemptions will be made in stock based on the redemption option the investor selects.

$1 million stock contribution

Redemption

Current NAV

Redemption options

- 20–30 stocks
- 12–15 stocks
- 3 stocks
- Single stock

Benefits

- No forced redemptions, ability to remain invested beyond year seven
- Potential step-up in basis at shareholder's death
- Redemption is not a taxable event under current U.S. federal tax law
- Taxes assessed if and when shares are sold

RBC Wealth Management

24-70-02950_7082 (10/24)