

HOW ETFs WORK



An exchange-traded fund (ETF) is an investment fund that holds a collection of investments, such as stocks or bonds, owned by a group of investors and managed by a professional money manager. ETFs trade on a stock exchange.

Four things to know



Risk

The level of risk and return depends on what the ETF invests in. You can lose money investing in ETFs.



Past performance

How an ETF has performed in the past can't tell you how it will perform in the future. But past performance can help you determine how volatile or risky the ETF's returns may be.



Buying and selling ETFs

You buy and sell ETFs on a stock exchange, in a similar way to buying and selling stocks.



Fees

You typically pay commissions and management fees to invest in ETFs. There may also be costs to set up an investment account.

How to make money on an ETF

Some ETFs pay out the money the ETF makes to investors. These payments are called distributions. For example, you may receive:

- interest distributions if the ETF invests in bonds,
- dividend distributions if the ETF invests in stocks that pay dividends, or
- capital gains distributions if the ETF sells an investment for more than it paid.

Here's what happens with your distributions:

- 1 The cash stays in your account until you tell your investment firm how you want to invest it. You may have to pay a sales commission on what you buy.
- 2 Your investment firm may offer a program to automatically buy more ETF units or shares for you. You likely won't pay a sales commission on these automatic purchases.

How ETFs are taxed

You'll pay tax on:

- any capital gains you make from an ETF when you sell it, and
- any distributions you receive from the ETF.

If you hold an ETF inside a tax-sheltered account such as a Registered Retirement Savings Plan or a Registered Retirement Income Fund, you won't pay tax on what you make investing until you take the money out. With a Tax-Free Savings Account, you won't pay any tax on the money you make while it's in the plan or when you take it out.



Key point: ETFs are similar to mutual funds in that they hold a variety of investments. But it trades on a stock exchange like a stock.

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