

# Total Expense Ratios - a new way of disclosing costs

## Greater transparency - making it easier to compare the costs of funds

Over the last few years the collective investment industry has seen tremendous growth in the number of funds with performance based fees. In addition, unit trust management companies have expressed fund expenses in different ways (especially performance fees) and it hasn't always been easy to compare the costs of funds. Fees can have a significant impact on investment returns and investors need greater consistency in terms of the disclosure of costs. The good news is that the costs associated with unit trust funds will now be expressed in a uniform way. April 2007 sees the introduction of the Total Expense Ratio (TER). This should help investors to directly compare the costs of the various unit trust funds. Investec Asset Management played a leading role in this process.

### What is the Total Expense Ratio or TER?

The TER expresses what percentage of a fund's assets was needed to pay for the operating expenses and investment management fees of the portfolio over a specific period (e.g. a calendar year). Basically the TER provides a way to measure how costs affect a portfolio. Every fund incurs costs which means that a certain percentage of the portfolio's assets need to be deducted so as to meet these costs. The following formula is used to calculate the TER of a fund:

Total Expense Ratio =

Investment management fees + Operating costs

Net asset value

### Performance fees and the TER

Some unit trust funds have performance fees and these are included in the TER of a fund. The performance fee portion of the TER is also shown separately. Although, the TER is a great way to compare the costs of funds, investors should not look at the TER of a fund in isolation. When assessing different funds, investors should compare similar funds looking specifically at net performance:

- A high TER is not necessarily bad - it may be high because the portfolio manager delivered significant outperformance.
- Similarly a low TER is not necessarily good - it may be low because the portfolio manager underperformed.

### Example

The Investec Value Fund class A has a TER of 1.68% (annualised) of which 0.73% comes from performance fees. If we assume that the investor had an average balance of R200 000 over the last calendar year it means that the investor had to pay R3360 in costs that were incurred in the fund. The performance fee is a substantial part of the costs, amounting to 43% of the fund's TER. However, the fund earned excellent returns for investors, outperforming the market by more than 5% over three years and by nearly 20% over five years.\* This clearly illustrates that a high TER is not necessarily negative - if supported by superior performance.

\* S&P as at 31 March 2007, lump sum, NAV-NAV, gross income reinvested in rands.

### Where will TERs be shown?

TERs will be updated every quarter and will be disclosed wherever performance is shown, for example on fact sheets and on financial statements. All domestic unit trust funds as well as rand denominated international funds will

show TERs. It is global practice to disclose expense ratios and foreign denominated offshore funds already use their own TERs. Historical data is used to calculate the TER of a fund. The TER of a fund could vary substantially from one year to the next, making it difficult to predict future costs.

### What is included in the TER?

- **Investment management fees** - including performance fees.
- **Fixed costs** e.g. bank charges, custody, trustee and audit fees.
- **Underlying fund fees for all Fund of Funds (FoFs)** i.e. where a fund invests in other funds. The Total Expense Ratio for FoFs will only be disclosed from 1 May 2007.

### What is excluded in the TER?

- Initial fund fees.
- Adviser fees for Linked Investment Service Providers (LISPs). (There are some exceptions).

If you need more information on the Total Expense Ratio please visit our website on [www.investecfunds.co.za](http://www.investecfunds.co.za).

### Benefits of the TER:

- Improves transparency
- Helps investors to track their portfolios' expenses
- Provides a uniform measure of costs
- Allows investors to directly compare the costs of various funds

