



## Total Expense Ratio (TER) Explained

From April 2007 onwards, the unit trust industry is introducing a new measure to evaluate the effect of costs on an investment. This measure is called a Total Expense Ratio (TER).

### What is TER?

Total expense ratios are used globally to measure the impact of management and operating costs deducted from a fund's portfolio. It gives you an indication of the effect these costs have on the growth you ultimately receive from your investment. Expressed as a percentage, a fund's TER is calculated by dividing the portfolio costs by the market value of the fund. The fund's market value (total assets) is the daily average value of the portfolio over a specific period (e.g. a financial year).

$$\text{Total Expense Ratio} = \frac{\text{Total Costs}}{\text{Total Assets}}$$

### Expenses included in TER

While a fund's initial (upfront) charge and annual service fee are disclosed prior to investing, there are other costs incurred by the fund that the unit trust management company is unable to quantify upfront. These expenses depend on specific circumstances and, along with the annual service fee, are deducted from a fund's portfolio:

- The fund's bank charges
- The fund's audit fees
- Taxes (e.g. stamp duty, VAT)
- Custodian and trustee fees – custodians and trustees are appointed to protect the interests of the unitholders, and the fees pay for their services
- Any income retained from scrip-lending, and not passed back to the fund
- Annual service fee – this will include any performance fees

These charges are accrued daily and deducted from income distributions as and when they are incurred.

### Expenses not included in TER

Charges not included are generally of a one-off nature and deducted from a client's investment as apposed to the underlying portfolio:

- Initial charges (including commission) – deducted from the investment amount prior to units being bought
- Annual adviser fees agreed upon between the adviser and the client – this cost of ongoing advice is deducted monthly through the sale of units
- Stockbroker fees – i.e. trading costs incurred when buying and selling securities
- Expenses related to the settling of transactions and taxes associated with these (e.g. UST)

### Reporting requirements for TER

As per the ACI\* requirements, all funds' TERs must be made available from April 2007 onwards – with the exception of fund of funds, which must be published from July onwards.

\*The **Association of Collective Investments (ACI)** represents the interests of South African unit trust management companies and their investors. Management companies' membership of the ACI is voluntary and, together with the ACI, they work on the principles of self-regulation. The primary aim of the Association and its members is to facilitate the development and growth of the industry, through its dealings with the authorities and regular communication with the media and investing public.

The total expense ratios published in April 2007 are annualised figures based on the data for the quarter to the end of March 2007. Community Growth Funds will be publishing each fund's TER in the following material:

- Fund Fact Sheets, under charges (updated quarterly)
- Quarterly Report (updated quarterly)
- [www.omigsa.com](http://www.omigsa.com)
- Buying Form and Switching Form
- Full and Abridged Annual Reports

In addition, a fund's TER must be disclosed whenever its performance is published. This will apply to sales aids, newsletters, the website and adverts.

An investor must be aware of these and all other expenses prior to investing.

### Advantages of TER

- It creates greater transparency as it includes all known and defined expenses deducted from the fund's portfolio.
- Investors will have a better understanding of the cost structure of their investments.
- TER will specifically disclose performance fees.
- Investors will be better able to compare differently structured investment solutions, e.g. costs related to investing in funds of funds versus investing in single or multi-manager funds.
- The disclosure of TER can potentially increase competition between management companies, ultimately resulting in lower costs for the investor.

### Disadvantages of TER

- The measure of the ACI has adopted differs from the calculation used by the life assurance industry (Reduction in Yield). This makes it difficult to compare products across these industries.
- TER does not include all costs, only those deducted from within the fund's portfolio.
- TER is calculated using historical information and may not necessarily be an indication of future expenses.
- The calculation is for periods of a full financial year and may not correspond exactly to the client's investment period.

"It is important that investors realise that costs are just one of a number of factors to consider when choosing or assessing a portfolio's prospects," says Di Turpin, ACI Chief Executive. "The value of TER is that it allows you to track your portfolio's expenses and also to directly compare various financial services products. We hope that other products will adopt this measure as well, resulting in far better disclosure for the consumer. The collective investments industry has always offered lower cost investments and been transparent, giving investors full information on costs and performance. We see TERs as another strategic tool for the investor".