

# WHAT DOES TER MEAN AND WHAT IS IT FOR?

TER stands for total expense ratio. This is the global standard used to measure the impact that the deduction of management and operating costs has on a fund's value. In other words, it gives you an indication of the effects that these costs have on the growth of your investment portfolio. 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

The costs that comprise the TER are costs that the unit trust management company is unable to quantify upfront as they depend on specific or variable circumstances. The TER is an annualised value and includes:

- the annual service fee – this will include any performance fees
- 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.

## Expenses not included in TER

Charges not included are generally of a one-off nature, and deducted from the investment capital as opposed 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 agreed between client and adviser is deducted monthly through the sale of units
- stockbroker fees – this is a portfolio fee and covers the trading costs incurred when buying and selling securities
- expenses related to the settling of transactions and taxes associated with these (e.g. securities transfer tax).

## Reporting requirements for TER

TERs were introduced in April 2007 and the reporting protocol of TERs is regulated by the Association for Savings and Investment South Africa (ASISA).

TER reporting was introduced to enhance transparency for investors. Therefore a fund's TER must be disclosed whenever its performance is published. This will apply to sales aids, newsletters, the website and adverts. Funds of funds have two layers of expenses – the costs of the top-tier fund and the costs of the bottom-tier funds. Their TER therefore includes both tiers of expenses.

Old Mutual Unit Trusts publishes each fund's TER in the following material and on the website stated below:

- Fund fact sheets, under CHARGES (updated quarterly)
- [www.oldmutualunittrusts.co.za](http://www.oldmutualunittrusts.co.za) (updated quarterly)
- Buying Form and Switching Form
- Full and abridged annual reports (published at the end of every calendar year).

## Advantages of TER

- It creates greater transparency as it includes all known and defined expenses deducted from the fund's portfolio.
- Investors have a good understanding as to the cost structure of their investments.
- TER specifically discloses performance fees.
- Investors are 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.

## Disadvantages

- As opposed to TER, the life assurance industry uses a different calculation called 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. This means you cannot compare the impact of costs on returns when investing directly via a life wrapper or via a LISP.
- TER is calculated using historical information and may not necessarily be an indication of future expenses.
- The calculation applies to a full financial year and may not correspond exactly to an investor's investment period.

## Value Add

TERs ensure that the unit trust industry offers investors excellent transparency when it comes to disclosing expenses. The value of a TER is that it allows you to track your portfolio's expenses and also to directly compare various financial services products.