



Total Expense Ratios (TERs)

Frequently Asked Questions

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About TERs

1. What is a TER?

The Total Expense Ratio is a measure of the total annual charges for a fund.

The total cost of running the fund is divided by the fund's total assets:

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

The TER is then expressed as a percentage.

The size of the TER is very important to investors because these costs come out of the fund, and affect the value of an investment in a fund.

2. What is included?

The costs included in the TER are all the annual operating costs, principally the annual management charge but also administration fees, and trustee and audit fees.

3. What is the history of TERs?

Fund providers are now legally obligated to display the TER on their fund literature, but this has not always been the case. Previously the only annual charge of which the investor could be certain was the annual management charge. Under this regime it was quite difficult for an investor to find out how much extra was going to be taken off the value of their investments each year.

The FSA (Financial Services Authority) introduced the new legislation to bring a greater degree of transparency to the fund industry.

The FSA, in consultation with the IMA (Investment Management Association) and other industry representatives, has determined that TERs must be calculated according to a common method, and must also be published by the fund provider at least once a year.

Financial Express, the leading fund data and web solutions provider to the UK fund management industry, is currently the only data company which collects these published TERs.

This new legislation, and the IMA's partnership with Financial Express, means that investors can be made more aware of the fees involved in certain fund investments.

A. What effect does it have on me, the investor?

1. How do I know what the TER is?

Now that Fund Management companies have to display the TER on fund literature it is much easier to identify the TER for a fund. TERs can normally be found on the 'Simplified Prospectus' and 'Key Features' documents, and sometimes on the fund's 'Factsheet'. These documents are often available on the company website of the fund provider.

All available TERs for UK Authorised Unit Trusts and OEICs are also shown on the IMA (Investment Management Association) website: www.investmentuk.org, and on www.trustnet.com.

2. How do I pay the charges?

Investors do not pay directly for these charges (eg by cheque). Instead, the charges are paid in the form of a reduction in the return on your investment. TERs are usually between 1% and 2% each year, and this charge will be deducted from the overall value of your investment.

3. What effect will these charges have on my investment?

Without any annual expenses, an investment of £5,000 with a growth rate of 8% each year over a 25 year period would be worth £34,242 at the end of the investment period.

However, if a TER of 1.5% is applied, the investment would be worth £24,138 after 25 years. This means that £10,104 has been deducted in overall fund charges.

Further examples (for the same investment scenario above):

A 1% TER would give an investor an investment return of £27,137, meaning that £7,105 has been deducted in overall fund charges.

A 2% TER would give an investor an investment return of £16,932, meaning that £17,310 has been deducted in overall fund charges.

A 3% TER would give an investor an investment return of £13,329, meaning that £20,913 has been deducted in overall fund charges.

4. Why and how do TERs differ?

Fund TERs usually range between 1% and 2% per year, however some funds have TERs as low as 0.3% and others as high as 4%.

There are two main elements of a TER, which affect the overall charge in very different ways.

The first part is the annual management charge. This charge is very low for funds which invest largely in cash or track a market index. In contrast, funds which are 'active' in their approach to investment management tend to have a higher annual management charge. The fund managers/teams of these funds are often aiming to beat the market and so charge more for their services.

The second part of the TER involves the 'additional costs' of a fund, including the marketing and legal costs.

It is likely that large funds will have lower additional costs than small funds because many of the costs are fixed and do not depend on the Total Fund Assets.

New funds have many start up costs that are passed on to the investor, making TERs higher for new funds than for old funds.

Funds investing in the UK tend to have lower TERs than funds investing in overseas markets, due to higher custody costs.

5. Are funds with the low TERs the ones to go for? Why would I choose a fund with a relatively high TER?

Funds with low annual management charges (AMC) and, consequently, low TERs are usually either very cautious (ie investing in cash) or they are tracker funds (eg the manager follows a specified index such as the FTSE 100). In both cases the investor is not particularly paying for the expertise of a fund manager/team and so the AMC tends to be low. Many investors prefer these funds.

However, other investors may prefer to take advantage of the expertise of a fund manager/team in order to maximise their returns on their investment. This 'expertise' is what is paid for in the form of a higher AMC. Some of the best performing funds have higher charges, but higher charges are no guarantee that a fund will perform well.

It is important to compare the annual management charge with the TER.



For example, Fund A and Fund B may have the same AMC but Fund B may have a higher TER. It is worth remembering that the extra fees for Fund B are going towards running expenses, not the investment management of the fund.

Therefore, an investor would not be paying for any extra fund quality with Fund B. So, in this scenario, if all other things being equal, an investor would be better off with Fund A because high-charging funds need to achieve better returns to make up for the extra running costs.

For further information about Total Expense Ratios, please contact:

Richard Casemore
Financial Express Limited
7 Chertsey Road
Woking
Surrey
GU21 5AB

Telephone: +44 (0)1483 783 928
Email: richard.casemore@financialexpress.net
Web: www.financialexpress.net