

## The facts about fees in managed investment products - By Michael Lannon

Managed investment funds - or unit trusts - can be an ideal way for you to achieve a wider diversification of your investments and gain access to professional fund managers. They can also give you easier access to some financial markets that are difficult for small investors to break into - such as overseas share markets and local bond markets. But fund managers do not provide their services free of charge. So if you invest in managed funds it is important to understand their fee structures.

The investment industry has guidelines for reporting the Management Expense Ratio (MER) of investment products, but I feel many investors are still in the dark when it comes to understanding the fees they are paying for using master trusts.

What constitutes full and plain disclosure? The law requires master trust operators to disclose all the fees associated with their products in the prospectus. This disclosure may meet the legal requirement but it falls far short of effective disclosure. Firstly, most investors never read an entire prospectus due to its dry legal terminology. Secondly, if investors did read the entire prospectus most would be unable to decipher the true facts about fees because of the myriad of fees, charges and purchase options that are available.

In an effort to standardise reporting of the cost structure of managed funds the Investment and Financial Services Association (IFSA) has issued guidelines for calculating the management expense ratio (MER) for managed investments.

The suggested **MER** formula is:

$$\frac{\text{Fees + Recovered Expenses}}{\text{Average Fund Size}} \times 100$$

The fees include all the fees received by the manager (**excluding entry and exit fees**) plus the trustee and custodian fees and audit fees. The calculated MER of a master trust or a fund of funds should include the cost of the underlying managers' fees and expenses but unfortunately this is not always the case: it pays to check carefully.

Recoverable expenses can include all expenses paid out of the fund for the operation of the managed fund structure. Some managers fix the recoverable expenses as a percentage while other managers have no cap - others have an all-inclusive capped MER. The actual expenses that can be charged to a fund are varied and are often buried in the back section of the prospectus.

If you invest in a master trust the problem of finding out what fees you are actually paying is even greater. I believe that the current practice of quoting a range of MERs is deliberately misleading. The only way you would receive the lowest MER would be to put your entire investment into the cash option of a master trust. Most investors in fact use master trust products to create a diversified portfolio. Therefore, you tend to pay fees toward the higher end of the MER range.

I have for the past several years been advocating a solution to this problem of effective disclosure. All of the fees associated with investment products should be put on each investor's statement so investors can see what fees they are actually paying. This allows investors to compare "apples with apples" and also would act as a check and balance on any dishonest advisers.

You also need to consider any investment adviser's fees. These can take the form of entry fees, exit fees, trailer commissions or ongoing service fees and usually are calculated as a percentage of the investment involved.

I always suggest that if you do go to an investment adviser, you are better off choosing one who charges a professional fee only. If advisers are receiving a percentage commission from the fund manager it is hard for them to be objective. Unfortunately, fee for service advisers are in the minority. Most financial planners are still commission driven. I suggest that if you use an investment adviser, always get an outline in writing of any fees you will be charged or fees the adviser will receive from the recommended investments.

To illustrate the effect of fees on an investment, let us compare a hypothetical \$50,000 investment in a no entry-fee fund with a similar investment in a master trust that costs you three per cent up front to purchase and has an MER that is one per cent greater per year. Over a ten-year period, assuming the underlying investment return is an average 11.95 per cent per annum (before fees).

The effect of the fees is quite astounding. The investment in the lower-cost fund would grow to \$129,700 (after fees) while the investment with the upfront fee and higher annual fees would only be \$114,800 (after fees). The **difference of \$14,900** illustrates the effect of higher fees on your long-term returns. The moral:

**What seems like a little difference today can have a significant impact on your long-term wealth.**

*The information contained in this article is believed to be accurate. To the maximum extent permitted by the law, 20/20 Investment Services Limited (ACN 069 774 456) disclaims liability for errors in, or omissions from, this article. Investment in the above mentioned funds can only be made using an application attached to a current prospectus. Michael Lannon is Managing Director of 20/20 Funds DIRECTINVEST, an organisation specialising in the provision of direct access investment services to members of professional associations. For more information or any questions please contact Michael Lannon on **1800 352 021** outside Sydney or **9222-2020** or visit 20/20's website on **[www.2020funds.com.au](http://www.2020funds.com.au)***