GRAY ISSUE

Fee transparency delivers value for your money

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If you have tried to review your cellphone contract or home internet provider by comparing them to their competitors, only to give up in despair because of the overwhelming number of options and bundles and the incomprehensible variety of charges – you are not alone. Complexity is baked into product design and, whether intentional or not, often hides the true cost of what the customer is paying.

Things are changing, particularly in the investment business. In a world of volatile or muted returns attention has turned to costs throughout the value chain, and the importance of transparent fee disclosure. Knowing what you are paying for and whether you are receiving value for money has become a mantra for advisers and investors alike. The industry has responded by moving towards clean pricing and better cost disclosure.

Let's look at the background to understand how things have changed over time and what the new cost disclosures mean for you.

The trend towards clean pricing

A few years ago, there was much media attention given to the 'clean-pricing' trend. This referred to the practice of investment managers issuing a new rebate-free class of their unit trusts, thus forcing fee transparency for their funds sold via intermediaries like investment platforms. The trend originated in the UK, following the UK industry regulator's retail distribution review (RDR), where a number of the intermediaries that were charging fees and keeping rebates they received for themselves (and in some cases not disclosing this fact to their clients), came under significant pressure when their regulator banned rebates.

Why do rebates exist in the first place?

Historically, an investment manager would have issued one fee class of each unit trust. The price for investment management charged inside the unit trust was the price that an investor would pay when they invested in the unit trust directly with the manager. There was also an implied amount for administration included in the unit price. This covered the cost that the manager bore for keeping track of each individual client and fulfilling their reporting and servicing needs. The retail class was the most expensive class and was also the class used in marketing efforts.

Unit trusts are sometimes bought through investment platforms which take care of client servicing and administration, making it easier for clients to invest across different unit trust managers, which is somewhat like buying your groceries from a supermarket rather than visiting the fish shop, the butcher, the bakery and the greengrocer. This reduces the administration cost for managers: from their perspective many small accounts are bulked up into a single wholesale account from each platform. Over time managers were persuaded by platforms buying in bulk to pay some of their fee to the platform as a rebate to help fund the platform's administration cost. Platforms are required to declare these rebates explicitly to clients, but this is not standardised and clients can easily become confused about who they are paying for what. On the other hand, transparent and clearly communicated rebates result in healthy and vigorous price competition between funds and between platforms.

Locally, rebates are more transparent than they were in the UK and have not yet been banned, but the regulator's draft RDR proposals suggest this is a possibility. As a result, clean pricing has taken off, with many managers now offering a clean class version of each of their unit trusts. This has added a layer of complexity as there are now multiple versions of the same unit trust available on various platforms.

Why haven't rebates been banned in South Africa?

While this has not always been the case, most platforms now pass the rebate onto their clients either in the form of discounted administration fees or reinvestment into units. So when clean pricing came to town in 2012, most managers simply issued clean fee classes for each of their funds, cancelled the rebate arrangements, and moved on.

Simple, transparent fee disclosure

The Allan Gray investment platform includes funds from other managers with clean priced funds on our fund lists alongside rebated funds. We have been working hard to find the right way to allow clear comparison without adding unnecessary complexity: trying to be both simple and transparent. We think it makes sense to look at the problem as one of 'total fee disclosure' and not 'unit trust price'.

We have always transparently passed on to clients any benefit that we received from a rebate. So, simply put, whether you were in a rebate unit trust before or the clean class equivalent today, you always pay the same (or a better) price for investment management and administration; the only change is where the fees you pay for administration are deducted (either in the unit trust, by selling units or a combination of the two).

To make it easier for you to compare rebate and clean-priced unit trusts on our investment platform list, we have changed the way we disclose administration and investment management fees. Although the total fee you pay remains unchanged, the new disclosure is now separated into two components:

1. The **Total annual administration fee** is the fee you pay for administration on our investment platform and is calculated using your investment values on our local and offshore platforms respectively. A portion of this fee may be deducted within a unit trust (previously referred to as a 'rebate' or a 'fund manager fee discount'), while the remaining amount will be deducted from your account through a monthly sale of units. By combining the portion deducted within the unit trust, with the portion deducted from your account, the 'Total annual administration fee' shows the true cost of administration on our investment platform.
2. The **Total Investment Charge (TIC)**, which was introduced when the ASISA Total Expense Ratio (TER) standard was updated last year, is equal to the TER of a unit trust plus any transaction costs. The 'TIC for investment management' is equal to the TIC of a unit trust less any administration fees deducted within the unit trust. The 'TIC for investment management' therefore shows the true, clean cost of investment management.

As both the Total annual administration fee and the TIC for investment management for a unit trust are consistent regardless of where the unit trust's administration fee is deducted, the new disclosure should enable simple comparison between rebate and clean-priced unit trusts.

Table 1 provides an illustrative example of our new fee disclosure for a unit trust on our investment platform that offers both a rebate class and a clean-priced class.

Table 1 | Illustrative example of our new fee disclosure

CLASS	ADMINISTRATION FEE			INVESTMENT MANAGEMENT FEE			TOTAL
	Administration fee deducted within unit trust	Administration fee deducted from investor's account	Total annual administration fee	Total Investment Charge (TIC)	Administration fee deducted within unit trust	TIC for investment management	
Rebate	0.46%	0.11%	0.57%*	1.57%	0.46%	1.11%	1.68%
Clean-priced	0.00%	0.57%	0.57%*	1.11%	0.00%	1.11%	1.68%

All amounts include VAT.
**Assumes the investor has less that R1 500 000 invested on our local investment platform and therefore pays a total annual administration fee of 0.57% (incl. VAT).*

Of the total fee that the investor would pay to invest in the unit trust (1.68%), 0.57% can be attributed to administration and 1.11% to investment management. This example excludes any financial adviser fees, if applicable.

Commentary by Michael Summerton, senior manager, product development, Allan Gray