



## **Enhanced disclosure of fund charges and costs**

**September 2012**

## Enhanced disclosure of fund charges and costs

This document summarises the current regulatory requirements and sets out IMA's additional recommended practice for the enhanced disclosure of charges and costs for UK-authorized funds. IMA's additional recommended practice is intended to promote understanding of the nature of charges and costs, and transparency.

When investors use funds to invest in financial markets they are charged for the running of those funds. All such fund charges must be disclosed in a standard format in the key investor information document (KIID). IMA's recommendations are consistent with the regulatory requirements but cannot alter or add to the disclosures that must be made in the KIID.

In addition, in common with other types of investors in financial markets, funds incur costs as a necessary part of buying and selling underlying investments in order to achieve the investment objective. These transaction costs affect a fund's investors in different ways depending on whether they are joining, leaving or continuing with their investment in the fund.

We recommend that these enhanced disclosures be made readily accessible to investors, for example via clearly signposted sections of members' websites. We suggest members also provide a link to our new website [guide on charges and costs](#). The IMA site will also allow users – as it does now – to view ongoing charges figures along with other charges.

In order to encourage members to comply with the guidance we will also indicate on our website which firms are complying.

### Current regulatory requirements

European regulations require the following disclosures in the KIID:

1. The maximum percentage of any **entry and exit charges** that might be deducted from an investor's capital commitment;
2. A single figure for the charges deducted from the fund in the preceding year, to be known as the '**ongoing charges**', expressed as a percentage of the NAV;
3. The amount of any **performance fee** charged in the last financial year expressed as a percentage of the NAV and the basis on which the charge is calculated; and
4. A statement where **portfolio transaction costs** are likely to be material.

In addition, portfolio transaction costs for the period are required to be disclosed in the annual report and accounts.

UK-authorized funds are subject to additional periodic reporting requirements: Investors must be sent a short report every six months, in which the FSA expects the ongoing charges for the period and any performance fee to be disclosed. Ongoing charges are required to be disclosed in the annual report and accounts.

## IMA recommendations

1. IMA recommends the following practices in relation to the disclosure of fund charges to complement the above regulatory requirements. The figures should be updated as often as necessary to ensure they remain consistent with the figures given in the most up-to-date KIID.
  - Explanation of the purpose of any **entry charge**. In respect of dual-priced funds, this should include a statement that the entry charge is included in the offer price and forms part of the bid/offer spread. Managers should also consider including an example to illustrate the effect of the entry charge.
  - Explanation of the purpose of any **exit charge**. Where appropriate, this disclosure should illustrate how the investor's holding period affects the charge.
  - Explanation of the types of charge included in the **ongoing charges** figure. IMA recommends disclosing the ongoing charges figure instead of the annual management fee because it gives investors the most complete picture of the charges deducted from the fund and is consistent with the KIID. However, wherever the annual management charge is given in marketing material, factsheets and so on, the ongoing charges figure should be presented with at least equal prominence. (This recommendation applies equally to those non-UCITS funds that have not elected to provide KIIDs.)
  - It should be stated whether or not the fund is subject to a **performance fee**, and the percentage of the NAV that was charged in the last financial year (including where it was nil) should be given alongside the ongoing charges figure. Further information as to the conditions that would give rise to a performance fee should be given. The location of more detailed information on how it is calculated may be signposted.
2. IMA recommends additional disclosures about the portfolio transaction costs necessarily incurred in buying and selling investments for the fund. Three-year average figures for broker commissions and any transfer taxes (such as stamp duty) should be presented separately as percentages of the NAV. Additional disclosures should be given to explain the significance of these costs and the bid-offer spread.

If SDRT is payable, the net amount charged to the fund for the last financial year should be presented as a percentage of the NAV. Alternatively, where SDRT is recovered directly from incoming or outgoing investors, this policy should be disclosed, together with the net amount paid by the fund itself, if any.

## Pricing policies

There are three pricing methodologies used in the UK – dual pricing, swinging single pricing and single pricing with a dilution levy. It could be argued that each method requires different disclosures in respect of entry and exit charges. For example, a dilution levy is a form of entry or exit charge whereas in both the swinging and dual approaches, dilution is addressed within the price. Moreover, dual pricing has no explicit entry or exit charges because they are built into the bid-offer spread.

The recommendations are designed to enhance comparability between funds. Therefore, they should reflect the substance rather than the form of the pricing mechanism employed. To achieve this any dilution levy should not be disclosed as an entry or exit charge, and the entry charge should be extracted from the bid-offer spread of a dual priced fund. The extent to which amounts may be recovered from incoming and outgoing investors in order to protect ongoing investors from transaction costs is disclosed in a comparable way in the pricing policy notes.

### **Existing IMA guidance on stock lending**

The true operating costs should be reported in the ongoing charge figure. In particular, stock lending income received by the fund should not be used to reduce the ongoing charges figure. Also, where stock lending income is shared with another party in order to subsidise the cost of the service provided by that party, that party's share of the stock lending income should be included in the calculation of the ongoing charge.

### **Calculation of the figures**

Portfolio transaction costs and SDRT are disclosed in the annual report and accounts. The amounts given should be used to calculate the figures to be disclosed in accordance with these recommendations by dividing by the average net assets figure used in the calculation of the ongoing charges figure (or TER). Where the fund has more than one class, the total of the average net asset values of all the classes should be used. Broker commissions for purchases and sales should be added together to give a single percentage.

### **Funds of funds**

Where a fund is invested in other funds, the regulations require a "synthetic" ongoing charges figure to be calculated. This takes account of charges incurred in those other funds and any costs associated with buying or selling the units. However, for the reasons given in the illustrative disclosures on portfolio transaction costs, we do not believe a synthetic transaction costs figure would be helpful to investors.

### **Disclosure notes**

In order that investors can properly understand the disclosure, the figures given should be accompanied by the following explanatory notes, which should be adapted to suit the circumstances. (It should be noted that the prescribed KIID layout does not accommodate these disclosures). Where appropriate, Managers should use signposting in marketing material, factsheets and so on to direct users to the location where this disclosure is given.

### **Effective date**

Managers are encouraged to adopt these recommendations at the earliest opportunity and in any case no later than the end of March 2013.

The following notes are illustrative examples of the content and are not intended to be a template for the presentation of the disclosures.

One-off charges taken before or after you invest	
<b>Entry charge</b>	<p>[This is the maximum that might be taken out of your money before it is invested. For example, if you invest £[ ], an entry charge of [ ]% means £[ ] of your money will be used to buy units in the fund. It covers the costs of setting up your investment. [It also covers payments to your financial adviser and/or any other firm through which you invest.][It does not include payments to your financial adviser and/or other firm through which you invest. You pay for their services directly.] <i>[For dual priced funds only:</i> It is included in the price at which you buy into the fund and accounts for [part of] the difference between the bid and offer prices.]]</p> <p>[There is no entry charge. You pay directly any charges made by your financial adviser and/or other firm through which you invest.]</p>
<b>Exit charge</b>	<p>[This is the maximum that might be taken out of your money before the proceeds of your investment are paid out. [The exit charge is used instead of an entry charge and is a delayed charge for setting up your investment.]]</p> <p>[There is no exit charge for this fund.]</p>
Charges taken from the fund over a year	
<b>Ongoing charges</b>	<p>This is [based on actual expenses for the [period] ending [date]][an estimate of the expected future charges. An estimate has been used because ...]. It covers all aspects of operating the fund during the year, including fees paid for investment management, administration and the independent oversight functions. [It also covers payments to your financial adviser and/or any other firm through which you invest.][It does not include payments to your financial adviser and/or any other firm through which you invest. You pay for their services directly.] Where the fund invests in other funds, the figure includes the impact of the charges made in those other funds.</p>
Charges taken from the fund under certain specific conditions	
<b>Performance fee</b>	<p>[No performance fee is charged.][This is the actual performance fee for the financial year ending [date]. A performance fee of [ ]% of any outperformance becomes payable only when the fund outperforms its performance fee benchmark, the [insert name of benchmark]. For further information on how the performance fee is calculated see...]</p>

### Portfolio transaction costs

[On average, over the last three financial years, the fund incurred broker commissions of [ ]% [and [transfer taxes][stamp duty] of [ ]%], as a necessary part of buying and selling the fund's underlying investments in order to achieve the investment objective.][A [significant] proportion of these costs is recovered directly from investors joining and leaving the fund.][During the last three years, the fund did not incur transaction costs.]

In the case of shares, broker commissions [and [transfer taxes][stamp duty]] are paid by the fund on each transaction. In addition, there is a dealing spread between the buying and selling prices of the underlying investments. Unlike shares, other types of investments (such as bonds, money market instruments, derivatives) have no separately identifiable transaction costs; these costs form part of the dealing spread. Dealing spreads vary considerably depending on the transaction value and market sentiment. The estimated average dealing spread for this fund is [ ]% of the transaction value.

Comparing portfolio transaction costs for a range of funds may give a false impression of the relative costs of investing in them for the following reasons:

- Transaction costs do not necessarily reduce returns. The net impact of dealing is the combination of the effectiveness of the manager's investment decisions in improving returns and the associated costs of investment.
- Historic transaction costs are not an effective indicator of the future impact on performance.
- Transaction costs for buying and selling investments due to other investors joining or leaving the fund may be recovered from those investors. For further information see... *Refer to pricing policy note.*
- Transaction costs vary from country to country.
- Transaction costs vary depending on the types of investment in which a fund invests.
- As the manager's investment decisions are not predictable, transaction costs are also not predictable.

#### **[Stamp duty reserve tax**

During the financial year ending [date], the fund incurred stamp duty reserve tax of [ ]% as a result of investors joining and leaving the fund.]

#### **[Stamp duty reserve tax (SDRT)**

The fund is required to pay SDRT as a result of investors joining and leaving the fund, in proportion to the amount that the fund has invested in UK equities. Our policy is to recover the SDRT payable from [incoming][outgoing] investors in the form of an additional [entry][exit] charge. As a result, the net amount of SDRT paid by the fund itself was [[ ]%][negligible][nil].]

#### *Pricing policy note*

We operate a dual pricing methodology for this fund whereby net contributions take place at the issue price and net withdrawals take place at the cancellation price. The issue price is currently [ ]% higher than the cancellation price. The issue price is calculated by reference to the buying prices of the underlying investments, plus an allowance for broker commissions [and [transfer taxes][stamp duty]]. The cancellation price is calculated by reference to the selling prices of the underlying investments, less an allowance for broker commissions [and transfer taxes]. This means that, when investments are bought or sold as a result of other investors joining or leaving the fund, your investment is fully protected from the costs of these transactions.

We operate a single pricing methodology for this fund and reserve the right to adjust the fund's price to protect your investment from the costs of buying or selling investments that result from other investors joining or leaving the fund. The amount of any such adjustment is calculated by reference to the estimated costs of dealing in the underlying investments, including any dealing spreads, broker commissions [and [transfer taxes][stamp duty]]. Typical adjustments to this fund's price are to increase it by [ ]% for net inflows or decrease it by [ ]% for net outflows. [We always adjust the price to the maximum extent possible whenever net contributions or withdrawals take place, which means that your investment is fully protected from the costs of the resultant transactions][We usually adjust the price to the maximum extent possible whenever net contributions or withdrawals take place, which means that your investment is usually protected from the costs of the resultant transactions][We usually adjust the price to the maximum extent possible when the value of net contributions or withdrawals is significant, which helps to protect your investment from the costs of the resultant transactions][We usually adjust the price whenever net contributions or withdrawals take place, which helps to protect your investment from the costs of the resultant transactions][We usually adjust the price when the value of net contributions or withdrawals is significant, which helps to protect your investment from the costs of the resultant transactions].

We operate a single pricing methodology for this fund and reserve the right to charge a dilution levy to protect your investment from the costs of buying or selling investments that result from large investors joining or leaving the fund. The amount of any such dilution levy is calculated by reference to the estimated costs of dealing in the underlying investments, including any dealing spreads, broker commissions [and [transfer taxes][stamp duty]]. [Investors joining the fund may be charged a levy of up to [ ]% of their contribution.][Investors leaving the fund may be charged a levy of up to [ ]% of their proceeds.] When we impose a dilution levy on a particular investor or group of investors, this is paid into the fund and helps to protect your investment from the costs of the resultant transactions.