

GAP MAYNARD

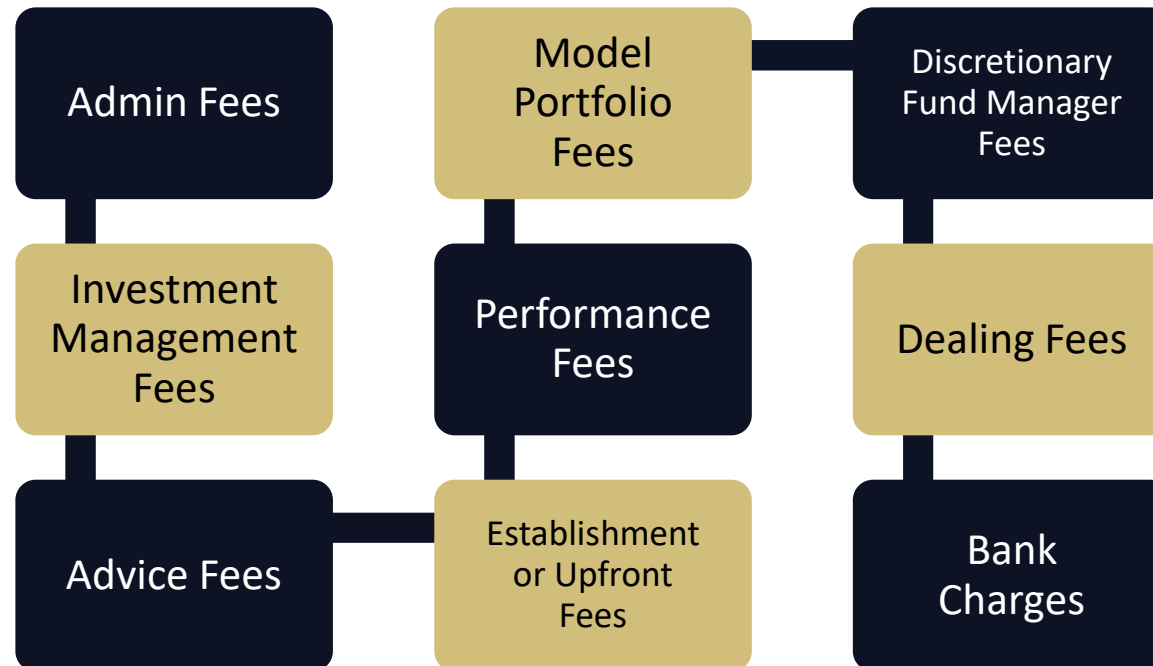
Personalized Investment Advice

TOPIC: Basic Information – Understanding Fees



Understanding Fees

- Fees are a delicate subject, but it is important to understand them and they must be discussed with your financial adviser.
- Fees are the financial services sector's form of remuneration.
- Having a better understanding of how these fees work, allows the client to make better informed decisions.
- Fees can be complicated however this is a simple guide to getting the basics and ensuring you ask the right questions. Let's look at the different types of fees that may be charged.





Understanding Fees

Admin Fees

These are fees charged by a provider for administration related to the services they offer. If they are a platform provider, those are the fees you pay for the use of their platform. If the service provider is a professional trust company, then those are the fees they charge for doing all your paper-work. These fees are difficult to eliminate or reduce and, depending on the provider, they should range between 0.1% p.a. to 0.5% p.a.

Investment Management Fees

These are the fees professional asset management firms charge for you to invest in their products. Allan Gray, for instance, has a Balanced Fund that is managed by a team of specialists. If you decide that this investment solution is best for you then you pay them an annual fee. Investment Management fees vary widely and can range from 0.1% to as much as 2,5% p.a.

Advice Fees

These are the fees you pay to a financial adviser. They are for the advice and services provided and vary significantly from firm to firm. These fees are flexible and should be negotiated and discussed prior to engaging the adviser's services. Advice fees usually range from 0.5% to 1.5% and are normally charged annually on the value of the funds the adviser manages (Assets Under Management or AUM) on behalf of the client.

Upfront Fees

These are a once-off fee that is charged usually when a client starts or opens a new investment structure or policy. The fee is sometimes split between the service provider and the adviser, however, it's normally the "commission" paid to the adviser for recommending the solution. These up-front fees can be paid all in one go at the start, or spread over a period of time (amortized). They can range from 1% to as high as 9% in some instances.

Performance Fees

These are fees levied by certain asset managers on investment solutions they run. Usually these types of fees appear in hedge fund type investments, but they can be seen elsewhere too. Essentially the investment management fee is linked to how well the fund performs. If it performs well, then the asset managers charge a higher fee. In some instances the converse is true but most times the asset managers have a fixed base fee they work from.

Understanding Fees

Model Portfolio Fees

A model portfolio is an investment portfolio that is selected, run and managed on behalf of the investor. It usually comprises a number of different funds within the portfolio and the asset managers, who control the model portfolio, have the authority to change any of the investments within the portfolio as they see fit. You pay an additional fee over and above the Investment Management Fee for their expertise. You are effectively hiring an investment expert - costs around 0.3% to 0.85% p.a.

Discretionary Fund Manager Fees

A DFM is very similar to a model portfolio, however they are often more client centric and offer more bespoke solutions. Model portfolios are usually freely available to everyone with little interaction between the asset managers and the clients, whereas a DFM has far more engagement with the client and are normally reserved for wealthier investors. The way the fees work however is exactly the same, you pay an expert to manage your money – costs around 0.3% to 1% p.a.

Dealing Fees

Dealing fees are those levied for executing a trade. A trade is when you buy or sell an investment like a fund or an equity. This fee is paid to the broker who actions the actual sale or acquisition of the trade. They are only incurred when a sale or acquisition is made, so can be termed ad-hoc fees. The dealing fees are either charged as a fixed amount per trade or as a percentage of the transaction. As such, it is very difficult to give you ball-park figures. They should however not be all that costly.

Bank Charges

Bank charges are very familiar to most people and are incurred any time money is moved from one bank account to another. These fees also vary widely but should not be exorbitant. In most instances these fees are fixed, however there are some instances where they are charged as a percentage of the funds being transferred.



Understanding Fees

- Having seen most of the different types of fees that exist, you'll be pleased to know that they do not all apply at the same time.
- As such, you need to understand how the fees are combined and presented to the investor. The following terms are important:
- **Total Expense Ratio or TER:** The total expense ratio (TER) is a measure of the total costs associated with managing and operating an investment fund. These consist primarily of the Investment Management fees, admin fees and performance fees. There could also be additional charges, such as auditor and legal fees,
- **Transaction Costs or TC:** The TC includes the dealing fees and any other costs involved in transacting.
- **Total Investment Charge or TIC** is simply the addition of the TER and the TC
- **Effective Annual Cost or EAC:** This is a little trickier to understand. It takes all the costs you pay, including the upfront and advice fees and works out what the effective cost to you, the investor would be, over different time frames. The EAC Calculation assumes that an investor terminates his or her investment in the Financial Product at the end of the relevant periods shown in the table

Fee Type	Year 1	Year 3	Year 5	Year 10
Investment Management Costs	1.05%	1.05%	1.05%	1.05%
Advice Fees	1.40%	0.86%	0.76%	0.68%
Administration	0.49%	0.49%	0.49%	0.48%
Other (Model Portfolio or DFM)	0.23%	0.23%	0.23%	0.23%
Effective Annual Cost	3.17%	2.63%	2.53%	2.44%

The Total Investment Charge	2.32%
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- In this example you'd effectively pay 3.17% in fees if you terminated your investment after 1 year, whereas after 10 years you'd effectively pay 2.44% a year.
- What this illustrates is the importance of trying not to switch your investments too often. Find a fund or strategy you like and believe in, and stick to it.

Understanding Fees

- Note that upfront fees / establishment fees as well as advice fees are usually charged in addition to the TER or TIC costs, unless otherwise expressly stated. Most advisers include it in the TER and TIC but best you ask, so as to avoid any nasty surprises.
- Note that the total Investment Charge and the Effective Annual Cost are different. The EAC includes any upfront fees that were deducted at the inception of the portfolio whereas the Total Investment Charge does not.
- **To avoid getting overly confused ask for the Total Investment Charge or the Total Annual Fees. Asking for the TER can mean that some fees are excluded.**
- I cannot emphasize how important it is for you to truly understand how the fees that you pay are broken down. The fees associated with an investment have a direct impact on the returns you are getting from that investment.
- As a simple example, let's say you get a return of 6% from a certain investment and your total annual fee comes to 2,5%. This means that your net real return is actually 3,5% ($6\% - 2,5\% = 3,5\%$). So if you need a real return of 6% per annum you need your investments to return 8.5%.
- Therefore trying to get your fees as low as possible is important, within reason.
- Remember that you pay a lawyer to help you with legal matters as you are not a legal expert, you pay a doctor to help you with medical issues as you are not a medical expert. Paying a financial professional is no different, just make sure that the fees aren't completely eroding your growth.



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Understanding Fees

Below is a table to help you know whether or not the fees you pay are low, reasonable or high. It is not exhaustive and there are plenty of variables, but it is a good barometer.

Fee Type	Frequency	Flexibility	Low End	Average	High End	Comment
Admin Fees	Annually	Fixed	0.10%	0.35%	0.50%	Admin fees do drop the larger the value of the investment
Investment Management Fees	Annually	Fixed	0.10%	1.35%	2.20%	Shop around there are great investments at reasonable a reasonable cost.
Advice Fees	Annually	Flexible	0.45%	0.75%	1.50%	You negotiate this fee with your broker - better brokers demand higher fees
Upfront or Establishment Fee	Once off	Flexible	1.00%	3.00%	5.00%	Understand this fee as it will impact the value of the funds you invest.
Model Portfolio or DFM Fees	Annually	Fixed	0.25%	0.35%	0.50%	DFM fees are more negotiable than Model Portfolio fees are.
Total Investment Charge or Total Annual Cost	Annually	Fixed	1.00%	1.90%	2.60%	Try and keep your annual fees below 2% if you can.



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