PRUDENTIAL
INVESTMENT MANAGERS

Prudential Investment Managers

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Understanding the costs of investing in unit trusts

If there's one thing most investors will agree on, it's that investment fees can be incredibly confusing. There have been countless articles about understanding the costs of your investments and making sure you're not paying too much in fees. But this can be tricky territory to navigate.

In general, unit trusts are a cost-effective way to own a portfolio of shares, bonds and other asset classes that are chosen and managed by professional fund managers. If you were to invest in stocks or bonds directly, you would need to do the research and management yourself, and you would incur costs every time you bought and sold a stock or other asset. With unit trusts, the cost of changing positions is minimal, and you can leave these decisions to an investment professional. However, these professionals (fund managers) do need to be paid for their expertise and administration services, and this is covered through a range of fees.

In recent years, fund managers including Prudential have been able to lower their fees by achieving cost savings, more automation and improving efficiencies, among other measures. However, these fees do vary from fund to fund and manager to manager, so comparing costs is an important part of the investment process. Here are the basics you need to know before investing.

Total Expense Ratio (TER)

The TER measures the direct total costs involved in managing a unit trust. Every unit trust management company in South Africa is required to publish this number regularly. Looking at the TER is a good way to compare the cost of investing in different unit trusts. It includes costs like management fees, trustee fees, legal and audit fees and other operating expenses. The TER is expressed as a percentage of the average net asset value of the portfolio.
It is important to note that:

- The TER does not include fees charged by a financial adviser or LISP platform.
- A higher TER does not necessarily imply a poor return, nor does a low TER imply a good return.
- The current TER is not an indication of future TERs. Good fund managers typically review their fees from time to time to ensure that they are still aligned with industry norms and their clients' best interests. At Prudential, for example, we have reduced the costs of our funds over the last two years.

Transaction Cost (TC)

This is a measure of the costs associated with the buying and selling of underlying assets within a unit trust.

Total Investment Charge (TIC)

This is the sum of the unit trust's TER and TC. The TIC is another useful measure for comparing the overall cost of different unit trust funds.

Initial fees

Initial fees are sometimes levied on new investments by an investor when purchasing units in a unit trust fund by a lump sum, top-up or debit order. Initial fees are deducted from the amount invested upfront, prior to the investment being made. As a result, the actual amount invested will be lower than the initial amount.

Prudential does not charge initial fees, nor do most other unit trust companies. However, your financial adviser may charge an initial fee upfront. This fee is negotiable, up to a maximum of 3% of the total investment amount. Some financial advisers prefer to discount the initial fee in favour of a higher ongoing fee. This is something to discuss with your adviser, and there should be some room to negotiate.

Annual fees

Charged by the unit trust company: This is an ongoing annual management fee that is levied by the unit trust company for administering the fund and managing the investments.

Charged by your financial adviser: Investors negotiate this fee with their adviser directly and agree what it will be upfront. Usually, these fees are taken by selling some of the investor's units in a fund.

Charged by the LISP: A LISP (linked investment service provider) packages multiple unit trust companies' funds together and consolidates your investment experience into one platform. So you could invest in Prudential unit trusts and other investment solutions via one LISP platform, using one login etc. Platform fees are levied to pay for administration, and different LISP platforms use different fee structures.

Switching fees

Switching fees may be charged if an investor switches from one fund to another. Prudential does not charge any switching fees between its unit trusts, but some management companies and investment platforms charge a fixed fee for each switch. Most do not charge for switching between funds within the same management company, however.

Exit fees

This is a fee you may pay if you sell an investment within a certain period (i.e. within the first year), and is based on the original capital invested as well as growth within the fund. Prudential does not charge exit fees for its unit trusts. However, some management companies may do so.

Performance fees

For certain unit trusts, asset managers charge performance-based fees that are linked to the performance of the unit trust fund. A performance fee may be charged if a fund's performance exceeds its benchmark. Prudential charges performance fees for the Prudential Dividend Maximiser and Prudential Equity Funds.

Complex but transparent

Unit trusts remain one of the easiest, most cost-effective ways to achieve a diversified investment portfolio. Understanding the various fees involved may take some time, but investors can take comfort knowing that that the unit trust industry is extremely well regulated and transparent, with the Financial Services Conduct Authority (FSCA) making sure investors are treated fairly.

For more information, please feel free to contact your financial adviser, call our Client Services Centre on **0860 105 775** or email us at query@prudential.co.za.