imas

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Revision to Guidelines on Calculation of Expense Ratio

On 18th January 2005, IMAS circulated a draft of a revision to its guidelines for the calculation for expense ratio to members for their comments. The purpose of the revision was to update the guidelines in view of changes in the industry and also new products that have been launched. Responses were received from certain members during the consultation period, and also the MAS.

The Standard and Practice Committee had considered the comments received and finalised the revision. The final version has been approved by the Executive Committee of IMAS and is now circulated as attached to all IMAS members to take effect for all reports issued in respect of periods ending June 30 2005 or later.

We would like to highlight the following new sections in the guidelines for the members' attention

- Para 5-Expenses of Funds of Funds
- Para 6-Expenses of Hybrid Funds
- Para 7-Restructuring of Funds

Members would appreciate that it is not intended that nor possible for the guidelines to prescribe a formula for all variations of products in the market. Rather, these guidelines were constructed with the intention of laying out the key principles in calculating the expense ratio that would provide investors with a fair representation of the cost of managing a fund. As such, where members have funds with features that lead to any need for clarification as to how these guidelines should be applied, or if they have any doubts, they should seek consultation with IMAS by contacting us at enquiries@imas.org.sg.

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IMAS GUIDELINES FOR THE DISCLOSURE OF EXPENSE RATIOS

1. Introduction

The regulations of the CPF Investment Scheme (CPFIS) require managers to make half-yearly disclosure to unit-holders and the CPF Board of the expense ratio of each Approved Product. The expense ratio is to be calculated according to these guidelines.

While IMAS referred to the CPF's requirements for disclosure, these guidelines have been drafted from first principles. The disclosure of expense ratios as calculated based on these guidelines will ensure that investors are properly informed of all relevant costs of having their funds managed and enable meaningful comparison among fund managers with different cost structures, thus creating a level playing field.

2. Principles

The guidelines are drawn up according to the following principles:

a) **Comparability** – the basis of calculation must facilitate the proper comparison of the expense ratios between funds on a consistent basis.

b) **Equity** – investors must be treated fairly and without discrimination in the allocation of costs. Existing investors should not wherever possible, suffer at the expense of future investors.

c) **Fair representation** – there must be a fair reflection of all costs relevant in managing the fund in the ratio and all costs that ought to be included should be captured.

d) **Fair disclosure** - where any fund manager deem that it is not appropriate to comply with any part of the guidelines for any of their funds, they should report the intended non-compliance to IMAS in a timely manner in order to provide IMAS with the opportunity to comment on the non-compliance prior to the finalisation of the report. Any eventual non-compliance must also be disclosed in the report.

3. The expense ratio

(a) The expense ratio expresses the sum of all operating expenses (as defined in para 3(d) and 3(e)) charged on an ongoing basis to the fund's assets as a percentage of the fund's average net asset value (as defined in para 3(h)), and is in principle calculated using the following formula:

$$\text{Expense Ratio (\%)} = \frac{\text{Total operating expenses}}{\text{Average Net Asset Value}} * 100$$

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(b) The expense ratio is to be calculated for the preceding 12 months at the close of the annual and semi-annual financial statements, i.e. either:

- For an annual report, the calculation is in respect of the financial year ended; and
- For a semi-annual report, the calculation is in respect of the year ended on the last day of the first half of the current financial year.

If the fee structure (e.g. percentage of management fee, trustee fee) of the fund has been changed during the reporting period or between the end of the reporting period and the publication of the financial statements, attention is to be drawn to this fact in a corresponding footnote to the financial statements.

(c) When a fund is newly launched and has been in existence for less than a year, the expense ratio is to be annualised by an appropriate factor as follows:

$$\frac{TOR * \frac{365}{N}}{NAV} * 100\%$$

TOR = Total operating expenses
N = No. of days in period post its fixed offer
NAV = Average NAV during that period

As an example, for a fund with a post fixed offer period from 1 August 2004 to 31 December 2004, the expense ratio should be computed as follows:

Total operating expenses for the 5 month to December 2004/average net asset for the period * 365/153 * 100%

(d) Operating expenses refers to all costs charged to the fund during the reporting period. These would ordinarily include, but are not limited to:

- Management fee;
- Trustee fee;
- Administration fee;
- Accounting and Valuation fees;
- Custodian, sub-custodian and depository fees;
- Registrar fees;
- Legal and professional fees;
- Printing and distribution fees;
- Audit fee;
- Amortised expenses;
- Performance fee
- GST on expenses.

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(e) The following expenses may be excluded from the computation of the expense ratio:

- Interest expense;
- Brokerage and other transaction costs associated with the purchase and sales of investments (such as registrar charges and remittance fees);
- Foreign exchange gains and losses of the fund, whether realised or unrealised;
- Tax deducted at source or arising on income received, including withholding tax;
- Front end loads, back end loads and other costs arising on the purchase or sale of a foreign unit trust or mutual fund, including any costs arising where a Singapore feeder fund invests into an off-shore parent-fund. Such expenses would generally be capitalised into the cost of the investment and will subsequently be reflected as a diminution in net asset value when the investment is first marked to market after purchase;
- Dividends and other distributions paid to unit-holders.

(f) Certain funds may include a performance-related fee payable to the fund managers. If a performance-related fee is paid to the portfolio manager, both

- The expense ratio excluding this remuneration, and
- The expense ratio including this remuneration

should be disclosed.

(g) For funds with several classes of units and where there are class specific expenses, such as different management fee structures, a separate expense ratio must be calculated for each class of unit.

(h) Average net asset value is defined as the average of net asset value computed based on all valuation days of the fund for the period of the ratio. Semi annual reports or annual reports should use the 12 month ended on the reporting date.

4. Expenses for feeder funds

Feeder funds typically invest substantially all of their assets in a single fund or a small number of designated funds which are managed by companies affiliated to the Manager.

IMAS is mindful that the expense ratio for the Singapore incurred costs of feeder funds will, generally, be lower than that for directly invested funds. Indeed, many managers cap the costs that are charged to a feeder fund in the knowledge that further costs, including management fees, are incurred at the parent-fund level.

To ensure comparability between feeder funds and direct investment funds, the expense ratio should look through the feeder structure established by the manager, and should include all expenses incurred at both the Singapore level and the parent-fund level.

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IMAS recognised that the practical difficulties of obtaining on a timely basis the necessary information to calculate expense ratios for parent funds may at times exist for some managers but

they must endeavour to obtain this information. These guidelines therefore require that for feeder funds the expense ratio should be calculated as follows:

a) Annualised expense ratio of the parent–fund should be added to the annualised expense ratio of the Singapore feeder fund less any rebates of management fees and commissions received from the parent-fund during the reporting period.

b) The expense ratio of the Singapore feeder fund should be calculated in accordance with these guidelines. The expense ratio of the parent-fund would be calculated based on the relevant guidelines in the country of registration of the fund. This would generally be acceptable as most of such parent funds are registered in Luxembourg and Dublin which have fairly similar guidelines as IMAS for the calculation of expense ratio. However, if the guidelines for the calculation of the parent-fund expense ratio are substantially different from those of IMAS, the fund managers should disclosed such discrepancies to the unit-holders.

c) Where the feeder fund retains a proportion of its assets in Singapore, for example as a cash or deposit balance, the parent-fund expense ratio may be reduced by the appropriate factor in accordance with these guidelines to reflect this asset weighting.

d) The parent-fund ratio referred to in paragraph 4(a) should be calculated using the coterminous actual expense ratio or should be based on the most recent published financial information of the parent-fund, if the former is not available notwithstanding best efforts made by the manager to obtain the expense ratio. As indicated earlier, many feeder funds feed into Luxembourg and Dublin SICAV funds or their sub-funds that publish reports for their unit-holders (who include the Singapore sub-fund) on a half yearly basis. Whilst the period covered by these reports may not coincide absolutely with the period of the expense ratio of the Singapore fund, IMAS believed that this approach would provide an acceptable reflection of the total cost base of the two funds taken together.

5 Expenses for Fund of Funds

In the case of funds of funds, which are generally defined as funds with more than 50% of their total assets in other underlying funds, a summarised expense ratio of the target funds and the fund of funds is to be calculated as of the closing date of the financial year or the end of the first half of the financial year in accordance with Appendix 1. This corresponds to the sum of

- The prorated expense ratio of the individual target funds, weighted according to the share they represent in the assets of the fund of funds as of the closing date (where

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there is no information on the expense ratio of a target fund it is to be extrapolated from the total of all investments), and the

- Expense ratio of the fund of funds minus any rebates of management fees and commissions received from the target funds during the reporting period.

This method is a simplified alternative to a consolidated calculation taking into account the length of time investments were held in the individual funds and the fluctuations in their weightings in the total assets.

The prorated expense ratio of the individual target fund should be calculated using the coterminous expense ratio of the said fund or if this is not available, based on the most recent published financial information of the target fund. If there is no such expense ratios available for the prorated majority of the target funds, no expense ratio is to be calculated for the fund of funds and an appropriate explanation is to be published.

IMAS recognised that funds of funds and hybrid funds, the latter addressed separately in the next paragraph, could have varying features and weightings in terms of composition. As such, fund managers who have any doubts with regard to the application of the above to their funds should contact IMAS for guidance.

6. Expenses for Hybrid funds

A hybrid fund is a fund where a portion of the portfolio, is invested directly and the balance of the portfolio is invested in funds which may or may not be managed by an affiliate of the manager. Generally, such funds would invest between 10% to 50% of its total assets in underlying funds with the remainder of the portfolio being directly invested. The expense ratio should be computed in accordance with the provisions contained in section 5 Fund of Funds.

7. Funds with expenses paid up-front

There are funds with finite tenure that are structured such that all or certain of the expenses that are included in the calculation of expense ratio are wholly taken up-front. For accounting purposes, these expenses are generally amortised over the life of the fund, while the remaining expenses, if any, are accounted for in the normal manner.

IMAS is cognisant that a wrong impression could be created if the expense ratio is calculated by

a) including all the expenses taken up-front in the first year or period of the fund as this would result in a very high expense ratio in the first year and low expense ratio thereafter; or

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b) taking the amortised expenses in a period and dividing it by the average NAV as the latter may decline over time with redemption, while the former would be constant.

For such funds, calculation of the expense ratio should therefore be based on the sum of

i) The expense ratio for those expenses that are incurred and charged to the fund during the period calculated according to the relevant guidelines as set our earlier; and

ii) The expense ratio for the expenses taken up-front amortised for the period and calculated based on the initial NAV of the fund post its fixed offer period and before deducting such expenses. An illustration is shown in Appendix 2.

8. Restructuring of funds

In cases where funds are restructured, the historical expense ratio is only to be used if historical performance data is also published. Similarly, in cases where funds are merged, the expense ratio is to be calculated for the fund whose historical performance is taken over.

If a new fund is created de facto as the result of restructuring or a merger, and no meaningful historical performance data can be produced for this new fund, no expense ratio is to be calculated until the first annual or semi-annual report is issued for the said fund.

9. Application of these guidelines to all funds

These guidelines are drafted with the intention of their application to all funds except for Recognised Funds, regardless of whether they are part of the CPFIS. IMAS recommends that managers disclose to unit-holders of all Singapore approved funds, the latest available fund expense ratio in the half yearly and annual reports to unit-holders. IMAS believes that the ratios provide useful information to support investment decisions and an assessment of performance of a fund and that all unit-holders should be provided with the same level of information. If any fund managers are uncertain of any aspects of these guidelines or have problem applying them in respect of their funds, they should seek consultation with IMAS.

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Appendix 1

Example : Calculation of the expense ratio of Funds of Funds

Based on the investments held as of the reference date on which the financial year or financial half-year closes

Average expense ratio of holdings

Holdings on the reference date	Latest available expense ratio	Share of total assets	Expense ratio weighted
Fund A	150 bp	10 %	15 bp
Fund B	180 bp	25 %	45 bp
Fund C	200 bp	15 %	30 bp
Fund D	170 bp	20 %	34 bp
Fund E	n/a	15 %	n/a
Cash	-	15 %	-

Calculation of overall expense ratio

Average expense ratio of portfolio [Sum of expense ratio of Fund A, B, C and D prorated to 85% being total investment in Fund A, B, C, D, and E] (124bp/70%*85%)		151 bp
Expense ratio of the Fund of Funds (Gross)	60 bp	
Less rebates/commissions received	50 bp	10 bp
Total		161 bp

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Appendix 2

Example: Calculation of the expense ratio for Funds with Expenses Paid Up-front

For the illustration purposes, the following are assumed:

- The fund tenure is for 5 years;
- Initial subscription is $100 million;
- Up-front fee of 5% and amortised straight line over 5 years (i.e. $5 million over 5 years)
- The fund has incurred other recurring expenses of $150,000 for Year 1 and $140,000 for Year 2
- Redemption is $10 million at the end of Year 1 and $10 million at the end of Year 2, and assuming no change in market value other than redemption

The expense ratio for Year 1 and Year 2 would be calculated as follows:

	Computation	***Expense Ratio***
Year 1		
Expense ratio arising from the other recurring expenses [A]	($150k / $94.425m [(a)] *100%)	0.16%
Expense ratio arising from the up-front fee [B]	($1m/$100m [(b)]* 100%)	1.00%
Fund Expense Ratio [A] + [B]		1.16%
Year 2		
Expense ratio arising from the other recurring expenses [A]	($140k /$ 83.280m [(c)] *100%)	0.17%
Expense ratio arising from the up-front fee [B]	($1m / $100m [(b)] * 100%)	1.00%
Fund Expense Ratio [A] + [B]		1.17%

[(a)] The average NAV has been arrived at as follows: $100m + ($100m – $10m – $1m –$0.15m))/2 =$ 94.425m

[(b)] Being the annual amortised up-front fee divided by the initial NAV without deducting such fees

[(c)] The average NAV has been arrived at as follows: ($88.85m + ($88.85m – $10m – $1m – $0.14m))/2 =$ 83.280m.