

Multi-Manager Fee Trends

An overview of the annual fees borne by funds of funds and managers of managers in the UK

Four years on from Lipper's first research into "inclusive" Total Expense Ratios (TERs) for funds of funds and managers of managers in the UK, as well as the same anniversary for the European Commission's recommendation for Ucits to publish TERs, the opportunity arises to present a summary of historical fee trends. This comes at a time when multi-manager products are increasingly being used by financial advisers for asset allocation purposes - data on the growth of funds of funds is also highlighted in this summary.

Latest Trends

Lipper's research into the annual charges for 138 multi-manager funds from 24 companies calculates the "inclusive" TERs reflecting both the annual operating costs of the fund of funds, as well as the weighted annual operating costs (or TERs) of some 4,000 underlying funds.

This analysis reveals that "inclusive" TERs have been falling, more obviously for external funds of funds, where there is more scope for different fee negotiations. The recent slight rise in the average TER for internally managed funds may reflect the increased use of more specialised funds in the tougher market conditions of 2007, also reflected in the slowing of the decrease in TERs for external funds of funds.

Multi-manager type	Spring 2008	Spring 2007	Spring 2006	Spring 2005
External funds of funds	2.34%	2.36%	2.49%	2.51%
Managers of managers and Internal funds of funds	1.84%	1.81%	1.86%	1.91%

In assessing the historical trends, the universe of multi-manager funds has been divided between external (unfettered) and internal (fettered) funds of funds. This is a result of the difference in cost structure between the two. For similar reasons, managers of managers have been included in the latter category*. Finally, those funds investing primarily into fixed income funds have been excluded, to ensure the most suitable comparisons.

* Only those managers of managers where fund accounts detail underlying fund holdings are included in this way, as their charging structure approximates internal funds of funds.

“The Cost Issue”

While costs can often be reduced to the small print in marketing documents for single manager funds, this aspect has long been flagged as a hot topic for funds of funds. As a result, many companies promoting their funds of funds offerings have been more pro-active in addressing this issue in the UK than their single manager counterparts.

Such activity may involve suggesting the importance of past performance over charges, or putting a fee cap in place to limit the total annual charges borne by investors. For both of these examples, companies are trying to justify the annual costs that are borne by investors.

As the Ucits Simplified Prospectus becomes the Key Information Document (KID), carrying with it the aim of making charges easier for investors to understand, it will be interesting to see what impact an increasing awareness of charges will have on investors' fund selections. Perhaps this has already been seen among those funds promoting their “value”, not just their cost.

Keeping Costs Under Control

Traditionally the most effective means to keep annual charges under control in a multi-manager product is to take the manager of managers route, rather than that of a fund of funds. The outsourcing of fund management via mandates, rather than the selection of underlying funds, aims to end the layering of annual charges that ultimately impacts on investors' returns.

The layering of charges is also generally minimised for those funds of funds that invest into internal funds by the common practice of not charging a full annual management fee at both fund of funds and underlying fund levels. This is done either by not charging a management fee for the fund of funds itself, or by investing into institutional share classes of the underlying funds.

In addition, initial and exit charges cannot be charged when the underlying funds belong to the same company as that of the fund of funds, in accordance with article 24(3) of EC Directive 85/611/EEC.

It is also possible that the number of underlying funds will put additional pressure on the management of costs. Interestingly, for external funds of funds, the average number of underlying funds has risen to 21, up from 19 in 2007 and 17 in 2006.

Third Party Rebates

Turning to external or third party funds of funds, there is the potential for full management fees to be borne at both layers of the fund of funds structure. However, there are reasons why the fund of funds should want to avoid this situation - in addition to a desire to act in the best interests of investors.

First, the fund of funds manager should be keen to minimise the difference between the performance of the manager and that of the fund in which he invests - this difference being the result of the charges which the fund bears. In a similar way, a fund company should be keen to minimise costs that are not attributable to the fund of funds which it promotes, in order to improve the performance track record of their product and thus attract investors.

Lipper's analysis reveals that the average rebate, or the amount reduced on the underlying funds' management fees is 0.38%. In other words, for a hypothetical underlying fund with a management fee of 1.50%, the actual amount borne by the fund of funds investor is 1.12%.

Such rebates are in addition to any benefits investors also receive from a fund of funds investing into institutional share classes of underlying funds, if these are available. It will be interesting to see if one day a fund of funds will guarantee institutional rates on underlying funds for their retail investors.

Low Cost Investments

Taking this one step further, it is possible for a fund of funds to reduce underlying charges more by investing in index tracking products, most notably Exchange Traded Funds (ETFs). Such an approach does change the dynamic of the fund of funds product, focusing solely on its use as an asset allocation tool and to create different risk profiles for clients, rather than the ability of the fund of funds manager to select managers/funds that will deliver above-average returns to investors.

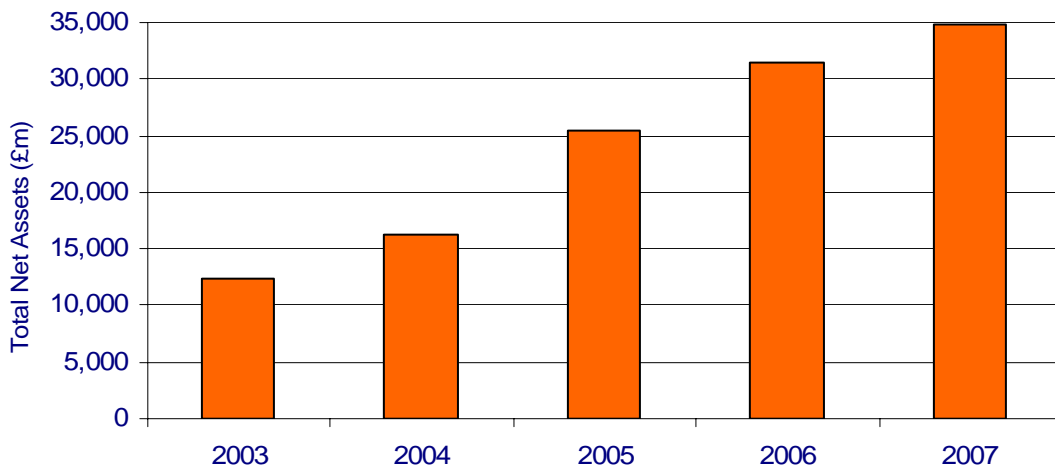
ETFs' TERs in Europe generally range from 0.20% to 0.75%, with the level varying depending on how specialised or exotic are the indices being tracked. Among ETFs listed in the UK, Deutsche Bank, iShares and Lyxor provide ETFs tracking the FTSE 100, FTSE 250 and FTSE All-Share, with TERs ranging from 0.30% to 0.40%.

Product Demand

Data from Lipper FERI reveals that demand for multi-manager funds is strong. UK domiciled funds of funds have grown at a compound annual growth rate of 29.4% from the end of 2003 to the end of 2007. This rate rises to 37.7% when one looks solely at external funds of funds. Most recently, while equity funds suffered outflows of £1.35bn for the first quarter of 2008, funds of funds attracted net sales of over £250m.

Looking forwards, one can expect that the market conditions that are making it difficult to sell funds will prompt more UK fund managers to seek out funds of funds as a means of increasing distribution. If this happens, it should put more power in the hands of funds of funds to negotiate greater reductions in fee levels for the funds in which they invest. This power will only be increased if financial advisers keep at least one eye on these products' fee levels.

Growth of Multi-Manager Funds



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