

Research

Introduction to the UK Mutual Fund Fees Regulation

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Mutual funds (established as securities investment trust by Taiwan laws) have become an indispensable investment vehicle for the local public. Furthermore, besides choosing the investment objectives, considering fund ratings and performance on returns when investing in funds, the amount of relevant fees charged is another factor affecting investment returns. In addition, the fees are an important source of income for the fund management company, and the collection thereof naturally relates to the conflict of interest between the fund management company, market intermediaries and investors. Therefore, the issue of fair charges is one of the major concerns for investors, fund management companies and the competent authorities. The mutual funds issued in the United Kingdom also take on authorised unit trust as mainstream, which is very similar to Taiwan mutual fund structure. This article introduces the relevant provisions governing the fees of mutual funds in UK, and hopes to serve as a reference for the readers.

The commonly known mutual fund in Taiwan is classified in UK as one of the “collective investment schemes”. All cur-

rent provisions governing financial related service industry and financial investments have been integrated under the parent law - Financial Service and Market Act of 2000, also known as FSMA 2000. The Act further authorizes the Financial Service Authority (FSA) to stipulate sub-laws relating to the management of mutual funds and regulate collective investment schemes under the Specialist Sourcebook – Collective Investment Schemes (referred below in short as COLL).

The FSA stipulates clearly in COLL that the primary purpose of regulating mutual fund fees is to protect the consumers, and thereby designate the expenses incurred by the scope of the scheme property, projects, and the relevant fees and requirement charges in purchasing and redemption by investors. Furthermore, the fund management companies are to disclose such information to protect the investing public.

The scope and items that are paid out of scheme property

1. The items that are paid by the Fund

In order to ensure that the scheme property is not disbursed arbitrarily and infringes investor rights, COLL has stipulated clear principle-based rules. There are three main types of payments that can be disbursed by the scheme property namely, remunerating the parties operating the fund (including performance fees), the administration of the fund, and the investment or safekeeping of the scheme property.

In addition, to retain the fairness in disbursing expenses, the COLL further rules out the following scenarios that are also not allowed to be expensed by the scheme property:

(a) Excluding the taxes that ought to be paid by the mutual fund, if the payment of a specific expense is unfair or severely damage the interests of fund investors or potential investors, then such expense should not be paid by the scheme property. What is considered unfair? For example, over-paying the fund management companies from the scheme property or provide benefits to fund management companies that is disproportional to their work.

(b) Except for the fees incurred in the preparing and printing of the simplified prospectus and main contents of the prospectus, the scheme property is not allowed to pay the relevant promotional expenses in principle; for example, the commission paid to intermediaries or the promotional expenses of the sale the fund. The FSA clearly prohibits payments for such commission and promotional expenses by the scheme property. The reason being that such expense is unfair and unnecessary for the investors who have purchased the units; therefore, these expenses should be paid by the fund management companies from their remuneration.

2. Performance Fees Collected

The performance fees refer to the ratio calculated by profits earned from investing the scheme property according to the management of the fund management company. When its trading performance exceeds certain profit level, the investor would, based on the arrangement and ratio, allocate part of the profit as the bonus for the fund management company. The purpose is to provide a greater operation incentive for the fund management companies, and maximize the profitability of the investors through investments. Therefore, besides collecting manage-

ment fees, the COLL also allows the fund management companies to collect related fees, and at the same time stipulates:

- (a) The prospectus shall clearly state the collection of performance fees in an appropriate manner. Furthermore, it must also state the highest limit on the collection of performance fees, or the ratio of the expense in the scheme property in an annual accounting period. All relevant statements should be written in plain English with sufficient explanations.
- (b) The collecting of the performance fees should be fair and reasonable, for example, its calculation and collection should be ranked after all expenses and fees of the collective investment schemes, and its profit benchmark should be objectively reasonable and the management company should consistently apply such benchmark.

Limit on the charges to investors

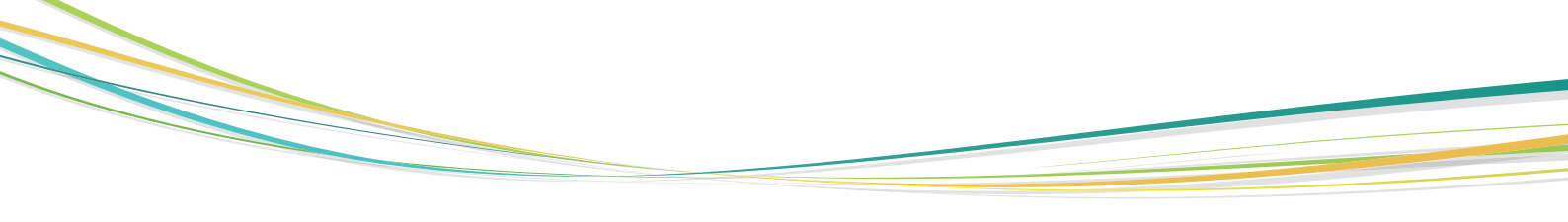
Except for the preliminary charge, the fund management company can not make any charge in connection with the issue or sale of units. The preliminary charge shall be in accordance with the prospectus which must be either a fixed amount or calculated as a percentage of the price of a unit.

Except for the redemption charge, the fund management company can not make any charge in connection with the redemption of the units. The redemption charge shall be in accordance with the prospectus current at the time the relevant units were purchased by the investor. The prospectus should contain a statement as to the determination of the order in which units which have been acquired at different times by the investor. COLL allows the redemption fee to be charged in terms of amount or percentage. It may also be expressed as diminishing over the time during which the investor has held the units or be calculated on the basis of the unit price performance of the units.

The obligatory disclosure of cost

1. The required expense details to be disclosed in the prospectus

Since the prospectus is one of the important tools that help investors to assess investment risks and rewards, therefore the major regulatory strategy by the FSA in UK on mutual fund fees is to require the industry to make all possible costs transparent and include it in the prospectus to fulfill its information disclosure obligation. The investors can then determine whether the investment is worthwhile and whether their profits will be affected or reduced by the costs. On the aforementioned basis,



the industry should, besides disclosing the subscription fees or redemption fees, also disclose the scheme property payments list and details. The details should include who the payment is made to; what the payment is for; the rate or amount where available; how it will be calculated and accrued; when it will be paid. Furthermore, if the particular fund has also collected performance fees, it ought to exemplify its calculation method with plain English, and explain the highest fees that can be charged.

Moreover, in line with the fees disclosed, the COLL also listed several items of expenditures, such as management fees (including the regular payment of management fees and performance fees), depositary / custodian fees, fund transferring fee (transaction fees), registration fees (registrar fee), audit fees, and FSA administrative fees, that is required to be disclosed by the management companies.

2. The disclosure of Total Expense Ratio (TER) in the simplified prospectus

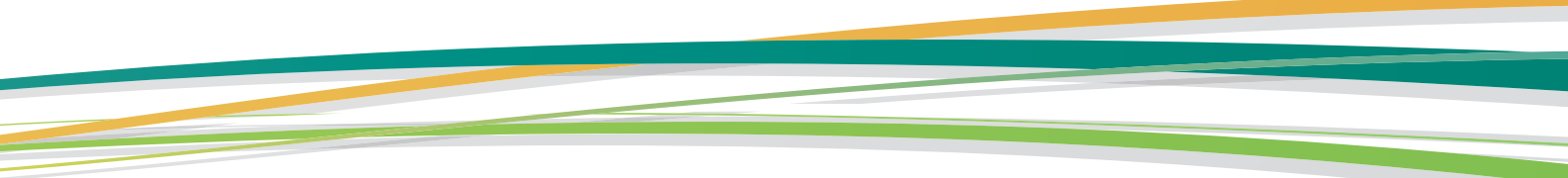
In addition to compulsory disclosure of all fees in the prospectus, the COLL further stipulates that all operators of collective investment schemes must include the TER in their simplified prospectus. The total expense ratio refers to all the fees that affect the fund's net value, in-

cluding management fees, custodial fees, accounting, legal and other costs combined, as a ratio in a fund's average net assets. The TER can be used to measure the cost of the collective investment schemes, where the investors can understand the amount of ongoing expenses deducted from the scheme property when subscribing to the fund, and evaluate the risks and rewards accordingly. The COLL also defined an annex in calculating the TER. Simply put, the ratio is derived from the total operation expenditure divided by the net asset value of the same year.

Conclusion

From the regulations governing mutual fund fees in United Kingdom, we can see that the United Kingdom regulatory policies emphasize the transparency of the fees. Furthermore, under this policy, the passing of the legislation aims to disclose the charges incurred and setup relevant information mechanism in the prospectus and simplified prospectus so that the investors can effectively make investment decisions and choose the favorable fund product.

But in order to further protect investors and maintain the fairness of paying fees, the FSA has to set a principle limit on the fees that are paid by the scheme prop-



erty. Only remuneration for fund management companies, the payments for administration of the fund, and the payments for the investment or safekeeping of the scheme property can be deducted from the scheme property. Moreover, the regulation forbids fund management companies to pay the fund's promotional related expenses or commission to the intermediaries from the scheme property. These principle rules are set to prevent unfair treatment to the consumers, and to reduce the risks of conflict of interest.

On the other hand, to respect the market mechanism and free competition, the FSA have not set any limits on the items of fund's operation expenses, the ratio of the expenses to the scheme property and the source of expenditure. Also, there are no maximum, minimum or ratio restrictions on the fund's purchase fees or management fees. Therefore, the legal policies pertaining mutual fund fees in United Kingdom were passed based on the presumption of protecting the investing public, at the same time, considers the free-market system and avoid over-intervention. So the market largely determines the fees charged by the management companies. Such structure is something worth considering and serves

as a good reference in regulating mutual fund fees.

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