

# Lifting the lid on investment costs



The costs attached to investment can be hidden. **Ralph Benson** uncovers the hidden fees.

**C**osts are one of the few things you can control in the world of investing. Future performance is unpredictable. Charges are certain. But in Ireland, you need the questioning abilities of Sherlock Holmes to understand what you'll pay to invest. In fact, the market-leading provider doesn't even calculate the true number.

I'm on a mission to lift the lid on investment costs in the funds industry. What are you really paying to put your money to work? In this article I will be outlining some of the hidden charges to look out for, and three questions to ask before you invest.

## THE OBVIOUS ONES

Of course access to decent investments isn't free. There are two charges you'll be expecting. One is the cost of using a financial advisor. This is one of the clearer aspects of the whole deal, because an advisor is obliged to tell you their fees before you invest. It's likely an hourly rate or a percentage commission.

The second obvious charge is the annual management cost, or AMC. This is an ongoing charge from the fund manager. It's the cost, for example, of choosing what to buy and sell, and above all the manager's pay cheque. The AMC is the figure most financial advisors in Ireland will focus your attention on. What's not obvious is that the AMC you pay is largely a test of your advisor's negotiating powers. What price have they struck with the fund provider?

## THE MAGIC 1%

So what should you pay? It's hard to generalise when there are hundreds of funds to choose from. But for a multi-asset fund from a mainstream provider, holding a range of equities, bonds and property, you can certainly do much better if you are paying more than 1%.

The management charge is not the only management charge, however; the AMC is not the whole story. For example, trading costs such as stockbroking fees and stamp duty are hard to predict. So these, and numerous other charges, are not baked into the AMC.

## COMPREHENSIVE FIGURES

A better metric to look at is the ongoing charges figure, or total expense ratio. These figures are more comprehensive, so you'll be getting a more realistic picture of what it actually costs to invest. Life assurers tend to keep quiet about the full cost. Unfortunately for Irish investors, there is no obligation for life assurance funds to disclose an OCF or TER, but most players will disclose OCF or TER charges if you ask.

Moneycube's survey of Irish life assurance

providers suggests that these hidden charges add about 0.1% to 0.2% to the annual cost of investing. The multi-asset funds from New Ireland, Standard Life, Friends First or Zurich Life are all within this range. But the extras can be substantially more, particularly for niche investments. For example, Standard Life's Indian Equity fund carries additional expenses of 0.65%.

## THE ALLOCATION RATE

You might have thought that having paid your advisor fees and your management charge, every euro you invest finds its way into your account. Not so. Enter the 'allocation rate', which defines how much of your money is used to buy insurance fund units. If this is below 100%, not all your money is being invested. And if it's above 100%, it's probably being taken back out again via an above-market AMC, or hefty early exit charges. If you want clarity on costs, 100% allocation is the way to go.

Investment houses have similar tactics. Away from the big insurance companies, investing still involves hard-to-spot charges. Tucked away in Davy Select's website, for example, you'll find detail on rebates; through the rebate system as much as 60% of the AMC is paid back to the fund manager. Most of the time it's then passed back to you, the investor. But for Davy's execution-only online and phone account holders, Davy retains the rebate.

## INCENTIVE FEES

These are a one-way bet for fund managers. Incentive or performance fees are paid by some funds to managers if they achieve certain investment returns. Irish Life's MAPS portfolio funds, for example, pay three external managers up to 20% of the growth they achieve. Some Friends First funds operate a similar approach. You won't find incentive fees in the AMC. And of course there are no refunds if your investment should fall in value. For the general investor, incentive fees often mean a fund manager eating up more of your short-term gains.

## HOW TO CONTROL YOUR COST

I suggest three questions to understand what you're really paying to invest in a fund:

1. What is the ongoing charges figure or total expense ratio in addition to the AMC?
2. What incentive fees apply?
3. Is all my money being allocated to the fund, and am I receiving all rebates?

I also highly recommend seeking a financial advisor who promotes open pricing for their customers. For everyone else, investing on decent terms in Ireland is a test of your powers of investigation. ■

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*About the author: Ralph Benson is founder of Moneycube. A chartered accountant and qualified financial advisor, he believes investments and pensions should be simple, clear and affordable.*