

## INVESTMENT MANAGEMENT

### C.E.S.R. CONFERENCE

#### **Palais Brongniart, Paris.**

6 December 2004

#### **TRANSPARENCY IN COSTS, PRACTICES AND PERFORMANCE.**

Euroshareholders is aware of the merits of mutual funds as a vehicle permitting to diversify portfolios and reducing idiosyncratic risks but is insisting on the need to make all relevant charges clearly visible to the investor.

We also think that investors have the right to be more and in a better way informed on the costs related to the services offered by the management of these funds.

Visibility of charges allows investor to compare between different financial instruments as well as between different intermediaries and fund managers.

Not only total expense ratios but also figures that will show the turnover rate of the fund would be most helpful. That way the small investor will have a better chance to judge whether the fund manager is creating value for the subscriber and not merely lining the pockets of his employer by excessive trading.

We also think that the publication of costs and fees should happen in a user friendly way, namely with the real intention to inform the existing and potential investors, not only just to satisfy minimum legal requirements.

We also feel that the financial industry concerned is not sufficiently aware of the growing mistrust among investors, a mistrust that probably has been increased by the misfortunes and experiences in periods of recession and downwards share values that were not the fault of the fund managers.

It remains true that all parties concerned have a real interest in restored trust and that such market confidence would be served by the transparency we insist on.

Amongst the usually well advertised fees we dare to mention.

- Entrance fees (also called front-end loads).
- Exit fees (also called deferred sales load, deferred sales charge, redemption charge and back-end load).

In order to discourage investors to withdraw from the investment fund some funds for instance in Malta are charging a back-end load that declines for each year that the investor has remained in the fund : after the first year the back-end load is 5%. The sales charge drops to 4% after the second year, 3% after the third year up to 1% after the 5<sup>th</sup> year.

Some charges are often poorly advertised. We mention here performance fees (also called incentive fees).

Some funds are charging for producing above average results, when the fund manager was able to top preset results.

In Sweden the usual performance fee is 20% of the total return above risk free interest rate return and this 20% goes to the fund management company.

We also noticed that there were transactions fees and price spreads for buying and selling securities that belong to the funds that are managed by the same fund manager

There are also a number of indirect, operating and undisclosed costs for trading and management that are often not so clearly indicated.

- Rotation or turnover strategies

Some fund managers are instructed to rotate investments (leading to “in and out trading”) in order to favour the group’s brokerage firm (we know of a case whereby the manager got instruction to rotate assets at least by 3,5 times a year) , quite naturally to the detriment of the unit holder.

These costs are associated with trading in underlying assets and on the basis of the recent study by Ken L. Bechman and Jesper Rangvid of the Copenhagen Business School (November 24, 2004) it was impossible to get the necessary data on the actual costs of trading in the underlying assets. So these scholars had to restrict their paper to the study of load fees and operating costs.

- Investment bank fee

A fee charged to the fund by the investment bank for its development of the concept, prospect, marketing plan and subscription guarantees as underwriter.

- Selling/agent fee

Retail marketing of the units

- Advisory fee

In fact, to persuade the customer not to move to another mutual fund

In Denmark we found a number of high charges are imposed on the unit holder such as the following:

S.K. (for the sake of discretion)

- To enter the fund : 3%
- Custody accounts charge : 0,75%
- Fixed fee 525 kr. Per annum
- To which transaction costs difficult to calculate, even for the management company we must admit) have to be added

In Sweden the management fee includes marketing costs, management, research and financial information and custody while most Swedish funds do not have entrance and exit fees.

In Belgium we were impressed by the entrance fee to a socially motivated fund (E.) that charges 5%...

In terms of performance transparency remains a major concern..

The study of the Copenhagen Business School indicated that in general the investor had more certainty about costs than about returns of funds.

Quite a number of funds with high costs have provided only low risk-adjusted returns to their investors which in other words means that the investor cannot be sure that if he invests in a high-cost fund, the fund will generate high performance and in the context of complex cost structures and difficulties in getting an objective track record and useful comparisons between performances ( starting dates, chosen periods of duration...) the investor finds himself in a difficult situation that may lead him to abandon this type of investment.

This document clearly indicates that even for pension funds the subscribers should do well in considering the many and complex charges that reduce the performance of their investments.

## **CONCLUSIONS:**

Private investors cannot figure out what all these costs mean to the results since it really depends on the level and structure of costs whether these costs will outweigh the gains.

The investors mainly doubt whether in a recent past most active funds were able to generate returns over and above their costs.

We like to pay tribute to CESR for having done excellent work in favour of cooperation between supervisory authorities. Supervisory authorities in Europe indeed organise via CESR a fruitful dialogue with all interested parties in the capital markets in Europe. By doing so CESR is playing an effective role of coordination in the interest of the European economy. We would like the European rules and regulations to impose such a disclosure that would provide the investor with understandable and sufficiently accurate and timely information by which the investor would be able to figure out the costs of the mutual funds he is interested in.

Jean-Pierre Paelinck  
EUROSHAREHOLDERS