



# Unpacking managed account fees

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**W**hile the benefits of the managed account structure for investors and advisers are clear, their fee structure, however, tends to be less so. The Australian Securities and Investments Commission (ASIC) has acted on this in the form of its Regulatory Guide

97 *Disclosing fees and costs in PDSs and periodic statements* (RG 97), which comes into effect from 30 September 2022, and which states:

“For PDSs given **before 30 September 2022** you must comply with [CO 14/1252]. The transitional version of RG 97 (released March 2017) applies to these PDSs.

“For PDSs given **on or after 30 September 2022**, you must comply with ASIC Corporations (Disclosure of Fees and Costs) Instrument 2019/1070.”

However, in terms of election arrangements, RG 97 makes the following qualification:

“You may elect to apply the updated requirements if the PDS is dated on or after 30 September 2020. If you do so, you must comply with ASIC Corporations (Disclosure of Fees and Costs) Instrument 2019/1070 for that PDS and subsequent PDSs.”

In the lead-up, Zenith has observed significant variability in fee disclosures.

Moreover, the presence, or otherwise, of underlying fund performance fees may have distorted the disclosed cost of a managed ac-

count and potentially dissuaded investors from accessing appropriate fund options.

Further, performance fees and returns are co-dependent, and investors seeking the ‘cheapest portfolio possible’ may have capped the risk-adjusted return potential of portfolios.

A growing number of advisers use managed accounts for the many benefits this structure provides for their clients and broader business. In the process of establishing their suite of managed accounts, advisers must also understand the nuances that exist in how fees are structured and disclosed to ensure their clients fully understand them. Unfortunately, the inconsistent application of ASIC’s fee guidelines has added a layer of confusion that has made comparing managed account portfolio options more challenging than it should be in recent years.

## Giving investors and advisers more clarity

ASIC is aware of the issues surrounding the inconsistent application of fee information and stated in its Consultation Paper 308 *Review of RG 97 Disclosing fees and costs in PDSs and periodic statements* that:

“The value to consumers of any fees and costs disclosure is lessened if there are significant inconsistencies in the compilation of this information.”

There have since been several reviews, consultations and recommendations made to improve RG 97 and the fee clarity that should flow from it for investors and their advisers.

The most significant change to RG 97 occurred in September 2017 when the fee disclosure regime was changed, requiring the disclosure of a number of costs not previously disclosed. Due to the complexity of the September 2017 version of RG 97, there have been different interpretations of the new regulation, which have resulted in unintended variability in the fee disclosure methodologies adopted by product providers.

The current iteration of RG 97, released in November 2019 and finalised in September 2020, greatly simplifies the previous disclosure regime. However, there was not a 'hard' date for compliance, as product providers could adopt the new regime any time from September 2020 to September 2022. Accordingly, for a two-year period, funds have been disclosing fees and costs under two different regimes. This has been far from ideal, and the variability of fee disclosures needs to be understood by advisers in developing recommendations for their clients.

### Current platform disclosures

From September 2017, many platforms have updated their fee disclosures to align them to an RG 97 world. Broadly, this means including indirect costs and performance fees within the overall cost of a managed account offering, in addition to applicable application, redemption and ongoing investment management fees. Nonetheless, a lack of consistency is also an issue when comparing fees for managed accounts across platforms.

Table 1 on the next page illustrates how disclosable fees of the same managed account product have been categorised and disclosed across different platforms. They all have complied with the disclosure requirements, but their fee outcomes vary across platforms.

### What's been driving this divergence?

The differences in fee disclosures have created an unfortunate challenge for potential investors and advisers in selecting both the platform and managed account option most appropriate to their goals and circumstances. The differences are broadly attributed to several factors:

- *Differences in disclosure:* As can be seen from Table 1, some platforms choose to include performance fees, and others do not. Similarly, some include other fees such as the fees on cash, while other platforms may not (they may not charge a margin on cash).
- *Treatment of fees:* In some instances, fee calculation methodologies vary. This is particularly the case with the estimation of performance fees and transaction costs.
- *Data sources:* Broadly, the platforms do a good job of ensuring the fee information they are collecting is correct. However, due to a reliance on third-party data sources which have their own fee calculation methods, further disclosure inconsistencies may occur.

### Performance fees need a closer look

Generally, performance fees and how platforms disclose these fees has been driving most of the divergence. The

inclusion or exclusion of fund performance fees in a portfolio's aggregate ICR can create the impression of an 'expensive' or 'cheap' cost to invest. Importantly, this ignores the more critical feature of a portfolio, namely, its post-fee return potential.

It is important for investors to recognise that the performance fees disclosed by platforms are largely backward looking. This by no means provides investors with an accurate indication of what they will pay going forward and, if elevated, generally means the investor has enjoyed strong performance in the past. Where a fund does not have a significant track record, estimated performance fees may be based on periods as short as one year. Funds that adopt the new iteration of RG 97 need to show the average performance fees for the previous five financial years.

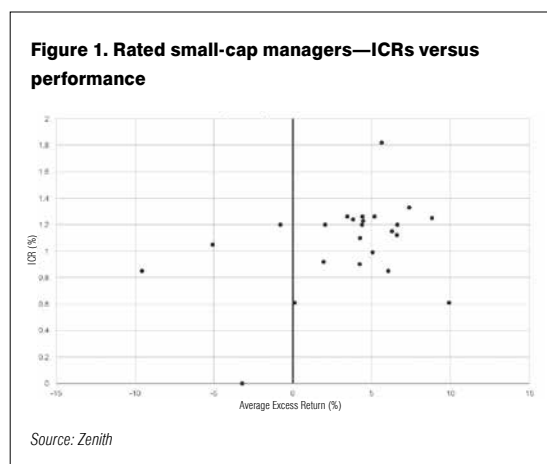
### Cheapest and best interests are not synonymous

Advisers and clients wanting the 'cheapest portfolio possible' run the risk of capping the risk-adjusted return potential of their portfolio—unnecessarily exposing themselves to both modest returns and heightened investment volatility due to reduced diversification.

At times, elevated ICRs are a result of performance fees payable, caused by the returns received by investors in previous years beating their benchmarks by a strong margin (which is a good thing). This is logical, as performance fees and returns are co-dependent.

To help illustrate this, a simple analysis of Zenith's rated Australian Equities Small Companies peer group, a sector where performance fees are common, is shown in Figure 1. It compares fund ICRs (as at 30 June 2019) with the average excess performance (net of fees) on a financial year basis over the past seven years, subject to data availability.

Noting the outliers, this analysis illustrates that, after taking all fees into account (that is, net returns to the investor), funds with higher-than-average ICRs are also often those funds that deliver superior returns to investors.



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### The quote

*For a two-year period, funds have been disclosing fees and costs under two different regimes.*

**Table 1. Variations in managed account disclosable fees**

Portfolio name	Investment management and responsible entity fee	Estimated cash fee	Indirect costs, management expense ratio	Estimated performance related fees	MER + estimated performance fees	Total indirect cost ratio (ICR)	Estimated transactional costs (buy/sell spreads)
<b>Platform A</b>							
Portfolio A	0.200%	N/A	0.820%	0.140%	0.960%	<b>1.160%</b>	0.37%
Portfolio B	0.200%	N/A	0.700%	0.060%	0.760%	<b>0.960%</b>	0.24%
Portfolio C	0.616%	N/A	0.380%	0.000%	0.380%	<b>0.996%</b>	0.23%
<b>Platform B</b>							
Portfolio A	0.220%	0.041%	–	–	1.055%	<b>1.316%</b>	0.425%
Portfolio B	0.330%	0.024%	–	–	0.767%	<b>1.121%</b>	0.287%
Portfolio C	0.610%	0.068%	–	–	0.172%	<b>0.850%</b>	0.063%

Source: Zenith

### Key

<b>Investment management and responsible entity fee</b>	Includes both the cost of the investment manager/consultant (the cost of managing the portfolio) and the responsible entity fee (the price of the entity that has legal custody of the client's assets).
<b>Indirect costs (MER)</b>	The management cost of the underlying investments as disclosed within the product disclosure statement (PDS). This is often calculated as a weighted average.
<b>Estimated performance-related fees</b>	Fees payable to underlying investment managers for performance in excess of a hurdle or benchmark. For managed accounts, disclosure is general. The disclosed fee is typically historical or estimated based on historical and, therefore, may not be the actual fee payable by the investor—which may be higher if the fund manager performs better than historically, or lower if it does not perform as well as it had historically.
<b>Total ICR</b>	Refers to the total amount payable by an investor within a managed account on an annual basis, generally excluding transaction costs.
<b>Estimated cash fee</b>	In some cases, an estimated cash fee (implicit cost of the cash account), if the cash account is in the portfolio.
<b>Estimated transactional costs (buy/sell spreads)</b>	An estimation of the transaction costs an investor will be exposed to. These calculations are often an average of the buy/sell spreads of the underlying managers. It is worth noting these costs do not relate to the transaction costs of the underlying investment managers which were not required to be disclosed in the RG 97 regime that applied up to 30 September 2020.

Another example to note—relatively high ICRs and performance fees are also common within the alternatives asset class, including but not limited to unlisted assets and hedge fund strategies. The fees in relation to these investments do not necessarily reflect their performance potential, but often the cost of accessing sophisticated investments that retail investors could not replicate directly or easily.

Zenith remains a strong advocate for alternative investments and believes their role in diversified portfolios is critical amid rising market volatility and the synchronised drawdown of bonds and equities in 2022.

## Conclusion

In the right context, performance fees can suitably align with the interests of both investors and advisers, as managers are rewarded for consistently outperforming their benchmark. Conversely, if they do not, performance fees will not be charged, and managers typically have to make up any performance shortfall for investors before they can again charge these fees (commonly known as a 'high-water mark').

The consistent disclosure of performance fees and ICRs by all managed account providers is important, as is the intention of RG 97 to make this clear and informative for investors and their advisers. Thus, they need to be well equipped to help navigate the confusion of fee disclosure and build portfolios that provide the best 'bang for buck'. **FS**



### The quote

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