



Investment Company Charges

TOTAL EXPENSE RATIOS

A Total Expense Ratio (TER) represents the drag on company performance caused by all annual operating costs (including administration, custody, audit and legal fees), not just the basic management fee. In other words, the TER is the annual percentage reduction in investor returns that would result from operating costs if markets were to remain flat and the fund's portfolio were to be held and not traded during a period. More detail on the calculation of the TER is outlined later in this document.

The TERs shown on www.theaic.co.uk have been calculated by Lipper, a Thomson Reuters Company, and are based on the information published in the audited (annual) financial statements and regular reported data such as the NAVs. The TER for each company is updated on an annual basis following the announcement of the final results. Varying year-end reporting dates necessitate that to ensure the cost comparisons are both relevant and timely the TER data on www.theaic.co.uk is updated on a quarterly basis (January, April July and October).

The European Commission published its recommendations on some contents of the simplified prospectus (UCITS III - document 2004/384/EC) in April 2004, which included guidelines for TERs. These TER guidelines are based on similar principles to the approach Lipper, a Thomson Reuters Company, has already established. One particular change in methodology is the inclusion of performance fees in the TER, where the simplified prospectus requires performance fees to be both included in the calculation of the TER and also shown separately, whereas historically Lipper, a Thomson Reuters Company, has published the performance fee charged as a separate field of information.

Although the requirements of the simplified prospectus do not apply to investment companies, the AIC recognise the desire for comparability across other types of collective investment vehicles (e.g. open-ended funds). The TERs published on www.theaic.co.uk are thus based on similar principles. On www.theaic.co.uk where a company has a performance fee charge, two TERs are published, including and excluding the performance fee.

In Lipper's opinion the NAV TER is the most directly comparable ratio to "Lipper TERs" that are published in other publications for other types of collective investment vehicles. As well as calculating a range of NAV TERs, Lipper, a Thomson Reuters Company, calculates additional TERs based on the Gross Asset Value and on the Market Value. For any queries, please e-mail lipperfitzrovia@reuters.com or visit www.lipperweb.com

DISCLAIMER

The Lipper, a Thomson Reuters Company, data on www.theaic.co.uk is provided strictly for information purposes only. It is not, and is not to be considered as, any form of investment advice. No investment decision should be taken based in whole or in part on the data we provide. All figures may and should be independently calculated and/or cross-checked with the relevant company promoter. If you choose to use the TER information, you accept that Lipper, a Thomson Reuters Company, will not be liable for any loss, however caused, resulting from use of the information provided.

LIPPER TER CALCULATION

The formula for the calculation of Lipper TERs shown is as follows:

$$\text{Total Expense Ratio (NAV) \%} = \frac{\text{Total Annualised Net Operating Expenses}}{\text{Average NAV of company during period}}$$

Underpinning this calculation are two key elements:

a) Total Annualised Net Operating Expenses

Underlying expenses are sourced from each company's annual audited accounts. These are categorised into operating expenses and non-operating expenses.

However, in broad terms the operating expenses are the costs that a company would have to pay even in the absence of any purchases and sales of shares, and if investment markets remained static for the whole period. They therefore include management fees, audit fees, directors' remuneration, custody charges and any administration and marketing costs, but exclude capital gains and losses, and costs associated with share transactions.

If a financial reporting period is less than a full year the operating expenses are annualised (multiplied by 365 and divided by the number of days in the period).

b) Average Net Asset Value (NAV) during the period

Wherever possible we calculate average net assets during the period using the month end net asset values, thereby providing an accurate estimate of the reduction in annual returns accounted for by a company's operating charges. Some companies such as venture capital trusts only calculate their net assets biannually. In this case, the average NAV is based on the average of the opening, half-year and closing values.

It should be appreciated that the net asset value is the underlying book value of the company's assets. This does not correspond to the price at which investors may buy and sell shares in the company as this is calculated from the market value of the shares. The difference between these two valuation methods is known as the discount or premium. Where the market value is lower than the net asset value, the share stands at a discount and a premium signifies that the market value is higher than the net asset value. Although investors cannot buy or sell their shares by reference to the NAV it is nevertheless an important valuation method because it indicates the investors' net exposure to the market in which the company is invested.

"Investment Company Charges" source: Lipper, a Thomson Reuters Company – updated

November 2009

DETAILED POLICIES REGARDING TER CALCULATIONS

As with any preparation of statistics it is necessary to set out policies and assumptions, some of which require subjective judgment. These situations are outlined below for information:

1) Annual Financial Statements

Audited annual reports have been used for all calculations. Semi-annual reports, if available, contain an insufficient analysis of expenses to produce an accurate Lipper TER.

2) Non-Operating Costs

In several cases a company's breakdown of expenses will include items that Lipper, a Thomson Reuters Company, do not consider to be operating expenses: these will have been excluded from the total operating expenses figure and there will be a reconciliation difference between this and the total expenses shown in the financial statements.

Company expense statements often include items that are excluded from the Lipper charging calculation for obvious reasons, such as dividend payments and capital items (unrealised losses on investments etc.) Other exclusions from calculations are as follows:

- a) Lipper, a Thomson Reuters Company, excludes **performance fees** from the standard TER calculation and continue to believe that two separate figures are most relevant and useful for clients and investors. The following points outline in detail why a consolidated [TER + Performance Fee] figure on its own may well cause confusion:

Annual operating expenses act as a drag each year on fund performance, and so if the TER is to be used as a guide to the ongoing drag, it is important for a single figure to exclude performance fees (with the latter then shown separately). In a combined figure one cannot see how much is a result of fund performance and how much is a result of largely fixed operating expenses.

Performance fees are, by their very name, performance-related and so might not be payable in any given period. Nevertheless, clearly understandable information on performance fees – both their structure and what has been charged – is essential for the investment community.

Two funds, with otherwise identical expenses, are likely to have different TERs if performance fees were included. Furthermore, the better performer could have a higher TER. This could also create a situation where the TER of a fund could look volatile over time, when, in fact, this merely reflects the fund's performance, rather than its operating costs. Indeed the inclusion of performance fees in a TER could partly reflect wider market conditions over the accounting period.

A TER can sometimes be lower than a fund's total operating expenses, or even negative, if performance fees are included. This is explained as follows: performance fees must necessarily be accrued at each fund valuation point. The actual crystallisation (i.e. when it is fixed and recorded as a payment) of that performance fee might not happen for some time. Any subsequent downturn in a fund's share price will result in reduced performance fee accruals at future valuation points. This could lead to a situation where, within a particular accounting period, there is actually a reduction in the accrued performance fees.

The impact of performance fees in terms of a fund's net assets, if the performance goals were achieved over an accounting period, can be expressed separately (and are expressed separately in Lipper research). However, the most useful and relevant

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performance fee figure for investors and others is not the performance fee that was achieved in any given period (in net assets), but the performance fee structure itself (together with the fund's performance).

- b) bank and loan interest, because this is deemed to be an investment related capital expense rather than an operating expense.
- c) brokerage, which is treated as a capital item and not an operating expense by the majority of companies;
- d) currency profit/loss on the companies revenue bank account, the inclusion of which would either increase or decrease the genuine operating expenses figure.
- e) restructuring costs, such as expenses associated with the buy-back of shares/warrants, restructuring of debt, mergers and other types of restructuring which are considered to be capital items, are generally one-off and which would distort the Lipper TER, thus making comparisons between companies meaningless.

3) Ordinary Shares and Other Share Classes

Certain investment companies issue more than one share class to meet the needs of different types of investor; for example, those requiring either income or capital growth or to suit different risk profiles. These share classes generally have differing cost structures. Described below is the treatment of the main types of share class currently in issue:

- a) Preference shares and zero dividend preference shares

No expenses are attributable to preference shares and they therefore always have a zero Lipper TER.

Although preference shares often carry voting rights and are treated in the accounts as being shareholders funds, to all intents and purposes they are a form of long term financing. They are consequently treated as such in the Lipper TER calculation and are deducted at book value from total assets to arrive at the net assets figure attributable to ordinary shareholders.

- b) Split capital investment companies with income shares

Lipper, a Thomson Reuters Company, has taken the decision not to calculate TERs for split capital investment companies as this could be misleading for investors. For example, the split between income and capital means that a TER could potentially be 0% or extraordinarily high. In addition, split capital investment companies TERs would not be comparable with any other company, or indeed any other type of collective investment vehicle.

More specifically, the NAV in the balance sheet is not always representative of the fair NAV of the shares (for example Income shares may receive all of the income and yet carry a value in the accounts of their redemption price, which may be nominal). Unfortunately, the process of deciding whether or not the balance sheet value is fair is a subjective one. Whenever possible it is Lipper's policy to avoid subjectivity.

4) Convertible loan stock

The issue of convertible loan stock (CULS) can have a material effect on the NAV of the ordinary shares. Where the share price has risen and the CULS may be exercised at a higher value than book value there is a clear liability that is not recorded in the balance sheet. To reflect this potentially material item the diluted NAV per share is used reflecting the NAV per share after the theoretical conversion of all of the CULS.

"Investment Company Charges" source: Lipper, a Thomson Reuters Company – updated

5) Fees Charged to Capital Account

As discussed previously, we do not include in our Lipper TER calculations capital items such as brokerage. The apportionment of operating expenses to capital is widespread throughout the investment company industry. To fairly calculate the Lipper TER in these cases we have "repatriated" such items for inclusion in our Lipper TER calculations.

6) Short Accounting Periods

Where companies have been launched part-way through an accounting period but the resulting reporting period is more than ninety days old, we have included charging structure data for reasons similar to those outlined in the first page of this section.

7) Errors in Lipper, a Thomson Reuters Company, TER Calculations

With any analysis such as this, questions regarding the accuracy of the underlying data are inevitable. In general, notified "errors" have in fact been the result either of a different method of calculating net assets (such as simply using closing assets, which is inferior), or the result of a subjective judgment made by the questioner with which we do not ourselves agree.

The majority of the remaining "errors" have been the results of a cry of "foul" from certain promoters, for example where it has been claimed that a high, all-encompassing figure termed "Other Expenses" in the financial statements has in fact included non-operating costs such as brokerage. While these cases are extremely infrequent, we are of the opinion that we can only work with the information that is provided within the financial statements, and that any investors conducting their own Lipper TER calculations on the basis of the companies report and accounts would reasonably only come to the same conclusions as ourselves. This often leads to greater disclosure in the accounts in future periods.

8) Property Investments

Certain companies invest directly in property. In these cases there are direct expenses incurred in managing the property. Sometimes these are shown netted off against income although the amount of expenses netted off is normally disclosed. These expenses, wherever identifiable are separated from the revenue and included as operating expenses in the Lipper TER calculation.

9) Third Party Investment Management

A handful of companies undertake investment management activities for third parties and receive revenue for these services. As it is almost impossible to identify the costs attributable to these activities accurately and the apportionment of such expenses between in-house and external companies is hardly an exact science, these expenses are included in the Lipper TER as operating expenses.

10) Custody Fees

Many companies pay custody fees in addition to the management fees. These costs are included as an operating expense unless it is clear from the financial statements that they are transaction charges that relate directly to the purchase and sale of securities. In this case they are treated as non-operating expenditure except where the manager is also the custodian.

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11) Negative Expense Items

We occasionally come across negative items in company expense statements. These are often the result of a previous over-accrual for items such as audit fees or VAT. We have decided to treat any such entry as a zero expense. We believe that the inclusion of any negative expense would distort the latest Lipper TER, which would be unhelpful to investors and analysts alike.