



Chapter 3

INDICATE HOW COLLECTIVE INVESTMENT SCHEMES ARE REPORTED

Overview This chapter focuses on the pricing of collective investment schemes and the various elements that influence its performance.

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3.1 Pricing

Learning outcomes

By the end of this section, the learner must be able to: -

- Explain the affects of the CISCA legislation on collective investment scheme pricing
- Understand the concept of single pricing and how the NAV price is calculated.
- Understand and communicate the meaning of subtitles in newspapers.
- Describe the difference between Historic and Future pricing.
- Differentiate between the multiple classes of units.
- Explain the basic financial concepts.

Assessment criteria

The learner will be assessed on the following criteria: -

- The effects of the CISCA are explained with reference to the transparency of fees.
- The formula for calculating the pricing of collective investments is known and used to explain the unit price.
- Terminology associated with the pricing of collective investments are understood and used in context.
- Difference between historic and future pricing is explained with reference to the standard method in the CIS industry
- Multiple classes of units are explained with reference to selected funds in the newspaper.
- The number of units that a specific amount of money will buy is calculated using information from a newspaper.
- Health warnings that need to appear on any collective investment scheme marketing or reporting documents are listed in terms of the Collective Investment Schemes Control Act.



3.1 Pricing

Overview A investor valuing his/her investment in a collective investment scheme requires the unit price provided by the manager, to determine the investment value. Where different methods and principles were used, it became a focal point and a factor for the consumer public and the press in evaluating the collective investment scheme industry. It is, therefore, essential that pricing be done consistently and correctly throughout the industry and the ACI has a standard for pricing that all managers follow.

Single Pricing This is the new method of pricing which was introduced with the CISCA legislation in March 2003. Single pricing means that only one price is used for all transactions. Initial charges must be shown separately. This will also be referred to as the Net Asset Value (NAV) price.

Net Asset Value (NAV) This is the price at which buying and selling take place. It includes the market value of the fund plus all accrued income minus permissible deductions.

Permissible Deductions Permissible deductions consist of:

- Quantifiable charges:
 - Initial fee & VAT
 - Annual service fee
 - Exit fee
- Non-quantifiable charges:
Charges payable on buying and selling of assets (in the past referred to as compulsory charges)
 - Auditors fees
 - Bank charges
 - Trustee fees
 - Other levies and taxes, re RSC levies



3.2 Historic vs. Future Pricing

Overview The NAV price is determined by using either historic or future pricing.

Historic Pricing With this method, the market value is determined each evening, based on that day's closing price for the assets owned by the trust. This price will then be used for all transactions that occur the following day. This means that the value is always a day behind and not necessarily a true reflection of the value of the trust. If the markets move violently overnight or during the day, it could affect the trust negatively, as owners of units could sell their units at higher prices than they are worth. To protect the trust, the Manager may re-price units at any time of the day, when the market is unstable. An advantage of historic pricing is that the investor knows the price he will pay or receive when units are bought or sold.

Future pricing This method is also known as forward pricing. With this method the price is established each evening, using closing prices of investments for the day, and is applied to all the transactions that took place during the same day. This means that all sales, repurchases and other transactions can only be priced and processed at the end of the day. Future pricing has the advantage that the need for re-pricing when the market is unstable is eliminated.



3.3 Multiple classes of units

Overview In March 2000, the Association of Collective investment schemes now known as the Association of Collective Investment Schemes introduced multiple classes of units, in line with international pricing standards. This system caters for different types of investors and managers are, therefore, able to differentiate between the service offered to different clients and the annual fees they charge accordingly.

What are Multiple Classes of Units? Multiple classes of units very simply, means that one portfolio, offered by one manager, may have two or more classes, charging varying annual fees. In other words, different annual fees are charged for the same portfolio with the same underlying assets. The different classes are sold to different types of investors (retail and institutional), and are usually based on different minimum investment amounts.

Annual fees Before the introduction of multiple classes of units, the Manager charged investors varying initial charges, usually based on the amount of money being invested. Institutional investors placing larger sums of money were likely to pay less than the individual with a smaller monthly debit order. However, both investors paid the same annual fees. These annual fees cover ongoing expenses involved in the maintenance of the investment, such as portfolio management and administration including the distribution of statements and other correspondence. The maintenance of an institutional investor account is much simpler and less costly than the maintenance of many individual investor accounts. This is the reason why multiple classes of units are an accepted practice in many other countries.



3.3 Multiple classes of units

Multiple Classes

- An R class (Ring fenced) was established for those older funds that have operated with regulated annual fees and their investors.
- A second retail class of units (Class A) opened for all investors and this class will operate with deregulated fees and charges. Here annual fees are likely to be higher than the R class.
- A third class (Class B) was established for institutional clients, who invest very large sums of money.

It is important to note that existing investors (at the time when this was introduced) were not affected in any way by the introduction of these new classes.

For portfolios launched after deregulation, there will be no Class R, only Class A and Class B as described above. Any increases in annual fees required that the manager give existing investors 3 months notice, after which existing and any new investments would all be subject to the higher annual fee.



3.4 Basic Financial Concepts

Costs There are certain charges involved to cover the costs of the professionals who administer the funds.

Initial charges (Managers fees) Initial fees are levied when purchasing units, be it any lump sum, additional deposit or debit order. Generally speaking the higher the investment amount the lower the initial charges. Initial fees are charged by the Manager of which a portion is used to pay the broker commission and the remainder covers marketing and administration costs. These fees are deducted from the amount invested and can range between 1% and 5%. However, since deregulation came into effect, there are no maximum restrictions in terms of initial charges. VAT is levied on the initial charge at a rate of 100%.

Annual Service Fee Managers levy a service fee on a monthly basis against the income of the fund. As this fee is recovered from the income (interest and dividends), it is not taken into account separately at the calculation of the NAV price, but is subtracted from the income awaiting distribution. Prior to the deregulation of charges in 1998, collective investment schemes could not charge more than 5% initial charge and 1% service fee. Collective investment schemes launched since deregulation, are not limited to these constraints. An interesting anomaly is that this fee is calculated daily, levied monthly and yet known as an annual fee. It is important to note that VAT is payable on all charges.

Income distributions Most Collective investment schemes declare an income, which is either paid out or reinvested. Distributions typically occur as follows:

- Most equity funds - twice a year
- Most income and bond funds - quarterly
- Money Market Fund, Enhance Cash Fund and Dividend Income Fund - monthly



3.4 Basic Financial Concepts

Income distribution

The fund earns dividends on the shares in the portfolio and interest on the bond and cash investments. The net income received (after deduction of service fees) is divided equally among the number of units in issue as at the declaration date. It is expressed as an income in cents per unit.

Cum dividend

"Cum" is Latin for "with". Investors who buy on or before the income declaration date i.e. 31 December, will receive the dividend, while those who buy after that specific day, do not qualify to receive the dividend declared. The unit price should, theoretically, decline on the day after declaration i.e. 1 January by an amount equal to the dividend that was declared.

Ex dividend

The ex dividend period is the period during which units are sold without the right to the next dividend. The collective investment scheme price declines on the ex dividend date i.e. 1 January, reflecting the "withdrawal" of the declared dividend from the price. Since you receive the dividend declared on payment date, the total value of your investment is unchanged.

Money Market Fund Pricing

Money Market funds are priced differently to other funds. The fund is not priced at market value but rather at a fixed price of R1.00 per unit. Interest is accrued daily and capitalized monthly.



3.5 Health warnings

Investment Performance

Investment performance can be advertised provided such figures:

- Are consistent with industry norms
- Are truthful
- Do not create unreasonable expectations of future returns
- Historical performance should be advertised against relevant benchmarks or indices
- Referenced to a source and data

Generic Non-performance advertising

The Manager must, before entering into a transaction with an investor, disclose information about:

- Investment objectives
- Calculation of net asset value and dealing prices
- Charges
 - Quantifiable/Non-quantifiable
- Risk factors
- Date of income distributions
- Give, timeously and in a comprehensible (understandable) manner, information that the manager consider necessary to enable investor to make an informed decision.



ACTIVITY SHEET 11



1. What is the standard method we use in the collective investment industry to calculate the price of the units of a collective investment fund? Describe this method.

- 2.1 Explain in the table below, the difference between forward pricing and historic pricing.

Forward pricing	Historic pricing

- 2.2 Which of the above methods does most CIS companies use?

- 3.1 What is the purpose of multiple classes of units?

- 3.2 Name and explain the various classes of units.



Use a financial newspaper to answer the following questions on the collective investment scheme funds of a specific manager:

4. How many units would an investor have bought with R2 000.00 in a specific fund?

Show the calculation in this space.





CRITICAL CROSS FIELD AND DEVELOPMENTAL OUTCOMES

1. **Identify and solve problems** - learners can analyse newspaper articles on legislation and use information to address enquiries.
2. **Organise and manage oneself and one's activities responsibly and effectively** - learners can use the time allocated for projects and learning - in which they must study the prices of funds over a specific period - , effectively and productively.
3. **Collect, organise and critically evaluate information** - in which they must collect information for projects and organise this information in an understandable and chronological order.
4. **Communicate effectively using language skills in modes of written presentations** - in which learners can explain concepts and calculations (in class and assessments - Single Pricing method) to trainer in an understandable manner.
5. **Work effectively with others** - in which they must complete a group project.