



Ongoing Charges for Closed-end Funds

Morningstar Methodology Paper

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Introduction

The Ongoing Charges figure replaces the Total Expense Ratios (TER) which, until May 2012, has been used to measure the impact of costs relating to the management and operations of a closed-end fund. The calculation for Ongoing Charges takes into consideration recent regulatory and market developments in relation to the calculation of expense ratios. The methodology is consistent with rules that apply to UCITS funds, who are also required to publish an Ongoing Charges figure, thereby creating comparable data between open-ended and closed-ended funds.

To calculate the Ongoing Charges, Morningstar stores accounting information from each closed-end fund's Annual Report & Accounts, including all line items from the detailed Fees and Expenses breakdown. Expense data is aggregated to calculate the Ongoing Charges for the year. Morningstar maintains this data historically so data and trends can be analyzed for previous years. Prior to May 2012, Morningstar stores the Total Expense Ratio, which was the prior ratio calculation.

The Morningstar Ongoing Charge is updated within 1 week of the Annual Report & Accounts publication date.

Methodology

The formula for the standard Ongoing Charges calculation is as follows:

$$\frac{\text{Annualised Ongoing Charges}}{\text{Average Undiluted Net Asset Value in the period}} \times 100$$

Morningstar defines Ongoing Charges and Average Net Assets in line with the European Commission's UCITS guidelines so that Ongoing Charges can be compared across different types of investment fund.

Ongoing Charges

Ongoing Charges are those expenses of a type which are likely to recur in the foreseeable future, whether charged to capital or revenue, and which relate to the operation of the investment company as a collective fund, excluding the costs of acquisition/disposal of investments, financing charges and gains/losses arising on investments. Ongoing charges are based on costs incurred in the year as being the best estimate of future costs.

Ongoing Charges includes management, administration, audit, custody, director, legal, listing, marketing, company secretarial, professional and registrar fees. Interest on borrowing, restructuring costs (including associated legal and professional costs for a restructure), transactions costs, trail commission and tax are not included:

The following expense items are included in the total:

- Management Fee (the fee paid to the investment management group for managing the fund)
- Administration Fee (costs incurred in administering the fund such as salaries, directors' fees, accounting and secretarial fees)
- Audit Fees (auditor's remuneration for audit and other services)
- Custody Fees (costs incurred in the safekeeping of assets by a brokerage or other financial institution)
- Insurance (for example Directors' insurance)
- Legal Fees (costs incurred for ongoing legal services, except those incurred during a restructure)
- Listing Fees (costs incurred in the listing of fund securities)
- Marketing Fees (costs incurred for marketing services)
- Professional Fees (other professional fees incurred, except those incurred during a restructure)
- Registrar Fees (costs incurred in the maintenance of the company's share register)

The following expense items are excluded from the total:

- Interest (interest paid on borrowings)
- Restructuring Fees (costs associated with mergers, debt restructuring, share buy-backs)
- Transaction costs (costs associated with the buying and selling of the fund's investments, including broker costs, stamp duty or similar taxes and other linked charges)
- Trail commission (where arrangements are in place, given the variation of amounts in such arrangements)
- Tax (tax paid by the fund, including corporation tax, overseas withholding tax, capital gains tax etc.
- Deferred Tax (potential future tax liabilities)
- Compensation schemes (incurred at self-managed investment companies)
- Performance Fees* (fees paid to the management group with reference to the performance of the fund)

*Performance Fees

Morningstar calculates its standard Ongoing Charges with performance fees excluded, in line with UCITS guidelines. However, we separately calculate the performance fee as a percentage of Average Net Assets. Morningstar then

provides a second Ongoing Charges figure including performance fees, in order to show the impact on performance return of the expenses including the performance fee.

The standard Ongoing Charges allows comparisons to be made on the fixed operating expenses of a fund, while the Ongoing Charges including the performance fee indicates the total impact of the costs and fees on shareholders' funds.

It is important to show these figures separately rather than producing only one Ongoing Charges figure, in order to distinguish between the impact of fixed operating costs and the impact of performance fees paid due to good performance. Performance fees can vary greatly from year to year depending on a fund's performance. Therefore when comparing funds' costs, the standard Ongoing Charges provides an important indication of operating costs, whereas the Ongoing Charges including performance fee indicates the additional expense paid for good performance.

Average Net Assets

Morningstar calculates the Average Net Assets for the financial year under review. The Average Net Assets are based on the actual "cum income" fair NAVs, as published by the Fund. Closed-end funds might report NAVs on a daily, weekly, monthly or less frequent basis. Morningstar only uses the Net Assets as calculated on the NAV reporting dates; estimated NAV data is not used. Ongoing Charges for periods starting prior to 31 May 2008 are calculated using ex par NAVs. The change to cum fair on 31 May 2008 is in line with the requirement for closed-end funds to produce cum fair NAVs from this date.

Financial Year

Where the accounting period under review is for a period other than 365 or 366 days, the Ongoing Charges are adjusted on a pro rata basis to provide the equivalent annual figure.

Other Methodology

Reported Ongoing Charges

Morningstar separately collects the Ongoing Charges figure published in each closed-end fund's Annual Report & Accounts and stores this as an "as reported" data point. The methodology used by fund companies may differ, so Morningstar recommends that the Morningstar standard Ongoing Charges data is used for comparisons across funds to ensure consistency. Prior to 31 May 2012, any data collected by Morningstar will be the Total Expense Ratio rather than Ongoing Charges.

Consolidated vs Company accounts

The Ongoing Charges figure is intended to include all costs to which a shareholder is exposed by investing in the company. Accordingly where the Annual Report & Accounts includes both Consolidated and Company accounts, the Consolidated accounts are used as they contain the total expenses borne by the shareholder.

Property Funds

Property funds that invest directly in property will incur costs associated with the management of the properties. Where such direct costs are provided in the Annual Report they are stored in our database as a separate data field. They are included in the Ongoing Charges calculation for our standard Ongoing Charges calculation. However, as these costs can be significant Morningstar also calculates Ongoing Charges where these costs are excluded from the calculation, so that Direct Property funds can more easily be compared with other property funds or funds in other sectors.

Appendix A - Available data items

The following standard ratios are calculated:

- Standard Ongoing Charges (%)
- Performance Fee (%)
- Ongoing Charges including Performance Fee (%)

In addition, these ratios are calculated on both a Pre and Post Tax basis (as a percentage of Average Net Assets):

Further, as Morningstar stores each individual line item of the expenses from the Annual Report & Accounts, custom ratios can be calculated, for example Marketing Fees / Average Net Assets.

For further information please contact your Morningstar Account Manager or FDsupport@morningstar.com