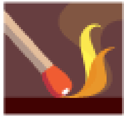

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Morningstar ups importance of fees in ratings tweaks

By Ed Moisson 9 July 2019

Morningstar is altering its fund analysis methodology to place more weight on fee levels when determining how highly a fund is rated.

The change reflects the growing importance selectors are putting on product costs in their selection process and increasing pressure on asset managers to justify their fees.

In a tweak to its forward-looking analyst ratings methodology, researchers will deduct fees and expenses from their estimate of how much value a product can add.

The approach will give "a sense of what value investors will net after fees are taken into account, which is what ultimately matters", the firm says.

Morningstar is trying to ensure that price "gets the weight it deserves" in its fund ratings.

Researchers will also assess and rate each share class on its own in order to account for any fee differences within a fund. Currently the firm evaluates a single representative share class for each fund.

"This could mean share classes that bundle advice and sales fees may see ratings downgrades," Morningstar says.

The research firm was previously forced to defend its ratings from criticism by the UK financial regulator two years ago, as part of its asset management market study.

But a spokesperson for Morningstar says: "The enhancements are not related to any past criticism by the FCA.

"Our analysts' assessments are independent and Morningstar continually evaluates its rating systems to try to improve outcomes for the end investor."

Meanwhile, the planned changes come as fund selectors and gatekeepers have been ramping up their scrutiny of asset managers' fees.

Chris Chancellor, senior director for Europe, the Middle East and Africa insights at Broadridge, says: "Our research suggests fund selectors are looking at fees in ever more detail and wanting to understand all components of the fees.

"The change by Morningstar is completely in line with the market. Fees are becoming a more and more important part of the selection process, in a number of markets it is now the second most important selection criteria [among professional fund buyers]."

Bella Caridade-Ferreira, chief executive officer of consultancy Fundscape, says: "Fees make or break your portfolio and today's investors and fund selectors are very picky.

“Fund managers can no longer take the L’Oréal approach and say ‘because I’m worth it’.”

Morningstar’s methodology change is “a significant, but long overdue, step in the right direction”, Ms Caridade-Ferreira says.

Greater scrutiny of charges does not mean all asset managers will rush to offer low fees, experts say.

“Selectors are looking for value for money, so if the product, performance and service are all excellent a higher fee may be fine,” Mr Chancellor says.

Philip Kalus, managing partner at fund distribution research firm Accelerando Associates, says: “A true active, high-octane fund charges by nature more than a benchmark-near concept should do and for most fund selectors there is nothing wrong with this.”

But Morningstar’s methodology change runs the risk of “comparing apples with bananas” among these different type of actively managed funds, he says.

Changes to the methodology will begin to take effect from October 31.

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