


## Two Year Anniversary Report

# *Legalised Looting*

## How the UK Savings and Investment Industry Continues to Pickpocket £ Billions from British Savers and Investors

### Report including New UK / US Consumer Research

**2014**

Initiated by

scm PRIVATE
The Investment Family

# Contents


| | Page |
|---|---|
| 1. Executive Summary | 2 |
| 2. A Sample of Recent Scandals | 6 |
| 3. SCM Private - New UK / US Consumer Research Findings | 8 |
| 4. UK / US Fee and Holdings Transparency Comparisons | 12 |
| 5. Review of Latest Industry Voluntary Codes | 16 |
| 6. Conflicts of Interest and Other Alarming Practices | 19 |
| 7. Transparency on the Horizon | 26 |
| 8. Fee Transparency in the Pensions Industry | 29 |
| 9. The True and Fair Calculator | 31 |
| 10. Conclusion | 32 |

## 1. Executive Summary

This report reveals a plethora of scandalous practises directly resulting from inadequate regulation and low industry ethics resulting in British consumers having very little understanding of how much their savings or investments are costing or where exactly they are invested. This has led to a grossly inefficient system in which countless layers and excessive 'deductions' are legally appropriated from British investment and pension pots. Successive UK regulators continue to ignore these issues whilst their US counterparts have been proactive and since 2004 have forced investment companies to operate with independent boards to safeguard investor interests.

Standards in the US investment industry are dramatically higher compared to the UK industry due to significantly higher transparency, more competition, less conflicts of interest, and considerably lower charges.

The end result is that on a like for like basis UK investors pay 58% more than US investors, and UK investors receive just 6% of the vast fund management economies of scale, versus 33% in the US. The continued prominence and promotion of the Annual Management Charge (AMC) in terms of fees paid to fund managers is completely misleading. In reality the AMC typically accounts for less than half the total costs of investing. The true total cost of investing consumes 53% of investors' likely real returns.

Evidence given by the Financial Conduct Authority's Chief Executive, Martin Wheatley, to the Treasury Select Committee in February 2014 stated that overall charges were falling. But new research findings within this report show that charges have actually risen by 28% since unbundling commenced at the beginning of 2013.

The investment industry propagandises Alice in Wonderland like communications in which consumers cannot possibly decipher what is real and what is not. Even senior industry professionals admit they find the distinctions baffling. This is why the vast majority of UK consumers want to see their TOTAL charges in one number (73%) and even more now want this forced into law (86%).

In the UK savings and investment industry, £1.5 billion pa is being extorted through inflated transaction charges, £1.1 billion pa through over-charging the largest funds, and £ billions more in countless deductions, for example 'cuts' from clients bank interest and foreign exchange, amongst others.

Nothing will change until recently enacted EU legislation incorporated within MiFID II is introduced towards the end of 2016. Reprehensibly, the largest UK investment trade body, the Investment Management Association (IMA) is already attempting to foil the improved transparency this EU directive will afford UK consumers. In light of the above London continues to be the centre for almost every major financial scandal.

The recent changes announced in the Budget on 19th March 2014 will grant pensioners the freedom to escape the rip-off annuities market. But it will engender a new group of "innocent" trusting investors who will be exploited by the pensions and investment industry. Unless the Government swiftly brings in rules that will afford these investors the ability to make fully informed decisions, knowing all costs and fees, they will be jumping out of the frying pan into the fire. The only practical solution is genuine transparency that gives UK consumers the basic rights of knowing how much they are paying and where their money is invested. Without 100% transparency the government may have unwittingly substituted the annuities mis-selling scandal with a future mis-buying scandal.

## Findings from new research[1] conducted by SCM Private across the UK and US investment industries found:

*Consumer Findings*

- 73% of UK consumers want all costs and fees displayed in ONE number
- 86% of UK consumers want this requirement enshrined in law
- 89% of UK consumers wants to see their charges displayed in £ or £ and as a %
- 29% of UK investors do not know the charges relating to their investments *(This percentage may be much higher since the majority of investors wrongly believe that the AMC is their charge)*
- 45% of UK investors know the returns from their investments compared to 59% in the US
- If there was full transparency of fees, 26% of UK investors would save more
- The percentage of UK investors planning to invest the majority of their 2014 investment allocation via unit trusts/investment trusts/ETFs is a third of the US equivalent - 15% in the UK versus 45% in the US
- Fewer UK investors, 31%, seek professional advice before investing compared to those in the US, 48%.

## New Industry research Conducted by SCM Private reveals:

*Industry Findings*

- Unbundling of charges has ***increased fees by 28%*** on a like for like basis
- Based on the ***actual amounts invested and the actual overall fund charges paid,*** UK retail investors pay 58% more for 'active' equity funds than their US equivalent[2].
- The Total Cost of Investing for retail investors in the UK is typically ***2.7% pa*** which, based on the long-term real return of world equities[3], may result in ***53% of investors' real returns being consumed by charges***

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[1] Based on an independent online survey conducted by Research Plus Ltd on behalf of SCM Private. A total of 2,046 UK adults and 2,030 US adults aged 18 and over, were surveyed between 31st January and 5th February 2014

[2] SCM Private analysis of KIID ongoing charge using Morningstar data as at 10th March 2014 of 3,112 on UK GBP denominated, non-index, non-institutional share classes of retail funds investing in equities with total aum of £300 Bn – weighted by share class size, and US Annual Report Net Expense Ratio of 5,000 largest US$ denominated, non-index, non-institutional share classes of retail funds share classes investing in equities with total aum of £2,613 Bn – all weighted by share class size

[3] Credit Suisse Global Investment Returns Yearbook 2014

- Little evidence of price competition or economies of scale benefiting UK consumers. In the UK the largest sized funds charged ***just 6% less***[4] than smaller funds compared to ***33% less***[5] ***in the US.*** This is because US funds are run by independent boards, mandated to pass economies of scale back to investors
- If large UK retail 'active' funds were forced to pass on similar economies of scale back to consumers, the UK public would save **£1.14 billion** every year in equities funds alone[6]
- The latest individual fund Enhanced Disclosures are yet to be disclosed on a single consumer investment platform or on the IMA's own consumer website[7]. **Only 3 out of the 14 IMA Board members[8] representing individual companies appear to follow the IMA voluntary code in full**
- **The IMA, under the supposed independence of the Financial Reporting Council (FRC) have proposed a new form of cost disclosure[9] that in execution would fail to meet virtually every IMA claim because:**
  - it is not ONE number but 23
  - it is not in £ & pence but partly per unit and partly per transaction
  - it is not all the costs
- Furthermore it will be disclosed in a place rarely read by investors, the annual report and accounts, and in a format that breaches most of the FRC's own accounting principles[10]
- **Conflicts of interest are rife within Discretionary Private Client Portfolios** with 'cuts' from clients' bank interest, 'cuts' from foreign exchange, and profiteering from client related investment transactions
- The **AMC could be mistaken for standing for the Annual Management Con** since many investment platforms and fund groups appear to breach the IMA and FCA rules by excessively promoting this measure, rather than fuller measures of costs. This serves to perpetuate the false illusion to customers that the AMC represents their overall cost
- Transparency within pensions is even worse with the DWP's own 2014 report[11] revealing that within Direct Contribution (DC) schemes, **two thirds of the pension schemes didn't tell the trustees what their Total Expense Ratio was and over 87% of trustees didn't even know the rate at which their investments were being traded (PTR).**

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[4] SCM Private analysis of KIID ongoing charge using Morningstar data as at 10th March 2014 of 3,112 on UK GBP denominated, non-index, non-institutional share classes of retail funds investing in equities with total aum of £300 Bn, the average KIID charge of the top 25% share classes ranked by size was compared with the bottom 25%

[5] SCM Private analysis of Annual Report Net Expense Ratio of 5,000 largest US$ denominated, non-index, non-institutional share classes of retail funds share classes investing in equities with total aum of £2,613 Bn, the average Annual Report Net Expense Ratio of the top 25% share classes ranked by size was compared with the bottom 25%

[6] This figure has been calculated on the amounts invested in the top 25% of retail GBP active, non-index share classes of funds ranked by size and assuming that their average KIID ongoing charge was 33.34% less than the KIID ongoing charge of the bottom 25% of similar funds ranked by size, as is the case in the US

[7] http://www.investinginfunds.org/

[8] http://www.investmentfunds.org.uk/the-industry-and-ima/about-ima/exco/ima-board-members/ The IMA Enhanced Fund Disclosure code recommends that the underlying dealing spread between the buying and selling prices of the underlying investments be disclosed as a single %age value of each transaction

[9] http://www.investmentfunds.org.uk/policy-and-publications/sorp-2013/

[10] https://www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/FRS-102-The-Financial-Reporting-Standard-applicabl.aspx

[11] Landscape and Charges Survey 2013: Charges and quality in defined contribution pension schemes February 2014

In no other sector or industry would consumers be faced with the scenario of handing over their hard earned cash, when more often than not, they only have a faint understanding of the exact cost they are incurring. This disgraceful state of affairs is deep seated and continues in the UK savings and investment industry unchallenged.

SCM Private has calculated that in UK retail funds alone, double charging and 'cartel-like' pricing together are costing the public **£2.6 billion per annum**. Hidden costs and fees and lack of genuine transparency continue to be a major feature of the UK's savings and investment management industry.

This is an utter disgrace and it is becoming increasingly urgent that politicians and regulators deliver accountability, transparency and equitable charging structures and optimal returns to consumers.

The impact of hidden and inflated charges has been masked by double digit returns prior to the financial crisis in 2008. But in a single digit low return savings environment, they have a devastating impact on real returns.

In the March 2014 Budget Chancellor George Osborne announced sweeping changes to the annuity market. The Chancellor's intervention is a condemnation that the pensions industry could not put its own house in order and have been procrastinating for far too long.

But the Government needs to heed the warning that unless they fix the issue of lack of transparency of charges and holdings, they may have unwittingly substituted the mis-buying annuities scandal with a mis-buying investment scandal.

Concealing charges is morally reprehensible and is tantamount to looting.

## 2. A Sample of Recent Scandals

Most of the recent scandals revolve around the consumer not knowing how much money from their savings and investments are being mis-appropriated through various hidden fees. If FCA fines are the clearest indicator of overall consumer pick-pocketing, then we are at a new epidemic high as the total fined (£408m) over the last 12 months equalled over half the total fines for the previous 11 years (£752m)[12]. Either the industry is becoming more avaricious or the regulator is finally bringing down its hammer.

It is clear that self-regulation by the Association of British Insurers (ABI) and the IMA has been an unmitigated disaster. It is astonishing that the FCA still relies on these self-interested bodies to police their members and the industry.

**Secret Cuts from Foreign Exchange Dealings**[13] - *'FXCM, a US forex trading group, has been hit with a penalty for failing to pass on profits to clients as regulators crack down on retail foreign exchange markets. It also forced FXCM to compensate its UK retail customers with £6m for profits that have been withheld. In a time period stretching from August 2006 until December 2010, it failed to pass on profits generated from price movements between the time orders were placed by its UK arm and executed by another part of the group, the FCA said.'*

**Secretly getting clients to pay for fund manager meetings with companies**[14] - *'The UK regulator has found that at least six fund companies misused client money to pay brokers in order to arrange meetings with corporate chief executives in the past five years.The FCA, however, declined to disclose the names of the six fund companies concerned as this "could prejudice the commercial interests of each [group] were it to be made public". The regulator has previously stated that there will be no penalties for companies found to have breached the rules.*

**Secretly charging hidden fees on securities trades**[15] - *State Street's U.K. unit was fined £22.9 million for charging clients "substantial" mark-ups without their consent and "developed and executed a deliberate strategy" to charge undisclosed fees on top of agreed management or commission payments at a unit that helps institutions restructure their investments, the FCA said in an e-mailed statement. The hidden fees came on a service State Street provides to large customers such as asset managers and pension funds, helping them switch money between outside asset managers or when they restructure investments. In several instances, State Street executives quoted fixed fees to its clients, who were not identified in the FCA's statement, and then built in extra profit through undisclosed mark-ups on securities trades, according to the FCA.*

[12] FCA Fines Hit Half of FSA's 11 Year Total in 10 Months, IB Times, March 3, 2014
[13] Regulator penalises US forex trading group FXCM twice Financial Times February 26, 2014
[14] Six fund groups misused cash for access, Financial Times January 26, 2014
[15] State Street Fined $37.7 Million in U.K. for Hidden Fees, Bloomberg Jan 31, 2014

**Secretly breaching of terms and conditions**[16] - *Four million on alert for compensation after Aviva's £323 million merger blunder over breaches of terms and conditions whereby hundreds of technical errors which resulted in underpayments over a number of years, some totalling thousands of pounds affecting people with personal pension plans, workplace pensions, life insurance cover and savings. The probe uncovered a huge range of problems - wrong income tax rates had been used on pension plans, there were problems with how pensioners' savings had been invested, and some people had been told that the value of their funds would not lose money, when in fact they could. Among some of the worst affected were people who had taken out endowment plans under the brands Norwich Union and CGU, who may have lost up to 20 per cent of the value of their savings.*

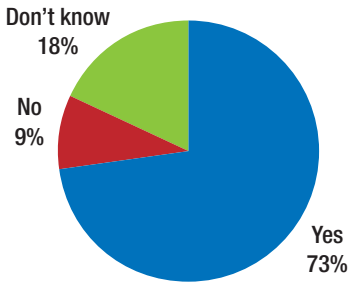
**Favouring particular clients on bond trades**[17]- *Aviva has said that the "improper" allocation of fixed income trades by two former employees has cost it more than £130 million and took place between 2006 and 2012. The breaches of dealing policy involved the late allocation of trades which favoured external hedge funds to the detriment of certain Aviva UK Life funds. The relevant regulatory authorities has been notified of the trades and the firm has brought in change to the internal controls of its dealing policy.*

[16] *Four million on alert for compensation after Aviva's £323million merger blunder* This is Money 8 February 2014
[17] Aviva takes £132m hit after 'improper' bond trades Fundweb 6 March 2014

## 3. SCM Private - New UK / US Consumer Research[18] Findings

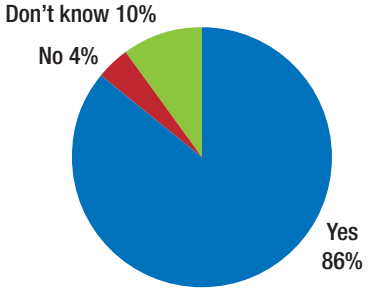
- Almost three quarters (73%) of UK consumers want costs and fees for investment and pension products displayed in one number:

**Those wanting all the costs and fees paid for investment and pension products displayed in one number**



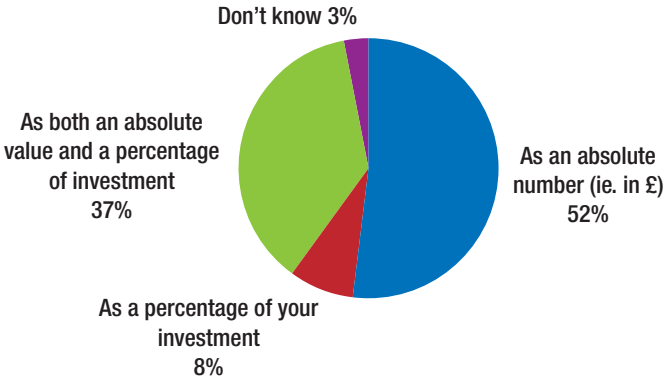

- Consumers do not trust the industry to bring in one number, and support a requirement for this to be enshrined in law

**Should UK financial services companies be legally required to fully disclose all costs and charges they levy on savings and investments in one number?**



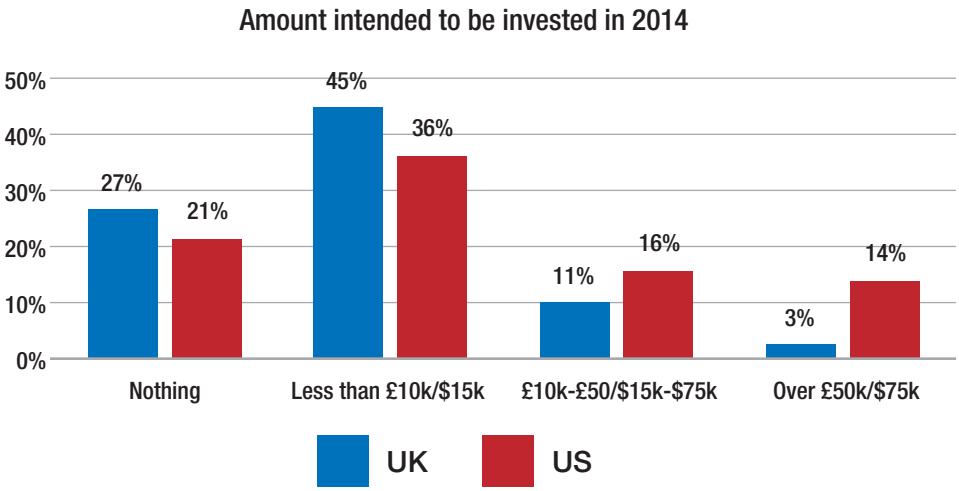

- The vast majority (89%) of UK investors want their costs & fees shown in pounds/pence whether just in £ or £ and as a %:

**How UK investors would like their investment and pension fees presented**

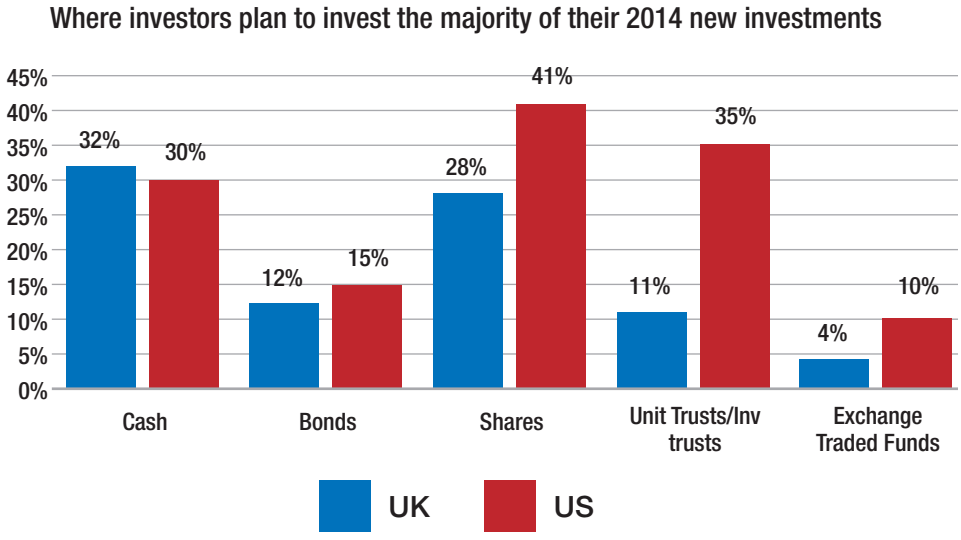



[18] Based on an independent online survey conducted by Research Plus Ltd on behalf of SCM Private. A total of 2,046 UK adults and 2,030 US adults aged 18 and over, were surveyed between 31st January and 5th February 2014

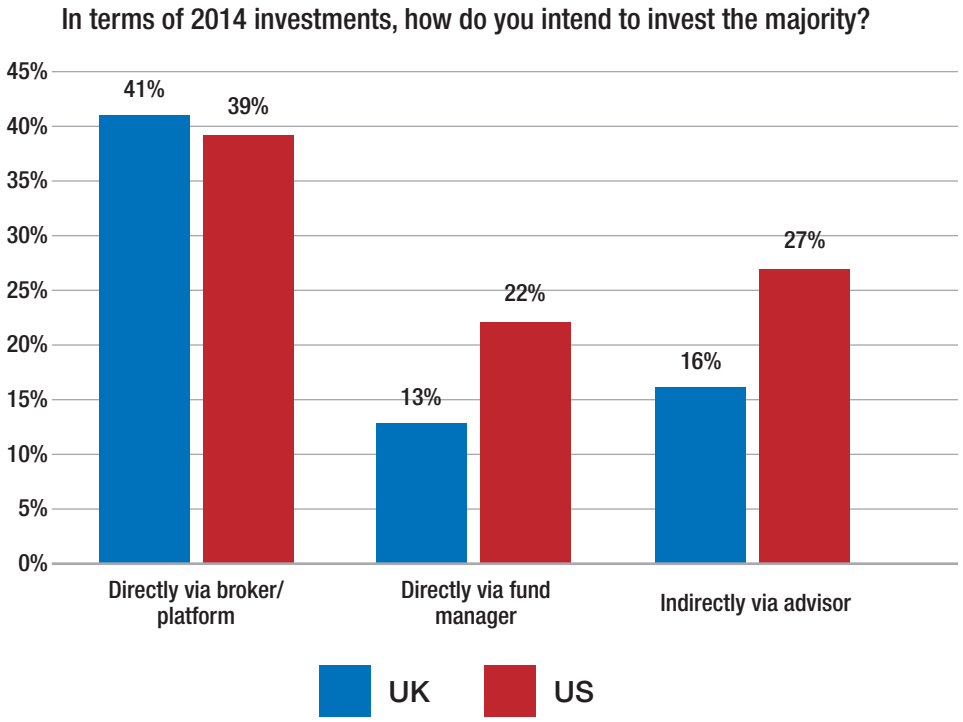
- Almost a third (29%) of UK investors do not know what fees they are being charged by their investment or pension fund manager
  *(In reality this percentage may be much higher since the majority of investors wrongly believe that the AMC is their charge)*
- Less than half (45%) of UK investors know the overall returns their investments are delivering in terms of income and capital growth
- Worryingly, around a quarter of consumers (27%) do not intend to invest anything in 2014
- If the regulator, the FCA, forced the UK investment industry to operate full transparency and clarity on ALL management and transaction fees, 26% of UK investors would invest more money into pensions and investment products
- US investors save much larger sums than their UK equivalent:



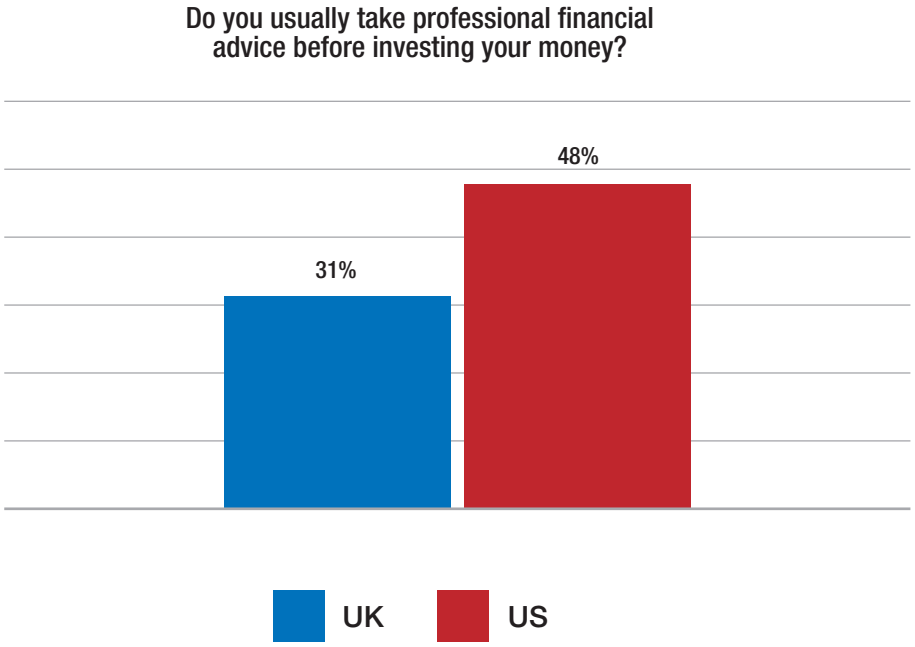

- US investors are three times more likely to invest via unit trusts / investment trusts ETFs than UK investors:



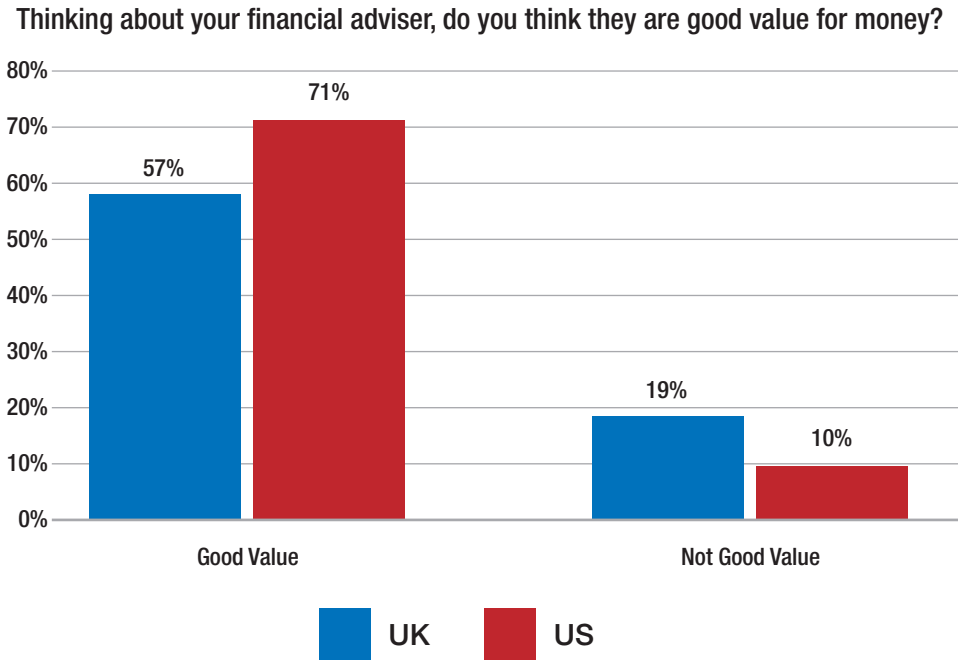
- US investors are much more likely to invest their 2014 allocations via a fund manager direct or an adviser, compared to UK investors



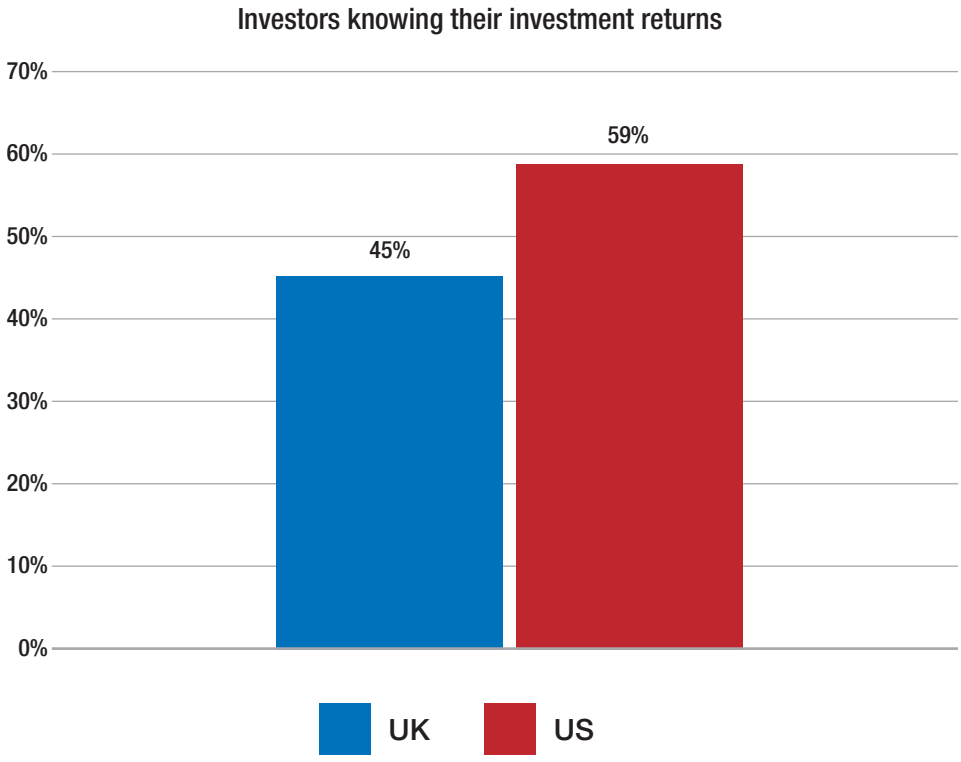

- US Investors much more likely to take financial advice before investing



- In the US, investors perceive their adviser as good value, and less as bad value than investors in the UK; although in absolute terms both in the UK and US perceptions of good value are still high.




- US investors are more likely to know how their investments were performing:



## 4. UK / US Fee and Holdings Transparency Comparisons

The FCA has claimed that the Retail Distribution Review (RDR) that came into force in January 2013 has improved transparency and reduced charges. Many UK consumers have been seduced into believing that they are somehow better off as their annual management charge (AMC) has come down from 1.5% pa to 0.75% pa, but what is the average fund cost actually paid by UK consumers? And how does this compare with the US?

The FCA Chief Executive, Martin Wheatley gave the following evidence to the Treasury Select Committee[19] in February 2014 regarding charges:

**Q44**

**Mark Garnier:** *The negatives that were being put forward to RDR is that it is increasingly difficult to access advice for the consumer, which we would agree; they have halved the number of banks that are participating in it and the total annual cost of ownership of a portfolio has in fact gone up to about 2% per annum, as opposed to being 1.5% per annum, because this is how the transparency of the cost had been rolled into long-term portfolios.*

***Martin Wheatley:*** *I do not recognise those percentages. What we have seen is -*

**Q45**

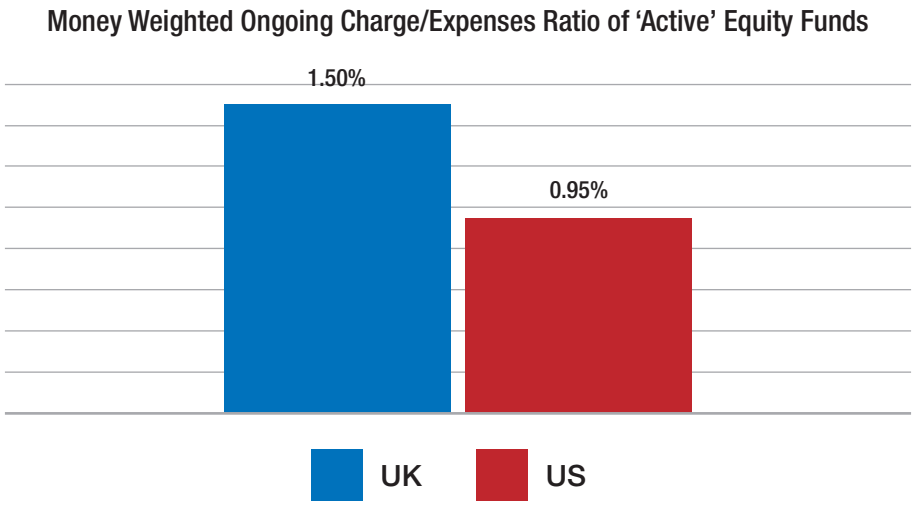
**Mark Garnier:** This is what the investment advisers were saying it is costing, so it used to cost you 1.5% of management fees to run a portfolio and now it is 2%.

***Martin Wheatley:*** *Again, my intelligence is that the funds are increasingly creating clean funds and super-clean funds that do not have bundled within them rebate charges that go back to the platform and then back to the individual. You get a very transparent charge of what you are paying to the fund manager. You get a transparent charge as to what you are paying for the adviser. You have seen in the last couple of weeks announcements from some of the big platforms, some of the funds, of pricing structures that they are introducing, which is bringing down the total cost of ownership, so the trend I think we are seeing is that those costs are coming down, but I accept entirely the point about the banks, the mass market withdrawal and what then happens to fill the advice need in that space. That is where, as John says, we are starting to see innovative models emerging in the market.*

**There are now countless share classes in the UK charging different fees. However, to date a comparatively small amount is invested in these 'clean' share classes so UK investors are still currently paying 58% more than their US counterparts[20].**

[19] *Treasury Committee Oral evidence: Financial Conduct Authority* Tuesday 4 February 2014, HC 1058

[20] SCM Private analysis of the KIID ongoing charge using Morningstar data as at 10th March 2014 of 3,112 on UK GBP denominated, non-index, non-institutional share classes of retail funds investing in equities with total aum of £300 Bn – all weighted by share class size, and US Annual Report Net Expense Ratio of 5,000 largest US$ denominated, non-index, non-institutional share classes of retail funds share classes investing in equities with total aum of £2,613 Bn – all weighted by share class size




The FCA could claim that the overall total cost ***will*** come down once more investors buy these new 'clean' share classes. However, to know the overall total cost requires investors to know the average 'clean' fund cost, the average platform cost, and the average adviser cost and the average underlying transaction costs. Once these charges are included, **RDR has turned out to be very costly for consumers as unbundling has resulted in charges increasing by 28% on a like for like basis (1.92% vs 1.5% pa):**

**COST OF INVESTING IN A TYPICAL EQUITIES FUND SOLD IN THE UK**

| | |
|---|---|
| Average 'clean' Annual Management Fee[21] | 0.75% pa |
| Average 'platform' cost[22] | 0.35% pa |
| Average annual 'adviser' cost[23] | 0.82% pa |
| **TOTAL OF ABOVE - *COMPARES WITH 1.5% pa PRE RDR*** | **1.92% pa** |
| Average Fund Custody/Administration costs[24] | 0.17% pa |
| Hidden transaction costs[25] | 0.41% pa |
| Average Initial Adviser charges of 2.4% annualised over a 10 year investment period[26] | 0.24% pa |
| **TOTAL COST OF INVESTING** | **2.74% pa** |

Furthermore, there is still no evidence of any economies of scale being passed back to consumers in the UK. In the US, since September 2004[27], the US Securities Exchange Commission (SEC) has required at least 75% of a mutual fund's board consist of independent directors and that the board chairman be independent. The fees for running the funds in the US are part of the advisory contract that directors review and approve every year.

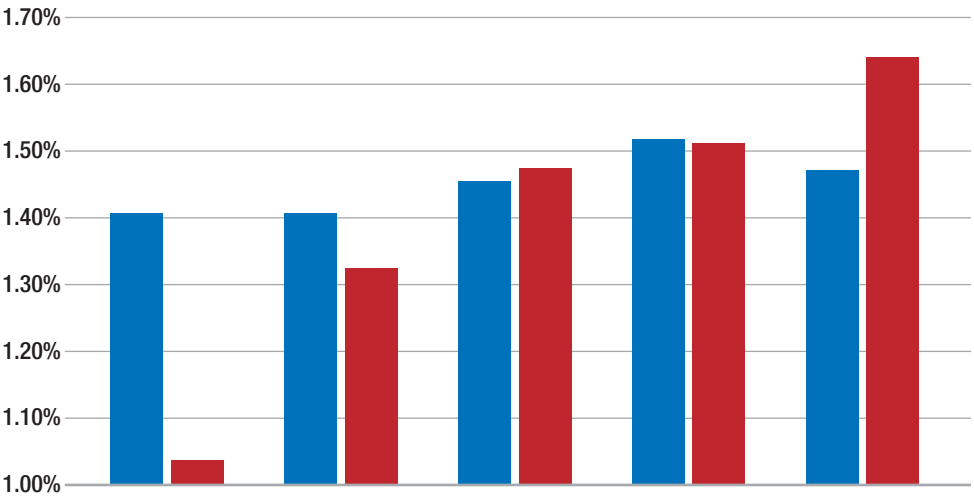
[21] March 5, 2014 Financial Times Isa guide 2014: Which provider? By Jonathan Eley
[22] Average ISA platform cost expressed as a percentage of a £50k portfolio across 17 major Direct to Consumer Platforms, Source: Tables: cheapest fund supermarkets for Isa investing Daily Telegraph 5th March 2014
[23] August 19 2013, FT Adviser Survey reveals advisers are charging lower initial fees, but are applying higher ongoing charge
[24] SCM Private analysis of difference between Annual Management Charge and KIID ongoing charge using Morningstar data as at 10 March 2014 of 3,112 on UK retail funds investing in equities with total aum of £300 Bn – all weighted by fund size
[25] Weighted average equities transaction cost of 0.67% * average Portfolio Turnover Rate of 61% pa as per assumptions http://www.trueandfaircalculator.com/content/files/assumptions/full-assumptions-calculations-explained-21may13.pdf
[26] August 19 2013, FT Adviser Survey reveals advisers are charging lower initial fees, but are applying higher ongoing charge
[27] Securities and Exchange Commission 17 cfr part 270 investment company governance under the Investment Company Act of 1940 Effective Date: September 7, 2004

In the fee approval process, these independent directors often force fund management companies to take initiative to reduce fees, for example instituting breakpoints at specified asset levels, waiving fees, reducing fees outright, or enhancing services. This leads to large mutual funds in the US being forced to return some of their substantial economies of scale back to investors through lower fees.

**In the UK, there is no evidence of price competition or economies of scale benefiting investors. In the UK the largest sized funds actually charged *just 6% less*[28] than the smallest funds. This contrasts with the US where funds charge *33% less*[29] than the smallest funds.**

Splitting the UK and US funds into five sized bands reveals a clear correlation between fund size and fees in the US.

Relationship between size of fund and charges




| | 1st Quintile Funds (largest 20%) | 2nd Quintile (next 20%) | 3rd Quintile (next 20%) | 4th Quintile (next 20%) | 5th Quintile (smallest 20%) |
|---|---|---|---|---|---|
| UK | 1.41% | 1.41% | 1.46% | 1.52% | 1.47% |
| US | 1.04% | 1.32% | 1.48% | 1.51% | 1.64% |

**This is clear evidence that the UK retail fund management industry is behaving as a cartel, acting against the public interest; and that a full Office of Fair Trading (OFT) investigation may be warranted.**

[28] SCM Private analysis of KIID ongoing charge using Morningstar data as at 10th March 2014 of 3,112 on UK GBP denominated, non-index, non-institutional share classes of retail funds investing in equities with total aum of £300 Bn, the average KIID charge of the top 25% share classes ranked by size was compared with the bottom 25%

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## Discretionary Fund Managers

In the world of discretionary fund management, understanding total costs and fees is no less confusing.

Numis Securities[30] recently conducted analysis based on a portfolio of £120,000. It looked at charges for discretionary portfolio management within 10 firms - Barclays Wealth, Brewin Dolphin, Coutts, Hargreaves Lansdown, Investec, Killik, Rathbones, Raymond James, St. James's Place and Towry. The total charges ranged from 1.7 to 7.5% pa even though these figures excluded any transaction costs incurred within the underlying funds within many of the portfolios.

**The average charge within the Numis table below was 3.24% pa. If the True and Fair Campaign's estimate of the undisclosed transaction costs within a typical fund of 0.41% pa[31] is added, this brings the full average total cost to 3.64% pa.**

| Advisory/Discretionary Managers | Total % pa |
|---|---|
| Barclays Wealth (1 year holding period) | 6.55 |
| Barclays Wealth (3 year holding period) | 3.88 |
| Barclays Wealth (6 year holding period) | 3.22 |
| Barclays Wealth (20 year holding period) | 2.75 |
| Brewin Dolphin Discretionary (fee only model) | 2.16 |
| Coutts (1 year holding period) | 3.77 |
| Coutts (3 year holding period) | 3.10 |
| Coutts (6 year holding period) | 2.93 |
| Coutts (20 year holding period) | 2.82 |
| Hargreaves Lansdown Portfolio Mgmt. Service | 1.74 |
| Investec Portfolio Management Service | 2.98 |
| Killik Discretionary | 3.04 |
| Rathbones Discretionary | 2. 31 |
| Raymond James | 1.91 |
| St. James's Place Advisory (1 year holding period) | 7.48 |
| St. James's Place Advisory (3 year holding period) | 3.10 |
| St. James's Place Advisory (6 year holding period) | 2.16 |
| St. James's Place Advisory (20 year holding period) | 1.94 |
| Towry (1 year holding period) | 4.30 |
| Towry (3 year holding period) | 3.30 |
| Towry (6 year holding period) | 3.05 |
| Towry (20 year holding period) | 2.88 |

Based on the long-term real return of world equities from 1900-2013 of 5.2%[32] pa, ***UK retail investors investing in equity funds are likely to be paying out 53% of their real returns through various charges and those employing discretionary wealth managers, an astonishing 70% of their real returns.***

[30] How much are they charging? New research reveals what the big firms cost 13 February 2014 http://www.fundweb.co.uk/news-and-analysis/wealth-management/how-much-are-they-charging-new-research-reveals-what-the-big-firms-cost/2006646.article

[31] Weighted average equities transaction cost of 0.67% * average Portfolio Turnover Rate of 61% pa as per assumptions http://www.trueandfaircalculator.com/content/files/assumptions/full-assumptions-calculations-explained-21may13.pdf

[32] Credit Suisse Global Investment Returns Yearbook 2013

## 5. Review of The Latest Industry Voluntary Codes

The investment industry appears to be taking steps to put its own house in order through various voluntary codes. For many years part of the transaction costs were buried away within obscure notes found in the annual fund reports.

Many industry trade bodies have claimed that transaction costs do not affect performance. But a recent academic paper published in The Economist in April 2013 entitled *"Don't just do something, sit there"* [33] - drawing on an academic paper[34] found hidden costs were, on average, higher than the funds' declared expenses and had a significant negative impact on returns. **The study found that the funds with the highest trading costs produced the lowest return; with those in the lowest 20% ranked by trading costs beating the 20% of funds with the highest trading costs by 1.8% per annum.**

The Economist concluded that a possible explanation for this expensive hyper-activity by some fund managers was that:
*"Professional managers have little reason to care, because the full cost of their trading activities is not revealed. Clients will discover that hyperactivity leads to underperformance only after they have invested, and that is too late."*

Despite years of denial of any hidden costs existing in investment management, the IMA announced in September 2012 a new Enhanced Fund Disclosure Voluntary Code[35] which it claimed would, *'help consumers better understand fund charges and costs and is intended to sit alongside and complement existing regulatory requirements. IMA today also launches its new website guide to charges and costs.'*

However, the sad truth is that the IMA's own new consumer website does not show any individual fund enhanced fund disclosures[36], nor does a single industry consumer platform, or a single data provider.

Often the largest element within transaction costs is the dealing spread between the buying and selling prices of the underlying investments, whilst the example in the IMA code recommends displaying *'the estimated average dealing spread for this fund is [ ]% of the transaction value.'*

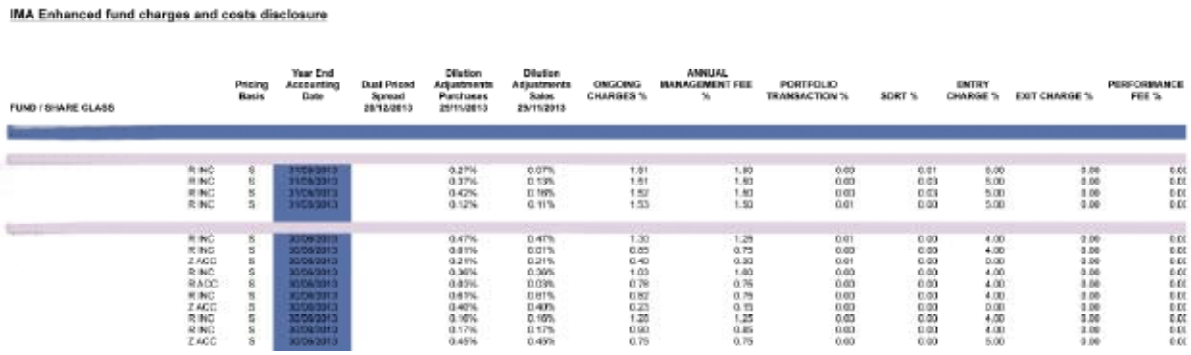
**We could only find 3 out of the 14 IMA Board members[37] companies that show this underlying dealing spread as a single number.** One IMA board member does not follow any part of the voluntary code at all. Another IMA board member explained why their company does not follow this code,

[33] http://www.economist.com/news/finance-and-economics/21576683-fund-managers-trade-too-much-retail-investors-can-learn-not-dont-just-do
[34] *"Shedding Light on 'Invisible' Costs: Trading Costs and Mutual Fund Performance"*, by Roger Edelen, Richard Evans and Gregory Kadlec, Financial Analysts Journal, Volume 69, Number 1
[35] http://www.investmentfunds.org.uk/assets/files/industry-guidance/20120920-enhanceddisclosureoffundchargesandcosts.pdf
[36] http://www.investinginfunds.org/
[37] http://www.investmentfunds.org.uk/the-industry-and-ima/about-ima/exco/ima-board-members/ The IMA Enhanced Fund Disclosure code recommends that the underlying dealing spread between the buying and selling prices of the underlying investments be disclosed as a single %age value of each transaction

*'One of the challenges with a "voluntary" disclosure is that there are no standards for calculating the data. Thus, different methodologies can produce very different results that may confuse rather than help investors. So, it would be nice if all members disclosed under a standard methodology.'*

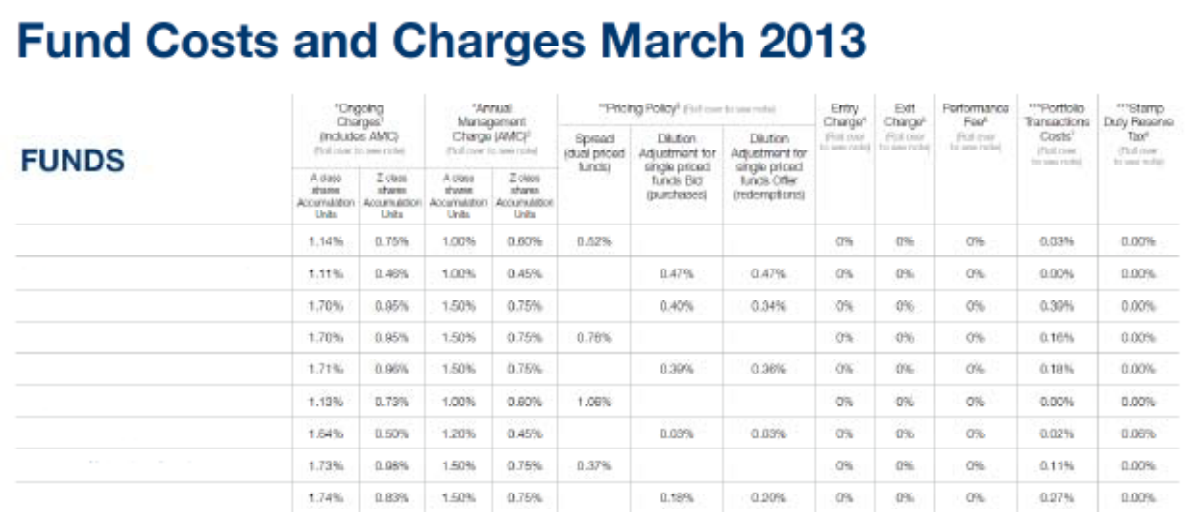
Even if fund managers were to correctly follow the code, the data is practically meaningless since it states the cost per transaction without telling you how many transactions took place. In a major anti-consumer move, this statistic (known as the PTR) is no longer mandated by the IMA since June 2012. It is akin to being told by an airline how much you would be paying per mile but not telling you the number of miles travelled.

As can be seen from the screenshots below, these disclosures are incomprehensible and have no sum totals but a myriad of individual numbers. The examples below have had their fund names removed as it would be unfair to single out any one group as this practice is so widespread.



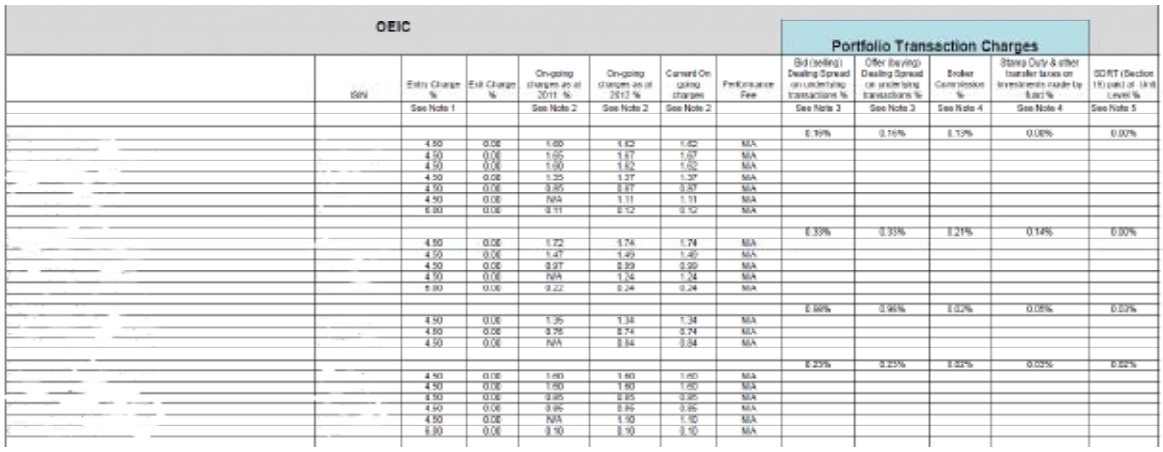
IMA Enhanced fund charges and costs disclosure

| FUND / SHARE CLASS | Pricing Basis | Year End Accounting Date | Dual Priced Spread 28/12/2013 | Dilution Adjustments Purchases 25/11/2013 | Dilution Adjustments Sales 25/11/2013 | ONGOING CHARGES % | ANNUAL MANAGEMENT FEE % | PORTFOLIO TRANSACTION % | SDRT % | ENTRY CHARGE % | EXIT CHARGE % | PERFORMANCE FEE % |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| R INC | S | 31/05/2013 | 0.27% | 0.07% | 1.81 | 1.80 | 0.00 | 0.01 | 5.00 | 0.00 | 0.00 |
| R INC | S | 31/05/2013 | 0.37% | 0.13% | 1.61 | 1.60 | 0.00 | 0.00 | 5.00 | 0.00 | 0.00 |
| R INC | S | 31/05/2013 | 0.42% | 0.16% | 1.52 | 1.50 | 0.01 | 0.00 | 5.00 | 0.00 | 0.00 |
| R INC | S | 31/05/2013 | 0.12% | 0.11% | 1.53 | 1.50 | 0.01 | 0.00 | 5.00 | 0.00 | 0.00 |
| R INC | S | 30/09/2013 | 0.47% | 0.47% | 1.30 | 1.25 | 0.01 | 0.00 | 4.00 | 0.00 | 0.00 |
| R INC | S | 30/09/2013 | 0.81% | 0.01% | 0.85 | 0.75 | 0.00 | 0.00 | 4.00 | 0.00 | 0.00 |
| Z ACC | S | 30/09/2013 | 0.21% | 0.21% | 0.40 | 0.30 | 0.01 | 0.00 | 0.00 | 0.00 | 0.00 |
| R INC | S | 30/09/2013 | 0.36% | 0.36% | 1.03 | 1.00 | 0.00 | 0.00 | 4.00 | 0.00 | 0.00 |
| R ACC | S | 30/09/2013 | 0.03% | 0.03% | 0.78 | 0.75 | 0.00 | 0.00 | 4.00 | 0.00 | 0.00 |
| R INC | S | 30/09/2013 | 0.81% | 0.81% | 0.82 | 0.79 | 0.00 | 0.00 | 4.00 | 0.00 | 0.00 |
| Z ACC | S | 30/09/2013 | 0.40% | 0.40% | 0.23 | 0.15 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| R INC | S | 30/09/2013 | 0.16% | 0.16% | 1.28 | 1.25 | 0.00 | 0.00 | 4.00 | 0.00 | 0.00 |
| R INC | S | 30/09/2013 | 0.17% | 0.17% | 0.90 | 0.85 | 0.00 | 0.00 | 4.00 | 0.00 | 0.00 |
| Z ACC | S | 30/09/2013 | 0.49% | 0.49% | 0.75 | 0.75 | 0.00 | 0.00 | 5.00 | 0.00 | 0.00 |



# Fund Costs and Charges March 2013

| FUNDS | "Ongoing Charges" (includes AMC) (Roll over to see note) | | "Annual Management Charge (AMC)" (Roll over to see note) | | "Pricing Policy" (Roll over to see note) | | | Entry Charge (Roll over to see note) | Exit Charge (Roll over to see note) | Performance Fee (Roll over to see note) | "Portfolio Transactions Costs" (Roll over to see note) | "Stamp Duty Reserve Tax" (Roll over to see note) |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | A class shares Accumulation Units | Z class shares Accumulation Units | A class shares Accumulation Units | Z class shares Accumulation Units | Spread (dual priced funds) | Dilution Adjustment for single priced funds Bid (purchases) | Dilution Adjustment for single priced funds Offer (redemptions) | | | | | |
| | 1.14% | 0.75% | 1.00% | 0.60% | 0.52% | | | 0% | 0% | 0% | 0.03% | 0.00% |
| | 1.11% | 0.46% | 1.00% | 0.45% | | 0.47% | 0.47% | 0% | 0% | 0% | 0.00% | 0.00% |
| | 1.70% | 0.95% | 1.50% | 0.75% | | 0.40% | 0.04% | 0% | 0% | 0% | 0.39% | 0.00% |
| | 1.70% | 0.95% | 1.50% | 0.75% | 0.76% | | | 0% | 0% | 0% | 0.16% | 0.00% |
| | 1.71% | 0.96% | 1.50% | 0.75% | | 0.39% | 0.36% | 0% | 0% | 0% | 0.18% | 0.00% |
| | 1.13% | 0.73% | 1.00% | 0.60% | 1.06% | | | 0% | 0% | 0% | 0.00% | 0.00% |
| | 1.64% | 0.50% | 1.20% | 0.45% | | 0.03% | 0.03% | 0% | 0% | 0% | 0.02% | 0.06% |
| | 1.73% | 0.98% | 1.50% | 0.75% | 0.37% | | | 0% | 0% | 0% | 0.11% | 0.00% |
| | 1.74% | 0.83% | 1.50% | 0.75% | | 0.18% | 0.20% | 0% | 0% | 0% | 0.27% | 0.00% |



| OEIC | | | | | | | | Portfolio Transaction Charges | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | SEDOL | Entry Charge % | Exit Charge % | On-going charges as at 2011 % | On-going charges as at 2012 % | Current On-going charges | Performance Fee | Bid (selling) Dealing Spread on underlying transactions % | Offer (buying) Dealing Spread on underlying transactions % | Broker Commission % | Stamp Duty & other transfer taxes on investments made by fund % | SDRT (Section 19) paid at Unit Level % |
| | | See Note 1 | | See Note 2 | See Note 2 | See Note 2 | | See Note 3 | See Note 3 | See Note 4 | See Note 4 | See Note 5 |
| | | | | | | | | 0.19% | 0.16% | 0.13% | 0.08% | 0.00% |
| | | 4.50 | 0.00 | 1.66 | 1.63 | 1.62 | NIL | | | | | |
| | | 4.50 | 0.00 | 1.65 | 1.67 | 1.67 | NIL | | | | | |
| | | 4.50 | 0.00 | 1.60 | 1.62 | 1.62 | NIL | | | | | |
| | | 4.50 | 0.00 | 1.35 | 1.37 | 1.37 | NIL | | | | | |
| | | 4.50 | 0.00 | 0.85 | 0.87 | 0.87 | NIL | | | | | |
| | | 4.50 | 0.00 | N/A | 1.11 | 1.11 | NIL | | | | | |
| | | 5.00 | 0.00 | 0.11 | 0.12 | 0.12 | NIL | | | | | |
| | | | | | | | | 0.33% | 0.33% | 0.21% | 0.14% | 0.00% |
| | | 4.50 | 0.00 | 1.72 | 1.74 | 1.74 | NIL | | | | | |
| | | 4.50 | 0.00 | 1.47 | 1.49 | 1.49 | NIL | | | | | |
| | | 4.50 | 0.00 | 0.97 | 0.99 | 0.99 | NIL | | | | | |
| | | 4.50 | 0.00 | N/A | 1.24 | 1.24 | NIL | | | | | |
| | | 5.00 | 0.00 | 0.22 | 0.24 | 0.24 | NIL | | | | | |
| | | | | | | | | 0.88% | 0.96% | 0.12% | 0.05% | 0.03% |
| | | 4.50 | 0.00 | 1.35 | 1.34 | 1.34 | NIL | | | | | |
| | | 4.50 | 0.00 | 0.75 | 0.74 | 0.74 | NIL | | | | | |
| | | 4.50 | 0.00 | N/A | 0.84 | 0.84 | NIL | | | | | |
| | | | | | | | | 0.25% | 0.25% | 0.02% | 0.02% | 0.02% |
| | | 4.50 | 0.00 | 1.60 | 1.60 | 1.60 | NIL | | | | | |
| | | 4.50 | 0.00 | 1.60 | 1.60 | 1.60 | NIL | | | | | |
| | | 4.50 | 0.00 | 0.95 | 0.95 | 0.95 | NIL | | | | | |
| | | 4.50 | 0.00 | 0.95 | 0.95 | 0.95 | NIL | | | | | |
| | | 4.50 | 0.00 | N/A | 1.10 | 1.10 | NIL | | | | | |
| | | 5.00 | 0.00 | 0.10 | 0.10 | 0.10 | NIL | | | | | |

The ABI has issued similar empty rhetoric and sound bites on this subject. Despite the public support by the ABI for this code in September 2012, to date (18 months later) it is yet to produce any recommended code for pensions. The ABI stated[38] that it would push for transparency of charges for pensions including transaction costs by the end of 2012. Again nothing has appeared. An ABI spokesperson said at the time[39],

*'The Association of British Insurers will not force its membership to improve pension charges disclosure as it presses The Pensions Regulator and the FSA to produce joint guidance covering contract and trust-based schemes.*

*Last month, ABI director general Otto Thoreson wrote to TPR and the FSA calling for an industry agreed protocol to make the costs associated with pension saving more transparent, including the disclosure of all transaction costs.'*

The ABI and the IMA have both claimed that it would be misleading to add the transaction charges to the annual management charges. This is vehemently contested by L&G[40] who have stated,

*"I would like to challenge the message that transaction costs are somehow different from other administration costs because they are for the good of the member. As a pensions administrator I find this quite insulting. I feel that what I do as an administrator is good for members and I charge for that, but I try to keep those costs right down. I cannot see why transaction costs are any different from that. In the same way an administrator spends money for the members' benefit, investment managers incur transaction costs for the members' benefit. I think they should be disclosed in exactly the same way as other charges and we should try to squeeze all those charges to the lowest possible level."*

Despite the NAPF[41] making identical recommendations to the IMA and ABI in its joint industry code of conduct document (the Society of Pension Consultants, or SPC, was also a signatory of the paper), we are not aware of a SINGLE pension scheme disclosing their costs in this recommended format.

[38] http://www.moneymarketing.co.uk/news-and-analysis/latest-news/abi-pushes-for-charge-disclosure-protocol-by-year-end/1056783.article
[39] http://www.moneymarketing.co.uk/pensions/abi-not-our-job-to-enforce-charge-disclosure-changes/1057285.article
[40] http://www.moneymarketing.co.uk/news-and-analysis/pensions/ima-and-lg-clash-over-transaction-costs/2002690.article
[41] http://www.napf.co.uk/PolicyandResearch/DocumentLibrary/0273_Pensions_charges_made_clear_code_of_Conduct.aspx

## 6. Conflicts of Interest and Other Alarming Practises

### Annual Management Charge – the Classic Con

The consensus within the investment industry itself is that the AMC is a useless guide to the overall cost of investments and pensions, yet the industry and the consumer platforms publicise little else.

The effect is that most consumers wrongly think the AMC represents their charges. Even though the original report on fees and charges commissioned by the then FSA in 2000[42] found that 50% of charges were hidden, to date, 14 years later, neither the investment industry nor the FCA has forged any practical solutions or changes to correct this complete misnomer. The effect is that the industry continues to pull the wool over customer's eyes.

In September 2012 the IMA[43] recommended that, *'However, wherever the annual management charge is given in marketing material, factsheets and so on, the ongoing charges should be presented with at least equal prominence'.*

Whilst the FCA[44] guiding principles state that promotions should be, *'Fair, clear and not misleading communications'.*

### Platforms

So far in 2014, there has been a huge amount of sabre rattling as the various consumer platforms announce their new fund charges, new post RDR lists of clean funds and recommended fund lists. But they all have, including the largest consumer platform Hargreaves Lansdown, announced new unbundled pricing of funds[45], which have tended to place emphasis on the average AMC of these funds rather than the Total Expense Ratio or Ongoing Charge in their key announcements.

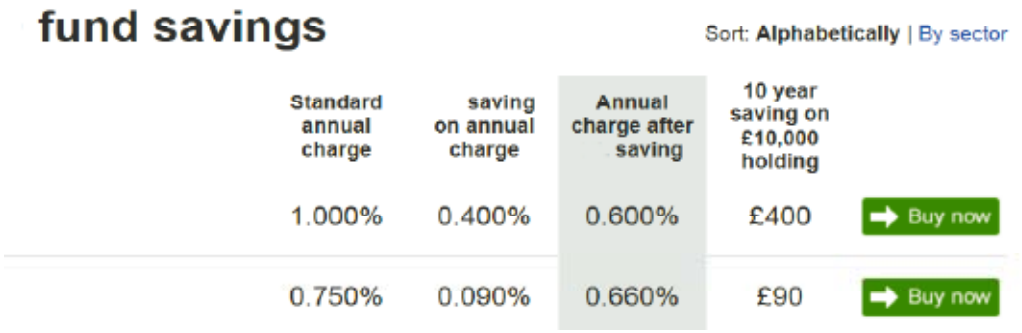
Hargreaves Lansdown Retail Distribution Review Pricing announcement stated,

*"We are pleased to announce that following successful negotiations with fund management groups Hargreaves Lansdown clients will be able to benefit from lower fund annual management charges (AMCs), particularly for funds on the Hargreaves Lansdown Wealth 150 list, from 1 March 2014. From 1 March 2014 the average AMC for a Wealth 150 fund will fall to approximately 0.65%."*

[42] The Price of Retail Investing in the UK, Kevin R James, FSA Occasional Paper Series 6, February 2000
[43] Enhanced Disclosure of Fund Charges and Costs September 2012
[44] *http://fshandbook.info/FS/html/handbook/COBS/4/2*
[45] http://m.londonstockexchange.com/exchange/mobile/news/detail.html?announcementId=11833831

Below are examples of charges information from three well known platforms and two well-known fund groups in which only the AMC, rather than the Ongoing Charge, is displayed on a key page. Again the platform / fund names have been removed as it would be unfair to single out any one group as this practice is so widespread:

Platform Example 1



**fund savings**

Sort: **Alphabetically** | By sector

| Standard annual charge | saving on annual charge | Annual charge after saving | 10 year saving on £10,000 holding | |
|---|---|---|---|---|
| 1.000% | 0.400% | 0.600% | £400 | Buy now |
| 0.750% | 0.090% | 0.660% | £90 | Buy now |

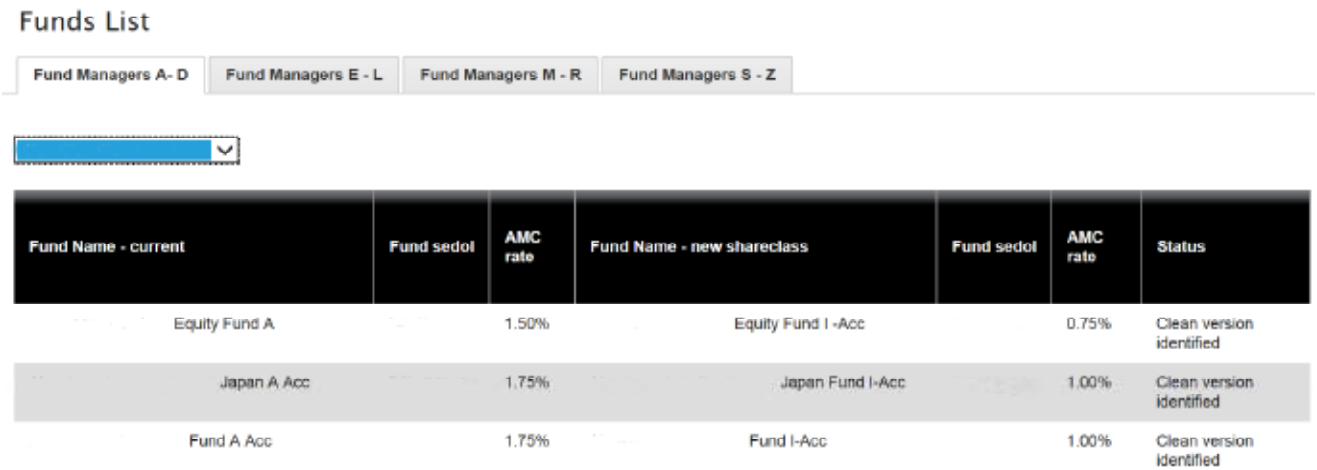
Platform Example 2



**Regular ISA Saver – clear & transparent pricing**

| | | | |
|---|---|---|---|
| Initial Charge: (Charge levied on investing) | **0%** | Annual Management Charge* (AMC): | **0.69%** |
| | | Service Fee**: | **0.25%** |
| Purchase Fee (lump sum): | **£40** | Minimum Investment (£): | |
| Purchase Fee (monthly): | **£8** | Lump Sum : **£200** | Monthly : **£200** |

Platform Example 3



Funds List

Fund Managers A- D | Fund Managers E - L | Fund Managers M - R | Fund Managers S - Z

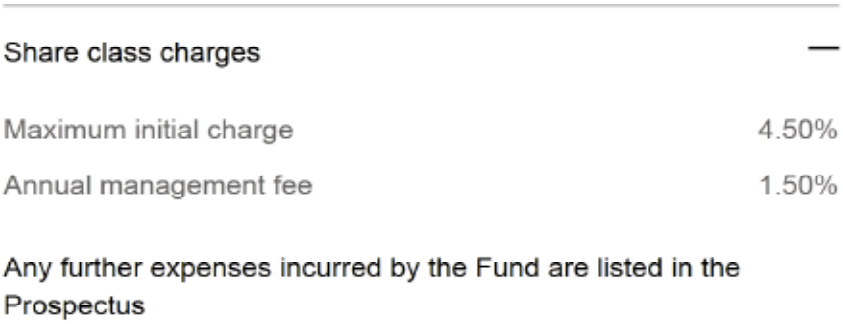
| Fund Name - current | Fund sedol | AMC rate | Fund Name - new shareclass | Fund sedol | AMC rate | Status |
|---|---|---|---|---|---|---|
| Equity Fund A | | 1.50% | Equity Fund I -Acc | | 0.75% | Clean version identified |
| Japan A Acc | | 1.75% | Japan Fund I-Acc | | 1.00% | Clean version identified |
| Fund A Acc | | 1.75% | Fund I-Acc | | 1.00% | Clean version identified |

Fund Group Example 1



| Fund Charges - INC as at 31.01.2014 | |
|---|---|
| Initial Charge (Up to) | 5.00% |
| AMC | 1.50% |
| Performance Fee | 0.00% |

Fund Group Example 2



| Share class charges | — |
|---|---|
| Maximum initial charge | 4.50% |
| Annual management fee | 1.50% |

Any further expenses incurred by the Fund are listed in the Prospectus

In February 2014, Invesco[46] announced that in future it would report the equivalent to the 'Ongoing Charge' rather than the Annual Management Charge. The implication was clearly that it thought this was a much fairer way to present its charges. So far no other major competitor has followed suit. BUT these are still not all the charges.

## Research Commissions – Double Paying Fund Managers For The Same Job – At An Annual Cost of £1.5 billion pa

Consumers believe that the AMC pays for the fund manager to research the best stocks or bonds to achieve their return goals. But the truth is that fund managers have been allowed by the regulator to charge once for selecting investments via the AMC and again through inflated dealing commissions paid to stockbrokers. These extra payments are borne by clients rather than fund managers and inflate many fund manager's profits by shielding them from significant direct costs.

**According to the FCA themselves[47], £1.5 billion** is being deducted in dealing charges from UK funds to pay for these research services. Whilst the FCA is currently consulting on changes in this area, they have shied away from abolishing the practise completely which is very disappointing. Cosmetic changes will tempt fund managers to find ways of evading the new rules by simply reclassifying the research to fit the new guidelines.

[46] http://www.invescoperpetual.co.uk/portal/site/ip/contentDetail?contentId=e3e1e9c0bb364410VgnVCM100000c1f1bf0aRCRD&title=Changing-the-way-fees-are-applied-to-our-Investment-Company-with-Variable-Capital-%28ICVC%29-fund-range

[47] http://www.fca.org.uk/news/fca-proposes-new-rules-on-dealing-commission-for-investment-managers

According to SCM Private research[48], active fund managers are typically paying their brokers five times the rate that passive fund managers pay, in order to obtain this 'free' research.

There will always be a significant conflict of interest through research being paid by commissions that come from the fund rather than the fund management company itself. The IMA in its recent response to the FCA consultation falsely claimed that there was some alignment of interest that mitigates this conflict as any extra commission paid would reduce performance.

However, basic maths reveal this to be totally untrue as if a typical fund manager turns over their fund at 50% pa and pays 0.1% rather than 0.02% commission, the fund would pay an extra 0.04% pa. This would have very little impact on its rankings in any league table and therefore sales. However, given a typical fund manager operates on 30%+ operating margins and a typical fee is 0.5%+ pa, we can see this extra 0.04% pa is boosting the fund manager's profits by 27%+ in this example. There is therefore precious little alignment of interest as falsely claimed by the IMA.

Furthermore, much of this £1.5 billion research is completely wasted since it is rarely read[49] - 38% of analysts had not read any of their analyst research documents. The 26,000 research reports produced by 33 investment banks, brokers and independent groups, were found to be opened by just 6% of recipients. Such wasted duplication incurs unnecessary costs which come directly from clients pockets.

[48] Financial Times March 10, 2013 UK funds dumping up to £1bn of costs http://www.ft.com/cms/s/2/8a27bce8-8738-11e2-9dd7-00144feabdc0.html#axzz2uBdQS2Pf

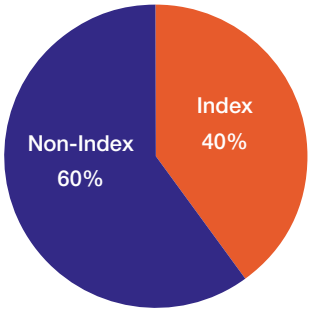
[49] Financial Times, December 15, 2013 Expensive research is not being read http://www.ft.com/cms/s/0/be5cdd68-63f6-11e3-98e2-00144feabdc0.html?siteedition=uk#axzz2uBdQS2Pf

## The UK Closet Indexation Epidemic

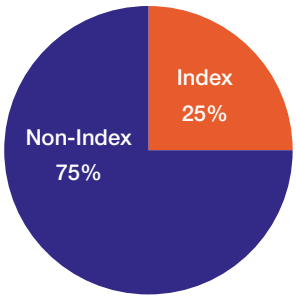
A report by SCM Private in September 2013 entitled **'Closet Indexing - A UK epidemic'**[50] revealed what many insiders have known for years - that many retail funds pretend to be different but in reality are simply expensive 'clones' of the overall market.

- In a typical UK equity fund, investors can expect 40% of the portfolio to be a clone of the index compared to 25% in the US. These funds' fees are often at three times the fees of a typical index fund.

Typical UK Equity Fund

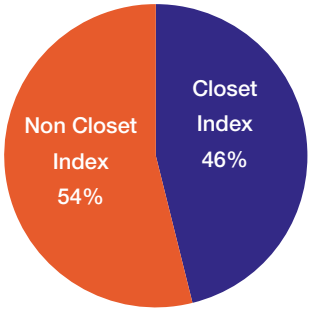



Typical US Equity Fund

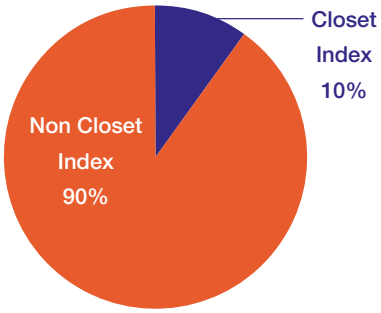



- Nearly half the UK equity funds analysed - 46%, were found to be 'closet indexers'[51] versus 10% in the US.

UK Fund Industry




US Fund Industry




- The vast majority, 88%, of the funds in which most of the fund was found to clone the index (i.e. active share under 50%), under-performed over the last five years.
- Applying a typical Annual Management Charge (AMC) of 1.5% to the part of the fund actually different to the market, suggests investors are really paying nearly 4% per annum for the active part of their investments.

As far back as 2004 US funds have been required to publish their portfolio holdings quarterly, via the internet[52]. In the UK, most clients only see their full portfolio holdings once a year and via the post, rather than displayed on-line.

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[50] Fin http://www.scmprivate.com/content/file/researchreports/closet-indexation-report-sept-13-full.pdf

[51] H K.J. Martijn Cremers and Antti Petajisto, "How Active Is Your Fund Manager? A New Measure That Predicts Performance, Working Paper, Yale School of Management, March 31, 2009. They define potential 'closet indexers' as those funds with 60% or less active share

[52] SEC Adopts Enhanced Mutual Fund Expense and Portfolio Disclosure; Proposes Improved Disclosure of Board Approval of Investment Advisory Contracts and Prohibition on the Use of Brokerage Commissions to Finance Distribution, Washington, D.C. Feb. 11, 2004

## UK Discretionary Fund Managers Dealing Rates - Often Dealing At Twenty Times the Normal Rate

So far the FCA has not addressed the significant conflict of interest related to dealing costs within UK discretionary portfolios. In addition to the various charges clients are also charged fees that are typically 1% on each trade.

Independent research described the typical discretionary fund manager dealing fees[53] as *"The added costs of dealing cover stamp duties, brokerage, and admin. Can be based on percentage of trade sums, or fixed towards each transaction. Typically £10-£80 or 0.25% - 1.25% per transaction. Often reduced as trade amounts increase -*

- *Dealing in foreign securities can have higher or differential rates*
- *Registering securities within mainstream nominees can incur additional admin costs*
- *Dividend collection from Equities can also add to the complexity of Dealing Charges*

**But the true third party cost of executing a transaction is typically 0.05% per transaction.**

This means many discretionary fund managers are charging 20x or more the cost of transacting bargains; again making significant profits. Clearly UK discretionary fund managers have a significant incentive and conflict of interest leading to unnecessary churning of client portfolios.

**Example from a large discretionary manager:**

*Commission per transaction*
*First £15,000 1.25%*
*Next £15,000 1%*
*Balance 0.5%*
*A minimum commission of £50 per transaction is payable,*
*excluding other transaction charges.*

## UK Discretionary Fund Managers - Cuts from Foreign Exchange

Rather than dealing at the 'spot' or third party execution rate for foreign exchange transactions, it is common practice for discretionary fund managers to deal with a margin that is kept by them - this is an extract from one well known discretionary manager's list of charges:

*The foreign exchange rate for currency conversion is based on the bid/offer exchange rate to which are applied the following margins at the time of execution of the transaction: +/- 0.05% where part of an equity transaction and +/- 0.30% for a stand-alone currency transaction with a maximum margin of £500. Details available on request.*

[53] http://www.find.co.uk/my_find/for-ifas/ifa-research/pensions-research/ifa-guide-to-discretionary-fund-management-charges

## UK Discretionary Fund Managers Often Take a Cut from Clients' Bank Interest

Instead of passing on client interest in full, it is commonplace for discretionary fund managers to take a 'cut' or deduction. For example one prominent fund manager takes up to 3% pa from clients' bank interest – so until base rates are above 3% again, clients could receive zero interest:

*In the event that the base rate falls to 3% or less, the firm reserves the right to vary the rates paid on client deposits. However, the rates paid will be no lower than those in the table below.*

| Cash Balance | Interest Rates |
|---|---|
| Under £5,000 | 3.00% below base rate |
| £5,000 - £10,000 | 2.25% below base rate |
| £10,000 - £25,000 | 1.50% below base rate |
| £25,000 - £50,000 | 1.00% below base rate |
| Thereafter | 0.50% below base rate |

*Example of text in discretionary fund manager literature.*

## 7. Transparency On the Horizon - But Not Via the Statement of Recommended Practice (SORP)

Since the last True and Fair Campaign report, the IMA has claimed that standards of fee transparency would improve substantially *"Using the Statement of Recommended Practice (SORP) for investment funds as our starting point, we have proposed a template that would allow for the reporting at unit level, and in pounds and pence terms, of all charges and transaction costs (including equity commission) incurred directly by the fund."*

However the proposed table is incomprehensible, does not add up the numbers and the costs and fees are not in pounds and pence. They are also set out in different formats and exclude transaction costs when a fund invests in other funds. All in all their proposal lacks intellectual rigour and practical merit.

**Comparative table**

3.12A A comparative table is required covering each of the last three financial years or, if less than three, each financial year since launch. All figures should be expressed "per unit" unless specified otherwise.

3.12B The comparative table summarises the financial highlights and should show, in a single table for each unit class, the following amounts:

Illustrative performance of a unit in issue throughout the period

| Change in net assets per unit | |
|---|---|
| Opening net assets | X |
| Total return before charges* | X |
| Operating charges | (X) |
| Total return after charges | XX |
| Distributions | X |
| Closing net assets[4] | XX |

| | |
|---|---|
| * after transaction costs[5] (see page x) of: | X |

| Performance | |
|---|---|
| Total return after charges | X.XX% |

| Operating charges[6] | |
|---|---|
| Annual management charge | X |
| Other charges paid to the Manager | X |
| Other charges | X |
| Charges made in underlying schemes | X |
| Total | XX |
| Operating charges[1] | X.XX% |

| Prices | |
|---|---|
| Highest unit price | X |
| Lowest unit price | X |

3.12C In addition to the table for each unit class the comparative table should show the following amounts for the fund:

| | |
|---|---|
| Net asset value (£'000) | X |

| Transaction costs: | |
|---|---|
| Transfer taxes | X.XX% |
| Commissions - execution | X.XX% |
| Commissions - research | X.XX% |
| Amounts recovered[2] on units issued and cancelled | (X.XX)% |
| Total | X.XX% |

An estimate of the average portfolio dealing spread on the balance sheet date should also be given.

There are basics that have been omitted. For example the various numbers are not uniformly calculated or on a consistent basis, making it impossible to add up the numerous numbers. The IMA's public claim that they would produce ONE number[54] appears to be a complete fabrication.

It is also meaningless and misleading since significant costs are still excluded, for example fund of funds where any fund invests in other funds, will not be required to show the transaction charges within the underlying funds.

The fact that virtually none of the FRC's overriding tests[55] would be meet by this SORP means it is a complete farce. It fails the Understandability Test, Relevance Test, Materiality Test, Substance over Form Test, Prudence Test, Completeness Test, Comparability Test and the overriding True and Fair Test.

**Perhaps even more fundamental is the fact that this incomprehensible table would be published in the fund report and accounts, which very few investors ever read. The conclusion might be that this is a simple PR exercise by the IMA to pretend it is putting 'these issues to bed'. In reality it is simply sweeping them under the carpet and creating a distraction.**

There is suspicion from several quarters that the responses to this so called public consultation were so scathing when collated after the closure date in October 2013, that the FRC and the IMA have kept these responses secret. This is despite both of their own codes for such consultations explicitly stating that *"copies of comments that are on the public record will be made available on request"*[56].

**The True and Fair Campaign, together with several journalists and senior industry figures, have made requests for a copy of these comments but all requests have been denied. This raises the question as to whether the IMA public consultation was intended as a sham but was derailed due to the high number of responses.**

## Impact of Forthcoming EU legislation on the UK Regulator and Industry

The European Union (EU) recently passed new laws requiring investment firms to reveal all costs and fees they charge investors, including the scandalous 11 to 13 layers of hidden costs and fees that have been secretly swindled out of savers investment pots.

A 464-page legal document innocuously entitled 'MiFID II' heralds a wave of change that will wash away the conflicts of interest, culture of opacity, and perplexing fees and cost structures that have been endemic in the UK investment industry for decades.

[54] http://www.investmentweek.co.uk/investment-week/news/2286042/ima-chief-how-we-plan-to-make-fund-charges-more-transparent
[55] https://www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/FRS-102-The-Financial-Reporting-Standard-applicabl.aspx
[56] http://www.investmentfunds.org.uk/assets/files/consultations/2013/20130731-SORP2013invitationtocomment.pdf

For the first time, consumers will not have to be rocket scientists or detectives to work out what they are really paying.

MiFID II requires:[57]

*"The information about all costs and charges, including costs and charges in connection with the investment service and the financial instrument, which are not caused by the occurrence of underlying market risk, shall be aggregated to allow the client to understand the overall cost as well as the cumulative effect on return of the investment, and where the client so requests, an itemised breakdown. Where applicable, such information shall be provided to the client on a regular basis, at least annually, during the life of the investment to have their hard earned cash managed."*

Soon after the EU announced the ratification of the EU law, the UK's IMA stated that these rules did not apply to funds in the UK, or to its members. IMA chief executive Daniel Godfrey was quoted in the media as saying MiFID II: *"does not apply to any form of collective investment fund such as unit trusts and UCITS' and that MiFID II will therefore NOT 'mandate any new disclosure by funds to fund investors*[58]*.'"* Having spoken to senior individuals in Brussels, we can confidently say UCITS products will be covered under the MiFID II directive.

It is a total disgrace that the IMA seems so willing to act against the spirit of this new EU law by gleefully stating that it doesn't apply to them. Their reaction beggars the question, are they genuinely interested in promoting consumer protection and transparency or just rhetoric?

[57] http://register.consilium.europa.eu/doc/srv?l=EN&t=PDF&gc=true&sc=false&f=ST%2525206406%2525202014%252520ADD%2525201

[58] http://www.ftadviser.com/2014/02/21/regulation/eu-legislation/mifid-ii-disclosure-rules-will-not-affect-funds-Wwsh2NfCzrvakfhTh5qtVI/article.html

## 8. Fee Transparency in the Pensions Industry

Earlier this year, the Department of Work and Pensions's own report[59] revealed that within DC schemes, two thirds of pension schemes did not tell trustees what their Total Expense Ratio was, and over 85% of trustees did not even know their portfolio turnover rate (PTR).

A report by the OFT on pensions[60] found that:

*The lack of comparability of the AMC and the lack of visibility of other charges, costs and expenses levied from a member's pension pot may be preventing competition on overall charges working optimally…*

*The OFT is concerned that there is currently insufficient transparency and comparability of charges to ensure that competition on costs and charges is working optimally. Buyers of services need to be able to see and compare the charges that they are paying so that they can reach the correct judgments on value for money. We have two particular concerns:*

- *providers are not including costs and charges within AMCs they quote in a consistent way – which means that the AMCs being quoted by different providers are not easily comparable, and*
- *AMC figures do not capture all the costs and charges that a scheme member pays, in particular:*

– *costs associated with investment management transactions are not included in AMCs quoted by any pension providers*

– *pensions sold before the introduction stakeholder pensions have a range of other types of charges in addition to AMCs, including fixed monthly fees, other monthly charges as a percentage of the value of the pension pot, and initial charges levied as a percentage of members' contributions on schemes.*

In the March 2014 Budget Chancellor George Osborne announced sweeping changes to the annuity market. The Chancellor's intervention is a condemnation that the pensions industry could not put its own house in order and have been procrastinating for far too long:

- 2012 - ABI itself announced in March 2012[61], a new compulsory Code of Conduct to 'ensure customers have access to information to enable them to make an informed decision about annuities appropriate to their needs and lifestyle in retirement.'
- 2012 to 2014 - It took until February 2014[62] for the FCA to announce that their thematic work which had commenced as long ago as 2012, had found that most consumers could get a better deal on the open market.

[59] Landscape and Charges Survey 2013: Charges and quality in defined contribution pension schemes February 2014
[60] OFT *Defined contribution workplace pension market study* September 2013 Revised February 2014
[61] https://www.abi.org.uk/News/News-releases/2012/03/insurance-industry-takes-big-steps-to-help-customers-make-the-most-of-their-pension-savings.aspx
[62] http://www.fca.org.uk/news/tr14-02-thematic-review-of-annuities

The FCA announced it would not publish its interim report until the summer of 2014, followed by a final report around February 2015; with any recommendations implemented at a later date. Therefore the time period between the FCA starting collecting data on this financial scandal, and the actual implementation of any change could well have been three and a half years or more.

- 2013 - The Financial Services Consumer Panel recommended urgent reforms in December 2013[63] following a twelve month study, which uncovered evidence of a complex market which failed to deliver good outcomes for many consumers.

The annuity reforms will be music to the ears of campaigners who have protested for years that the emergency treatment of low interest rates administered to the economy to encourage borrowing have hammered savers and pensioners unfairly.

From April 2014 people retiring will no longer have to buy an annuity and can choose to take the entire sum they have saved and put it into another savings product that they hopes pays a better return.

Analysts at RBC Capital Markets have predicted that the individual annuity market would shrink by 90%[64]. If the millions of new 'free' retirees put their retirement pots into investments when they do not have all the information to make fully informed decisions, it will prove to be a job half done.

**The Government needs to heed the warning that unless they fix the issue of lack of transparency of charges and holdings, they may have unwittingly substituted the mis-buying annuities scandal with a mis-buying investment scandal.**

[63] http://www.fs-cp.org.uk/newsroom/2013/244.shtml
[64] Source: Financial Times March 20, 2014 Budget 2014: Pensions revolution casts pall on insurers Josephine Cumbo, Matthew Vincent and George Parker

## 9. The True and Fair Calculator - www.trueandfaircalculator.com

In May 2013, SCM Private launched the True and Fair Calculator as a standalone, not-for-profit business providing a free online calculator and comparison investment tool which was a global first in offering investors:

- the ability to fully analyse and calculate a Total Cost of Investing
- to enter data at every level of the investment chain – fund costs, wrapper costs, platform costs and adviser costs
- one Total Cost of Investing number, in pounds and pence, as well as a percentage
- the option to compare up to three completely different products, side-by-side, for example Unit Trusts, Exchange Traded Funds and Investment Trusts
- a risk and performance measure as well as a Total Cost of Investing number for each product entered.

One substantial fund management company, who objected to the true higher costs the calculator produced, threatened legal action. This was not a deterrent so they encouraged the third party data supplier to remove all historic Portfolio Turnover data for its funds.

This was a deliberate backdoor attempt to prevent the True and Fair Calculator making any estimates for its funds, even though the actual underlying Portfolio Turnover Rates were provided by this fund management company themselves. This data has since been reinstated by the data supplier.

**Even though the True and Fair Calculator has not been advertised or to date hosted by any platform or provider it has received over 60,000 page views, 55,738 of which have been from the UK.**

## 10. Conclusion

It is surprising that the FCA has placed such importance on behavioural economics[65] whilst allowing important cost disclosures to be provided in an incomprehensible format, in rarely viewed documents. The FCA's own 2013 research paper clearly states:

*A rapidly growing literature on behavioural economics shows that some errors made by consumers are persistent and predictable. This raises the prospect of firms designing business models that do not focus on competing on price and quality. Behavioural economics enables regulators to intervene in markets more effectively, and in new ways, to counter such business models and secure better outcomes for consumers.*

*The UK Parliament has created the Financial Conduct Authority (FCA) and has given it an additional objective and duty to promote effective competition, which we believe should be on price and quality (rather than on false focal points or strategies to exclude rivals at point-of-sale). To achieve this, the FCA will first need to undertake integrated analysis of economic markets.*

The current UK investment industry continues to fail to meet the FCA's own objectives of competition based on price and quality, since few customers can ever work out the full price. Analysis of proposals from industry bodies also fail to grant consumers the basic rights of knowing what they are paying, where their money is invested, and that professionals they are dealing with are honest, true and fair.

As a direct consequence, UK consumers pay 58% more than their US equivalent and save much less through the most popular forms of investment products.

The vast majority of modern technology based economies of scale that operate within the UK investment industry are pocketed by the industry rather than passed on to consumers.

It is clear that the UK public will not countenance this mass deceit which is why 86% of the public want ONE number for their TOTAL investment costs, enshrined in law.

Recent announcements by the Chancellor in the March 2014 budget will bring sweeping changes to the ISA and pensions industry. But the raft of new savers and investors will be confronted with an investment industry devoid of any genuine transparency.

Only legislation can halt the shameful abuse of UK investors' basic consumer rights.

[65] Financial Conduct Authority Occasional Paper No.1 Applying behavioural economics at the Financial Conduct Authority April 2013 Kristine Erta, Stefan Hunt, Zanna Iscenko, Will Brambley




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