The True and Fair Campaign commends the Financial Services Consumer Panel for commissioning and publishing two independent reports and a summary paper 'Collective Investment Schemes Costs and Charges' seeking to interrogate investor protection – the findings supports all the True and Fair Campaign's findings over the last three years.

The findings provides independent academic evidence of widespread anti-consumer behaviour and systematic practices that amount to legalised fraud in the British pension and investment industry. The True and Fair Campaign says the findings warrant a Competition Markets Authority enquiry combined with immediate action from the UK Government and Regulator in order to prevent any further pickpocketing of hard working people.

Commenting on the Financial Services Consumer Panel (FSCP) Report Gina Miller, founder of SCM Direct and the True and Fair Campaign says:

"Exploitation of pension savers and investors is a national scandal and this report exposes the depths of the scandal.

"The damning conclusion of this report that: *"The evidence reveals a market characterised by a weak demand side that is rapidly growing numerically, and a powerful industry in which misaligned incentives are systemic and which enjoys, largely unchallenged, the potential to exploit consumer behaviour, product structure complexity and the lack of cost transparency"* should act as a wake-up shout, not call, for all political parties, Government, regulators and the industry.

If you take the Investment Management Association's (IMA) data that the industry is worth £5 trillion, and that the typical 0.75% per annum annual management charge is in reality less than a 1/3rd of the total (the undisclosed transaction costs alone were found to "*add almost 1.5% per annum to the disclosed costs of a collective investment scheme*"), the conclusion must be that the UK industry is secretly hiving off billions of pounds from the British public every single year. This is the only industry in which fraud is legal; as per the Serious Fraud Office's (SFO) definition of fraud as being '*an act of deception intended for personal gain or to cause a loss to another party.*'[1]

"There have also been numerous reports, from the Financial Conduct Authority (FCA), the Office of Fair Trading (OFT) and Government Departments such as the Kay Review, which have all highlighted the structural issue around hidden costs and fees in the UK and called for radical change. This has been met by empty speeches and worthless industry voluntary codes. The principle of 'Treating Customers Fairly' (TCF) has turned out to be just hollow words.

[1] http://www.sfo.gov.uk/fraud/what-is-fraud.aspx

"The two reports that lie behind today's Financial Services Consumer Panel (FSCP) Report provide a dossier of widespread consumer abuse that must not be allowed to be swept under the carpet, or hushed up in any cosy industry/regulator/government meetings. The scale of the deception is staggering and is both immoral and unjustified.

"The conclusion of this FSCP report that *'a single charge merits consideration because other options are not working'* would be a huge leap forward for consumers' basic right to know how much they are paying. The FSCP states that it believes reform would fall within the remit of the FCA or Government.

We at True and Fair believe there needs to be a full inquiry by the Competition Markets Authority (CMA) to protect the British consumer, due to the conflicts of interest and powerful influence the pension and investment industry exercises.

Gina Miller added, "while it is not our place to prejudge the outcomes to such an inquiry, the findings of the FSCP Report that the full costs of investments "*are not consistently and comprehensively defined, nor understood*" and that "*there is a lack of competition*" due partly to *"profit maximisation combined with incomplete disclosure and poor management of conflicts of interest",* strongly support a full blown CMA inquiry. The weight of evidence is now undeniable. Full transparency on all costs and fees in one number must now be implemented."

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Notes:

Findings from the FSCP's commissioned reports that the True and Fair Campaign believe necessitate proper investigation:

1. **Nobody understands and few declare the full charges on customers savings and investments:**

Extracts from the Reports

'It is not possible from the literature to know with any accuracy, the costs borne by the saver.
This is because many costs are not declared to the saver; implicitly and explicitly they are deducted from the savings account without the customer's knowledge…If customers were to purchase at lowest cost, this could dramatically improve long term outcomes.'

'*Individuals are therefore dependent on the asset management industry to deliver good outcomes at an acceptable cost. But the full costs incurred by consumers when making long- term investments are not*

consistently and comprehensively defined, nor understood.'

'The full costs borne by savers are simply not known, and costs are deducted from the fund directly by the provider. The main reasons are simply that many costs are not properly measured or declared.'

'*Even professionals in the market may not understand some of the complexities. Put simply, the old adages*

what you see is what you get', and 'you get what you pay for', often do not stand up to scrutiny in the world of retail investment funds.'

'This should involve ensuring that customers receive comprehensive information and estimates of the total costs that will be incurred both before, and during the period over which funds are managed. That information should be presented in a form which is readily understood, particularly as regards its effects on investment outcomes.'

'But by far the greatest difficulty in calculating charges is that many of them are not declared.'

'There have been recent reports that the FCA is to investigate exit fees that firms charge their customers, with examples being quoted that some firms are charging fees of 6% of the value of the assets for customers to exit products. These are likely to be designed to discourage customers because of the significant profits that can be made from those customers.'

'The potential scale of the hidden costs problem is perhaps best illustrated by a recent comment from on the CEO's of one of Britain's largest pension funds, Chris Hitchen of Railpen Investments which manages £20 billion. He claims that "what we are getting billed for is far less than what is being siphoned off underneath". Railpen pays £70 million a year in upfront disclosed fees, but that additional costs are "multiples of that number, 300-400 per cent of that"

2. ***The industry is "economical with the truth" in respect of the importance of costs (together with asset allocation) in choosing funds:***

<u>Extracts from the Reports</u>

> *"As noted above, investment management costs are of great importance in investment outcomes. Indeed, together with asset allocation, they may be the most important factor, if assessment is being made at the point of sale,(that is before the event)."*
>
> *"There is also a natural inclination for the industry to downplay the effect of charges, and even to be 'economical with the truth' in advising customers, since it is through charges that their income is earned."*

3. **There is no genuine price competition despite the overwhelming evidence of the importance of costs**

Extracts from the Reports

'The lack of competition in terms of price and costs stands in stark contrast to the intensity of competition between fund managers in terms of short-term performance, and the attendant emphasis on sales marketing and product proliferation.'

'Although relative performance may be significant at the end of the investment period, before the investment is made, one of the most important criteria is the cost which will be involved in management.'

'The price of similar products varies very significantly, perhaps by as much as four or five fold, for near identical services'

'If the current status quo is maintained, the incentives for the manager to reduce costs in order to act in the interests of the investor are low. The position is made worse given the propensity for retail and pension money to be quite 'sticky' once it has been invested in a fund.'

4. **The industry can arbitrarily choose how to allocate many costs to client funds rather than pay these costs from their own pockets**

Extracts from the Reports

'The fund pays its own transaction costs, the costs of custody, any borrowing costs, audit and legal costs and asset managers can even charge consulting fees to the fund if they can justify direct benefit to the fund. The manager has a wide discretion on the charges that can be allocated against the investment fund.'….'access to management and dealing commissions for research are some of the hidden charges that investment managers can use to reduce their own costs by charging these indirectly to the funds they manage.'

5. **These scandalous practices have been well known for years, with one particularly damning report dating back to 2002:**

Extracts from the Reports

'*In 2002, the Sandler Report on the UK retail investment market found "the reporting of product charges is typically neither clear nor consistent". It is striking that the problems of cost opacity and cost control are both widespread and long-standing…..Little progress appears to have been made. In May 2014, following its thematic review of retail funds, the FCA castigated firms for too frequently providing information on fund charges that was unclear, insufficiently comprehensive and misleading*.'

6. **The new pensions charge cap and the proposed fund cost disclosures of the IMA, approved by the FRC, are all fundamentally flawed as they exclude transaction costs which can be significant:**

Extracts from the Reports

'Members of DC workplace pensions are especially badly placed. The key choices about the scheme and its costs are effectively made by employers, but many may well be ill-equipped, or lack the incentive, to make cost-effective choices on behalf of their employees.'…'The charge cap is set at 0.75% of funds under management, covering many costs but initially with the (very significant) exception of transaction costs arising from the buying and selling of securities'

'Regulatory requirements on disclosure continue to omit full disclosure on all costs such as transaction costs. Transaction costs can form a significant proportion of the costs investors bear. In the absence of full information on all costs it is difficult to compare investments and make investment judgments.'

'The IMA research contrasts with other evidence that suggests undisclosed transaction costs could, for example, add almost 1.5% per annum to the disclosed costs of a collective investment scheme.'

7. **The Industry has been closet indexing and deceiving investors:**

Extracts from the Reports

'Frequent monitoring of short-term performance combined with inadequate scrutiny of costs encourages the practice of "closet indexation", also known as "closet tracking": funds that charge for active portfolio management, typically of company stocks, but which in practice do little more than mimic the composition of a relevant index.'

8. **The UK regulator has failed to properly address these issues and one report even suggested it may not be 'threshold competent' to regulate anyway:**

Extracts from the Reports

'In view of the persistence of non-TCF behaviour, confusing and inadequate information and embedded conflicts of interest, it is difficult to disagree with the conclusion of the Kay Report that regulation has been costly but not self-evidently successful.'

'It is interesting to note that while the industry is required to comply with these requirements there appears to be no equivalent mandate requiring those who regulate or determine policy in these areas to have equivalent levels of threshold competence. It is therefore inevitable that despite the extensive use of industry consultation and experts there appears to be no evidence that regulators sent in to investigate regulatory issues or

determine policy considerations can demonstrate whether they themselves have the threshold competencies to understand the products they are reviewing, recognise problems, develop policies and then enforce them.'

9. **The UK investment industry and its self-interested trade bodies have been largely responsible for these anti-consumer practices:**

Extracts from the Reports

'Required disclosure of costs and the use of charge caps (as in the case of stakeholder pension schemes) have been piecemeal rather than comprehensive, partly as a result of stiff and effective industry resistance.'

'*The ABI made much of its published agreement by some of its members on the disclosure of pension charges and costs in January 2013. The signatories to this agreement committed to implement the agreement by the summer of 2014. The purpose of the agreement is to disclose all charges and costs in a consistent way both at the outset and crucially as people build their savings. There appears to be no information on the ABI website of the progress made by the ABI on this initiative since January 2013*.'

'The IMA Guidance on fund charges and transaction costs … The code is a voluntary code and not all IMA members have adopted it although they are expected to do so.'

10. **The UK investment industry has preyed on its customer's lack of knowledge:**

Extract from the Reports

'Overall, the complexities of retail fund structures, combined with weak fund governance and asymmetries of information and power between the retail investor and the investment manager, have resulted in an extremely unbalanced principal-agent relationship. Profit maximisation combined with incomplete disclosure and poor management of conflicts of interest has skewed the basis on which healthy competition depends.'

11. ***The leading industry trade body, the IMA (Investment Management Association) has been allowed by the FRC (Financial Reporting Council) to produce a completely misleading presentation of fund costs – this follows s stunningly poor study that denied there were any hidden costs***

Extract from the Reports

'The IMA has responded with proposals of its own, and has introduced a Statement of Recommended Regulatory Practice (SORP), compulsory for UK authorised funds, which requires disclosure of operating costs, dealing commissions and stamp duty but stops well short of the disclosure envisaged by MiFID II.'

The 2012 IMA study of Fund Management charges, investment costs and performance was found to be *"methodologically suspect since it used only data for the largest funds, (ex post), whose*

performance is likely to have been good, (that is why they became the largest funds).”

12. Economies of scale tend to benefit the investment business more than the consumer

Extract from the Report

‘‘Integrated’ or affiliated business models can lead to significant economies of scale. However, it is not a given that these savings are passed on to retail investors in the form of lower costs and charges.’

13. **Performance reporting can be very misleading**

Extract from the Reports

‘The reporting of performance – the main metric on which investment managers compete – can be very misleading. Investment managers can disguise investment losses when they close and merge poor-performing funds and transfer the assets to a new fund. This creates significant distortions (‘survivorship biases’) in the way performance is reported, which can serve to suppress the poor performance of the original fund in which the consumer invested.’

All these points have been made by SCM since June 2009 and via its True and Fair Campaign since January 2012. They have always been vehemently, even aggressively, denied by all industry trade bodies.

Suggested Recommendations in the FCSP Paper / Reports and views of the True & Fair Campaign

1. ‘*One option therefore is that the FCA considers mandating full MiFID II style disclosure of all costs as soon as possible*.’

   T&F view: This is the most practical and swiftest solution that will positively affect millions of pension and investment savers. The largest trade body has wrongly suggested that these full disclosures will not be required by their members[2]

2. *‘One solution might be a single investment management charge; all other intermediation costs, charges and expenses incurred by the investment manager, including transaction costs, would be borne directly by the firm and reflected in the single charge. A ‘softer’ option would be to allow investment managers to quote the costs of buying and selling (entry and exit) separately*. ‘

   T&F view: The problem with this solution is that it would require every global investment or security to be sold at a single price. This would require all regulators and markets globally to follow this

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

solution for it to be effective. The softer option would not work as consumers want just one number, not even two in different formats.

3. *'The regulator and government could also consider additional ways to strengthen existing governance fund structures to ensure these genuinely represent consumer interests and manage conflicts of interest robustly. The principle of IGCs could be extended to retail investment funds.'*

   T&F view: The UK fund industry should simply emulate the US industry in which independent directors have been mandated since 1940 and since 2004 the majority have had to be independent with extensive fiduciary duties to act on behalf of the investors.

   As our 2014 Legalised Looting report[3] showed, '*In the UK the largest sized funds charged just 6% less than smaller funds compared to 33% less in the US. This is because US funds are run by independent boards, mandated to pass economies of scale back to investors*.'

4. '*To help consumers and their representatives assess value for money, the regulator could usefully consider a requirement for fund managers to justify that their management of index constituents was active management, rather than closet index tracking. This would probably require trading disclosure for active managers, that is, to disclose what proportion of their trading was on index constituents and whether they were short or long of the relevant security*.'

   T&F view: As our 2013 Closet Indexing Report[4] suggested, this simply requires fund managers to show their 'active share' i.e. how much of their fund is different to the index and the report concluded '*Funds should be forced to disclose their active share combined with their fund portfolio turnover data.*'

   Sadly once again the industry trade body, the IMA has hampered improved consumer protection by abolishing the requirement to publish how much their members' funds trade (the Portfolio Turnover Rate – PTR) in June 2012. The IMA has even publically defended this deception saying it was OK to have 95% secretly cloning the index as long as the fund manager had the other '*5% of the fund being placed on at 3.30 at Ascot*'[5]

[3] http://scmdirect.com/sites/default/files/FINAL%20True%20and%20Fair%20Campaign%202nd%20Anniversary%20Report%202014%20(Secured).pdf
[4] http://www.scmprivate.com/content/file/knowledge/research/closet-indexation-report-full-sept-13.pdf
[5] http://news.bbc.co.uk/1/shared/spl/hi/programmes/money_box/transcripts/money_box_21_sept_13.pdf