PRESS RELEASE – 12 April 2016

Portfolio Turnover and Hidden Transaction Costs -The Devil in the Detail that Amounts to £1.75 bn in hidden Fees Per Annum

Last Monday, 4 April 2016, Woodford Investment Management (WIM) announced they would be paying the research part of the transaction costs from their annual management fees, rather than passing these onto clients. Whilst we applaud this decision, we have always believed that research is a fundamental tool of an active manager's job and as such should never be paid for separately by clients. It remains a scandal that the wider UK fund management industry shows no willingness to behave ethically regarding transparency of these research costs; as well as overall transaction costs.

It is also exceptionally poor that the Financial Reporting Council has allowed the investment trade body, the Investment Association (formerly the IMA) to set its own accounting standards, which resulted in it abandoning the requirement for funds to report their Portfolio Turnover Rate (PTR) after June 2012. Without this crucial statistic, it is impossible for investors to calculate the transaction cost.

Two years later, in April 2014 the then Chief Executive of the IMA, Daniel Godfrey announced "*What we are going to do next is agree on a standardised basis for the calculation of portfolio turnover rates*," yet over the near four years following the abandonment of this key statistic, the IMA (now IA) simply resorted to empty soundbites and discussion papers without ever requiring the publication of PTRs.

In light of this lack of transparency, what was of great interest to us in the Woodford Investment Management (WIM) announcement, is its guide to wider total transaction costs. Woodford manages his fund with a comparatively low turnover of stocks, and tends to invest for a much longer period of time than most managers. Their announcement showed that the total transaction costs (execution costs + research costs + transaction taxes + spread) amounted to 0.09% in 2015, even though the portfolio turnover rate for the CF Woodford Equity Income Fund was just 15.3%.

Hidden Transaction Costs in the Wider UK Investment Industry

According to the IA, total funds under management for UK domiciled funds investing in equities amounted to £524,266m at the end of 2015. It estimates that tracker funds represented 12.4% of UK domiciled funds, i.e. active funds represented 87.6%.

Utilising data from Fitz Partners[1], the average PTR for equity funds was recently found to be 64.7% pa, more than four times the WIM reported turnover. SCM has used this data, together with the WIM statistics, to calculate that **hidden transaction costs for actively managed UK domiciled funds are currently running at c. 0.38% pa or £1.75 Bn pa[2]. This is virtually identical to the estimate made we made via the True and Fair Campaign in 2013 for equity funds.[3]**

[1] http://www.fundstrategy.co.uk/how-much-is-portfolio-turnover-adding-to-ters/

[2] Calculated as 64.7%pa/15.3%pa * 0.09% pa * £524,266m * 87.6% = £1,747m pa

[3] http://www.trueandfaircalculator.com/sites/default/files/Full_Assumptions_Calculations_2015.pdf in which average fund turnover was found to be 61% pa and weighted average of equity funds buying & selling cost 0.674% i.e. 0.61*0.674 = 0.41% pa

SCM recognises that this will vary from fund to fund according to their individual PTR and the transaction costs of buying and selling the particular assets they specialise in. For example, funds investing in less liquid securities e.g. emerging market stocks or smaller company shares, are likely to result in far greater transaction related costs due to much higher spreads (the difference between the buying and selling price). The fact that the average UK fund is not transparent or adding these costs to their published investment fees total is a travesty bordering on deceit.

The FCA should act urgently to mandate that all funds show, in a format that is 'fair, clear and not misleading', full transaction costs and added to other ongoing charges. This would make the 'true' charge 45% more than the typical 0.85% pa headline charge (OCF) of many equity funds.

In May 2013 we launch a True and Fair Calculator (www.trueandfaircalculator.com), a free online calculator allowing investors to see exactly how much they are paying in fund management, including transaction costs via their PTR, platform and advice charges in one simple Total Cost of Investing Number. The True and Fair Calculator works out the cost of investments shown in pounds and as a percentage, giving an estimate of returns after costs and fees. The Calculator listed over 7,500 investment products across UCITs funds, Investment Trusts and ETFs, and received over 73,000 visits. But due to the IA no longer requiring funds to publish their PTR, we were forced to amend the Calculator in 2014 so users have to now enter their own data. We have been informed on many occasions that fund managers have refused to give investors the necessary cost information to input details for their own funds. The site hosts a template and full assumptions document that any investor can download and send to their managers or adviser.

In any other industry, hiding such a cost would be illegal. It is shameful that neither the IA, and more importantly, the UK regulator, the FCA has never properly addressed this widespread underhand practise from UK investors. The FCA and its predecessor, the FSA, have had clear evidence of the effect of hidden transaction costs being as long ago as 2000, when its own commissioned research revealed that as much as an additional 50% of overall fund costs were hidden[4].

The EU regulator has been more decisive and via MiFID II, in 2018, will force the UK industry to be transparent as regard ALL charges – implicit and explicit, for the first time. Until that time, pressure needs to be placed on fund managers to stop hiding fees and misleading their clients as to the impact of fees destroys their returns.

Gina Miller, Founder of SCM Direct and the True and Fair Campaign said*, "It is a travesty that the UK regulator refuses to enforce a common template of all charges published at the point of sale, even after this new legislation takes place in 2018. Such a decision would allow consumers to easily compare one fund or most other forms of investment, with another. In the US a similar calculator to the True and Fair Calculator has been linked to the SEC website since 2005."*

End

[4] The Price of Retail Investing in the UK, by Kevin R. James, London School of Economics; February 2000. Financial Services Authority Occasional Paper 6.