

**Ahead of the FCA Asset Management Report this Wednesday, SCM Direct mystery shopping research reveals UK wealth managers continue to significantly mislead clients on charges, and may be breaking FCA rules.**

**SCM Direct's eight-year anniversary performance figures show the discretionary fund manager is outperforming peers.**

SCM Direct conducted a mystery shop of 31 leading UK wealth managers, with total assets managed in the UK alone of over £440bn, who were asked four basic questions for a £1m+ potential new client.

The 31 well-known firms' responses to the four questions were as follows:

**1. *Is £1 million a level you take?***

- 13% did not respond to the email questions within a calendar week
- 11% said a £1m+ investor was below their minimum investment level

**2. *How you would invest my money – what type of shares / bonds / funds or investments? How it would be allocated?***

- 38% of those who responded were unable to indicate how the money would be invested, within 7 days.

**3. *What are all the charges including the investment charges or anything else on this £1million?***

- 52% of the managers who responded refused to add up costs together, even when explicitly requested to do so in a subsequent email
- 38% of the managers who responded and whose services are subject to VAT, failed to include this cost within their headline charge within their initial email
- 45% of the managers who responded and who invested in funds, failed to include any underlying fund costs within their headline charge within their initial email
- **Overall 69% of the managers that provided a headline fee, failed to include VAT or the underlying fund costs within their initial email even when one or both of these additional costs were payable by clients**
- 91% of the managers who responded, failed to show their costs in £ (as will be required by MiFID II from 3<sup>rd</sup> January 2018).

Most managers revealed just part of the transaction costs, sometimes including the commissions paid to external brokers or to themselves, but rarely the stamp duty on shares or the market maker bid/offer spreads. As the FCA Asset Management Study<sup>1</sup> states:

*‘investors are not given information on transaction costs in advance, meaning that investors cannot take the full cost of investing into account when they make their initial investment decision. These costs can be high and add around 50bps on average to the cost of active management for equity investments.’*

The format for most of the wealth managers replies were highly confusing and difficult to understand – even by a professional investor, which made comparisons virtually impossible.

Despite extensive emails, SCM Direct found it practically impossible to deduce which costs the manager had included. However, we did find that the initial ‘headline charge’ was frequently misleading as it would often exclude VAT, underlying fund charges, commissions charged by the fund managers, and many other elements of transaction related charges.

**4. What kind of returns can I expect – ideally, I would like to earn over 7% pa after costs – is this something you can guarantee?**

- 57% of the managers who responded provided an indication of expected return.
- The average expected return was 7.1% pa.

It is SCM Direct’s view that this projected estimated return of 7.1% after fees is totally unrealistic given the prospective client told the wealth managers that they *‘would expect something like 70% invested in stocks and 30% in bonds or cash’*.

Based on assumed inflation of 2% pa, overall costs of 2.5% pa, a real return on equities of 5.1% pa and bonds of 2.8% pa<sup>2</sup>, SCM Direct believes that a more realistic return would be just 3.9% pa after costs, significantly less than the 7.1% indicated by the wealth managers.

However, the good news is that 100% of respondents correctly said that they could not guarantee a return.

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<sup>1</sup> <https://www.fca.org.uk/publication/market-studies/ms15-2-2-interim-report.pdf>

<sup>2</sup> Credit Suisse 2016 Investment Yearbook returns for equities and bonds 1900-2016 <http://publications.credit-suisse.com/tasks/render/file/index.cfm?fileid=80603618-9230-382D-C51FF70FAF7A4A65>

### **SCM Direct's observation on the mystery shopping findings:**

- SCM Direct believes that many of the managers appear to be flouting the overriding FCA principle<sup>3</sup> requiring communications to be 'Clear, Fair and not Misleading'.
- A typical 'all-in fee' of c. 1% was frequently quoted but the real fees could easily be 2.5 times or more this amount, once VAT (0.2%), underlying fund costs (often 0.75%+ pa), and underlying transaction costs (0.5% pa according to FCA) were included.

SCM Direct's view is that only by adding up all the costs together, in one number, will clients be able to comprehend and understand the impact of the full cost of an investment. This requirement is part of MiFID II which will require all UK firms to total all fees, from the 3<sup>rd</sup> January 2018<sup>4</sup>.

The UK investment industry through its self-interested trade body (IA) is lobbying the UK regulator to ignore the forthcoming law<sup>5</sup> requiring ALL costs to be added up together. Should the UK regulator adopt the IA's fee code, which SCM Direct believes to be contrary to the forthcoming laws, SCM Direct intends to pursue an action against both the Investment Association and any of its members who might choose to adopt it. The UK Investment Industry is not above the law and must be held to account to protect the British public's hard-earned savings and investments.

### **SCM Direct Performance**

SCM Direct also reveals its class beating performance, both against respondent private client managers, and the new entrant robo advisers (whose performance is even worse than the traditional managers).

According to the ARC Private Client Indices (PCI) which are based on the actual returns being generated by investment managers for their discretionary private client portfolios and our own results, there is little evidence that paying private client managers higher fees result in better outcomes for clients.

SCM Direct's performance to the end of May 2017 and over the last one, three and five years has been compared against these industry returns. The data shows that the three core SCM Direct GBP portfolios, have after costs, outperformed their peers by between 1.3% pa and 2.9% pa over the last 5 years.

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<sup>3</sup> <https://www.handbook.fca.org.uk/handbook/COBS/4/2.html>

<sup>4</sup> <https://www.esma.europa.eu/policy-rules/mifid-ii-and-mifir>

<sup>5</sup> <https://scmdirect.com/adding-childs-play-fund-managers/>

|  | 2017 YTD     | 1 Year        | 3 Years       | 5 Years       |
|--|--------------|---------------|---------------|---------------|
| <b>SCM GBP Bond Reserve (after all fees)</b>     | <b>+2.5%</b> | <b>+12.8%</b> | <b>+23.2%</b> | <b>+31.2%</b> |
| ARC Sterling Cautious (after all fees)           | +2.5%        | +7.3%         | +11.6%        | +24.7%        |
| <b>SCM GBP Absolute Return (after all fees)</b>  | <b>+6.1%</b> | <b>+22.2%</b> | <b>+27.6%</b> | <b>+53.9%</b> |
| ARC Sterling Balanced Asset (after all fees)     | +3.9%        | +12.2%        | +17.6%        | +39.7%        |
| <b>SCM GBP Long Term Return (after all fees)</b> | <b>+6.2%</b> | <b>+25.1%</b> | <b>+34.2%</b> | <b>+67.7%</b> |
| ARC Sterling Steady Growth (after all fees)      | +5.3%        | +16.7%        | +23.1%        | +52.4%        |

Source: SCM Direct

ARC Private Client Indices (PCI) are based on the actual returns being generated by investment managers for their discretionary private client portfolios. ARC Indices include estimates for April and May 2017 and were accessed on 5<sup>th</sup> June 2017.

**The individual 12m returns are shown below:**

|                      | 12m to<br>31.05.17 | 12m to<br>31.05.16 | 12m to<br>31.05.15 | 12m to<br>31.05.14 | 12m to<br>31.05.13 | 12m to<br>31.05.12 | 12m to<br>31.05.11 |
|----------------------|--------------------|--------------------|--------------------|--------------------|--------------------|--------------------|--------------------|
| SCM Bond Reserve     | 12.80%             | 3.50%              | 5.50%              | -2.20%             | 8.80%              | N/A                | N/A                |
| SCM Absolute Return  | 22.20%             | -3.60%             | 8.30%              | 1.30%              | 19.20%             | -5.40%             | 11.20%             |
| SCM Long-Term Return | 25.10%             | -3.00%             | 10.60%             | 2.00%              | 22.50%             | -5.40%             | 12.90%             |

Please note: Past performance should not be seen as a guide to future returns. The value of investments and the income from them can go down as well as up and investors may not recover the amount of their original investment.

**The newer companies, often referred to as ‘Robo-Advisers’ do not appear to be performing any better, despite their typically lower fees.**

SCM Direct analysed the average performance of the robo-adviser portfolios displayed on their website over the longest available period and compared the return with the average SCM portfolio return displayed by on the [SCM Direct website](#) over the exact same period.

**The average outperformance by SCM Direct over five leading Robo-adviser companies, who publish their performance, was 4.7% pa over the periods analysed.**

Please note that most of the managers that reported performance only provided performance for a 12m period.

**Past performance should not be seen as a guide to future returns. The value of investments and the income from them can go down as well as up and investors may not recover the amount of their original investment.**

**Appendix – extracts from emails**

Mystery Shopping examples of misleading statements re charges (all references to names of the managers have been removed):

**Manager A**

**'Discretionary Portfolio and ISA Example – Charge for £1,000,000 portfolio = 1.3% + VAT p.a.'**

Potential Client:

'So just to be clear, that the "Discretionary Portfolio and ISA Example – Charge for £1,000,000 portfolio = 1.3% + VAT p.a." That includes all fund costs, spreads, dealing cost etc on £1 Million?'

Manager A

'The only other charge would be a £20 bargain charge on each transaction (sales and purchases). Apologies for omitting this in my last email. There would be no trading commissions on the "fee only" rate card that I have noted below. This would be all the charges for running the portfolio...The exact cost of this would be dependent on the percentage of the portfolio that is held in funds, and which type of funds...'

Potential Client:

'I am trying to compare like for like and it is very hard to understand the fee structure.

Could you please give me an estimated cost? ...'

Manager A:

Firstly apologies for not being clear in our first email exchanges .... I have noted two scenarios below... The rate with trading commissions tends to be cheaper if there are fewer ongoing transactions...

Headline Management Charge - 0.75% plus VAT plus trading commissions

Investment Manager Charge 0.600%

Financial Planning Charge 0.600%

SIPP Provider Administration Charge 0.028%

Bargain charge of 12 transactions per annum 0.024%

Commission Charge on 12 transactions per annum (£20,000 bargain charge) 0.340%

Stamp duty on 5 UK equity purchases (£20,000 bargain size) 0.050%

Underlying fund charge of 0.65% on 50% of portfolio 0.325%

Underlying ETF charge of 0.15% on 10% of portfolio 0.015%

**Total 1.982%**

**Manager B**

'We have two different charging structures. For an amount of £1m we offer client an all-inclusive annual management fee of 1% which includes dealing costs, or an annual management fee of 0.75% plus dealing costs (which are tiered depending on the size of the transaction). There are also other costs that may be incurred depending on the nature of the portfolio, and I can provide a full fee schedule if that is of interest. There are also fees on the underlying investments (for collective funds) and these will also vary, however typically for an amount of £1m this could range from 0.35% to 0.60%.'

Potential Client:

'I would appreciate more clarify of both performance and fees as I'm finding it very difficult to compare one company with another.'

Manager B

'Total fees charged would either be 1.00% on an 'all inclusive' fee basis (i.e. annual management fee with no dealing costs) or 0.75% + dealing costs (which are tiered as follows: 1% on the first £10,000 per trade, 0.15% on amounts of £10,001 - £250,000 and 0.11% on amounts over £250,000). Indicatively, assuming a 20% portfolio turnover and a portfolio size of £1m, this would be c.0.16% per annum, and so would total 0.91% on an indicative basis, but would be higher if we saw a period of increased trading activity (e.g. in the aftermath of the UK Brexit vote)

There are also administration costs of £15 per trade which (again indicatively and assuming 20% portfolio turnover per year) amount to c. 0.02% per year.

The annual management fee is subject to VAT (which is the same for all investment services provided by any firm), and there are also underlying fund manager fees...

Potential Client:

'Could you give me an estimated total cost for investing?'

Manager B

'Please see below for a breakdown of an estimate of ongoing portfolio costs based on a £1,000,000 investment portfolio.....'

|  |              |
|--|--------------|
| Annual management fee                                    | 0.75%        |
| Dealing charges  | 0.16%        |
| Administration Charges                                   | 0.02%        |
| <b>Our Charges</b>                                       | <b>0.93%</b> |
| VAT (at 20%)   | 0.15%        |
| Annual Management charges of underlying fund investments | 0.46%        |
| <b>Total cost</b>  | <b>1.53%</b> |

**Manager C**

**'Management fee only**

**'On the first £5,000,000 1.15%'**

Potential Client:

*'I would appreciate more clarify of both performance and fees as I'm finding it very difficult to compare one company with another.*

Manager C

*'Based on the information below that you have given me...**An estimated Total Expense Ratio would be somewhere between 1.4-1.65%** depending on the allocation to direct equities over third party funds.'*

**Manager D**

*'In terms of fees, it is a clean all-inclusive tiered 'fee only' structure i.e. no commission for dealing or any other charges – everything is included. **On a portfolio worth £1m, the fee is a little less than 1%.***

Potential Client:

*'I would appreciate more clarify of both performance and fees as I'm finding it very difficult to compare one company with another'*

Manager D

*'In terms of fees, our fee structure is charged as a percentage of the portfolio value (there are no other charges such as commissions or administration fees). Based on a portfolio value of £1m, the annual fee would be 0.99% (ex VAT)...*

Potential Client:

*'You mention you invest in funds. So does your 0.99% (ex VAT) include the fund underlying cost as well as your management cost? Are there not spreads and other costs?'*

Manager D

*'Any underlying funds will deduct their costs separately.... Most funds that we use are charging a total fee of around 0.75% being conservative, **therefore if you were to have half of your portfolio in funds it would be an extra cost of circa 0.4%.** ... The bid-offer spread will vary depending on the investment but this is a market adjustment. However, almost every investment we buy is extremely liquid and easily realisable, with minimal spread. We do not include this in the calculation of fees.'*

**Manager E**

**'Fees for the Discretionary Investment Management Service is an all-in 0.95% for £1,000,000 – reducing for higher values...'**

Potential Client:

*'I understand that your discretionary service invests in funds and that the 'all-in' fee for this service is 0.95% for this service.*

*Sorry I am still a bit confused as the other replies have said whether or not this fee includes VAT and they have added the likely fund charges for someone like me (I would expect to maybe be something like 70% invested in stocks and 30% in bonds or cash).*

*Can you please confirm that this 0.95% fee does include VAT, include the underlying fund charges and any dealing commissions or other charges you might make in changing these funds for me.'*

*Manager E*

*'If you are resident in the UK the discretionary fees are liable to VAT on top of the 0.95% pa.*

*We don't charge trading fees within the portfolio i.e. on buying and selling funds , although we do pass on any external brokerage charges. If investing on a funded basis there are not likely to be any brokerage fees charged as this tends to be more applicable when investing in individual shares rather than funds.*

*Potential Client:*

*'Sorry if I'm being a bit dim here, just trying to get my head around it. is 0.95% the total I would be charged? That include the underlying fund charges ?'*

*Manager E*

*'If you are wholly UK resident and domiciled for tax purposes the Fees would be 0.95% pa plus VAT...The underlying funds we would invest in for a traditional growth mandate typically charge around an average of 0.60% pa as we can buy the institutional share class without any hefty front end fees. Therefore overall the total expense ratio for a traditional growth portfolio would be ...1.74% pa if adding the VAT in. These are indicative figures depending on the funds and investment approach taken.*

### **Manager F**

*'At a simplistic level the fee drag on the attached performance for a £1m portfolio would be in the region of 0.9625% per annum (which is the blended cost across two bands).*

*Potential Client:*

*'...I just want to understand fully. The estimated 0.9625% would that include VAT, the index funds and active managers cost? Or is that just your fee?*

*Manager F*

*'The fact sheet shows performance after the embedded costs of the various funds, so it is only our fee that is a drag on the indicated performance. We are advisory so the service is not subject to VAT.*

*Potential Client:*

*'I'm just asking what those costs are. You have in your factsheet the performance that. It states in small print - "... underlying fund management fees, custody and transaction charges assuming £1m"*

*I just want to know if your estimated 0.9625% per annum Includes those costs. Sorry again if I am asking you to repeat yourself. I am just finding it difficult in making comparisons, I don't know who includes these hidden costs or not! Very frustrating*

*Manager F*

*'..Underlying funds have "ongoing fund charges". The cost of a specific portfolio will depend upon the funds in it.*

*Our own fee, estimated at 0.9625% in my last email is what we charge for our service.'*

*Potential Client:*

*'I understand but in my first email I asked what the "what are all the charges including the investment charges or anything else on this £1 Million". I just want to know the total cost of investing (estimate). You state 0.9625%, but on your fees factsheet you state "additional third party charges may apply and will be passed on..." So is the 0.9625% a estimated total or not?*

*Manager F*

*'the total cost of investing will depend on the solution recommended which in turn will depend on your objectives, personal circumstances, etc. Our fee does not include underlying fund manager fees or custody fees but again these will vary.*

### **Manager G**

*'I suspect that the discretionary route would work best for you and thus DPM fees is the most relevant – basically 1.25% on the first 1m...*

*Manager G (in reply to further email from potential client)*

*'the fee of 1.25% on the first £1m applies on an ongoing basis ...There are also fees that are embedded in the funds.... The indicative on-going charge here is 0.8%.*

### **Manager H**

*'Discretionary Management*

*Combined Fee Rate*

*First £3 million      Rate 1% pa*

*Within notes 'funds will apply annual management charges which are reflected in the values of the investments held.... We pass on to clients any third party brokerage charges and other costs normally incurred on their behalf including transfer and registration fees, taxes and stamp duty. Such charges are shown in the relevant transaction advice.... Fees, charges and commissions are, where applicable, subject to VAT*

*Manager H (in reply to further email from potential client)*

*'There are fees within any investment fund but these will vary for a portfolio depending on which risk profile is appropriate (these normally top out at 0.75% p.a.).*



*Report by SCM Direct*

Contact: Alan Miller – [alan@scmdirect.com](mailto:alan@scmdirect.com)

Tel: +44 (0) 7838 8650

2 Eaton Gate, Westminster, London SW1W 9BJ

[www.scmdirect.com](http://www.scmdirect.com)

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