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MPs and peers urge Treasury to amend proposed investment trust rules

By David Thorpe

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MPs and peers have teamed up with a range of asset managers, law firms and investment banks to submit a response to the UK government consultation on the future of investment trust regulation.

In a recent budget, chancellor Jeremy Hunt announced his intention to replace the Priips (Packaged Retail Investment and Insurance) product regulations with a new regime.

These new rules, he said, would take into account the previous concerns of the industry around how investment trust cost disclosures have to be reported.

FT Adviser previously disclosed that Baroness Sharon Bowles, a former MEP, raised the issue of cost disclosures that could make the charges on investment trusts seem higher than they are.

This is because the trusts are treated as if they are open-ended funds, rather than listed equities.

Bowles said the rules as proposed previously risked “decimating” the investment trust industry, and, in particular the renewable energy investment trust sector.

The latest plan from the Treasury is to replace the existing regulations with a regulatory framework for Consumer Composite Investments (CCIs), which treat open-ended funds and investment trusts the same way.

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The plans were open for consultation until midnight yesterday (January 10).

Now 24 parliamentarians and a range of asset management firms have come together to contribute a response to the consultation.

Baroness Bowles is one of the 24 parliamentarians to have signed this, among the others are John Baron MP, and former pensions minister Ros Altman.

Higher charges

Speaking to FT Adviser, Baroness Altmann said: "This is a spectacular own goal by the UK. I'm amazed the FCA is relaxed about this. This should be an emergency situation, investors are not able to make informed decisions, which undermines the aim of the consumer duty.

"The appearance of higher charges is leading to investors selling investment trusts. The appearance of higher charges is misleading investors."

An example of the rules impacting in, what Altmann views as, a negative way for investors is that, by classifying investment trusts in the same way as open-ended funds, the charges appear higher to own the same asset.

For instance, a renewable energy investment trust, which is a listed company owning renewable energy assets such as a wind farm, has to disclose charges such as audit fees, which are not paid by the investor directly, as if they are paid by the investor directly.

Yet a conventional equity company, such as a listed energy supplier, does not need to report such charges as part of the cost of ownership for an investor, despite the costs also being paid.

Altmann said: "This is leading to a situation where people are selling investment trusts or not buying them. Its undermining competition and the UK is the only country in the world that treats investment companies this way."

The response, seen by FT Adviser, states the requirement in the proposed new rules for “repayment” of an investment leaves open the risk that clients could misunderstand the nature of investment trusts.

Cost disclosure

Open-ended funds have one price, a net asset value, which is also the unit price and therefore the price the client receives when they sell investment.

However, investment trusts have two values, the price at which the investment trust shares trade on the stock market, and a net asset value, which is the value of the underlying investments.

With investment trusts, these two values are rarely the same, with the share price trading at either a premium or a discount to the net asset value.

The rules as written, according to Gravis Capital's Bill MacLeod, may imply that an investor has a legal right to the repayment of the net asset value of their investment, even if this is a higher cash amount than the value of the shares they own.

Right now, the average investment trust trades at a discount of 10.8 per cent, that is, the difference between the net asset value and the share price, according to data from the Association of Investment Companies.

An investor selling their shares gets the share price amount, not the net asset value amount.

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> Richard Stone, AIC

The signatories to this consultation are concerned that the wording of the proposed new legislation may confuse investors into thinking they are entitled to the net asset value amount.

Bill MacLeod, managing director at Gravis Advisory, said the new rules "don't really address" the issue of how investment trusts are treated in legislation.

He wants investment trusts to be excluded from the new regulations on cost disclosures, so they are treated as neither the same as equities or open-ended funds.

This call is echoed by Richard Stone, chief executive of the AIC, who said: "Regulated cost disclosure in its current form causes market distortions. It creates incentives for investment firms to hold investments that do not have an explicit cost disclosure, such as trading company shares.

"The costs disclosed can be inherently misleading where they do not compare like with like or exaggerate the cost of holding an investment, particularly where an investment company is holding unquoted assets.

"For investment companies the simplest way to resolve these problems is to remove them from the scope of regulated cost disclosure. Transparency will be maintained as their shares are traded on the stock market.

"This means that they make disclosures like any other listed company. The market in turn provides a strong discipline to bear down on excessive costs.

"If the government does not take this step, then we would urge the FCA to use its new powers to focus regulated cost disclosure on the cost of asset management. This would shine a light on an expense which is obscured by the current approach, which bundles costs together. This makes it more difficult for consumers to make price comparisons and reduces competition in the public interest."

Another impact is being felt by those who run fund of fund strategies, as thsis may restrict their capacity to buy investment trusts within those funds, as the costs appear higher.

Rob Burdett, head of multi-manager at Columbia Threadneedle said: "Cost transparency is an important feature of consumer information, but there were flaws and unintended consequences as to how other layers of legislation impacted how LCICs costs were presented. The response from the LSE and other industry participants seeks to resolve this issue."

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