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# Computer says ‘no’; FCA says ‘yes’: Where are we on cost disclosure reform?

Plans to reform UK retail disclosure rules have left the UK’s capital markets in limbo, with ‘everybody doing different things’.

BY DANIELLE LEVY

- The investment trust industry has been left in limbo as confusion reigns about the path forward for cost disclosure.
- In September, the Treasury’s forbearance statement exempted investment companies from the EU’s Priips and Mifid II directives, which had required them to disclose ongoing charges.
- The industry had long argued this requirement did not apply to them as these expenses are already reflected in their shares’ value. As a result, they were double counting their costs.
- Since the statement, investment companies are no longer required to provide key information documents (KIDs) with data that double counts their operating expenses. The same advice is understood to apply to the European Mifid templates (EMTs) that investment platforms, wealth and fund managers use when investing in investment companies on behalf of clients.

Responding to the announcement, the Association of Investment Companies (AIC) encouraged its members to show their ongoing charges as zero and to provide investors with an explanation about recurring costs being included in the share price.

New UK disclosure rules for 'consumer composite investments' (CCIs) will follow in the first half of next year after the Financial Conduct Authority (FCA) completes a consultation, due to start in the coming weeks, canvassing industry views on the best way forward.

## Impasse: Trusts vs platforms

The Treasury's announcement was greeted with elation, but this soon turned to confusion. Investment trusts that apply zero ongoing charges to their EMTs have run into challenges with platforms, which claim doing so is misleading for investors and have barred the trusts from taking on new investments.

Today, many investment trust managers and investors are adamant that it is correct to publish zero for ongoing charges and that doing otherwise is misleading.

'We've got this bizarre situation where some investment trusts are continuing to disclose ongoing charges because they are so terrified of "de-platforming",' said Ben Conway, chief investment officer at Hawksmoor and a member of the Disclose: Don't Double Count campaign.

In his opinion, trusts find themselves between a rock and a hard place. On the one hand, they want to appease platforms and continue to take on new investors. On the other hand, wealth managers and funds of funds are keen to reinvest in trusts but need them to publish zero ongoing charges before they can do so.

**“We’ve got this bizarre situation where some investment trusts are continuing to disclose ongoing charges because they are terrified of de-platforming.”**

Nathan Long, senior policy analyst at Hargreaves Lansdown, said: 'Nobody is suggesting there are not operating expenses for an investment trust that essentially are deducted from the NAV [net asset value].'

However, he acknowledged that forbearance ahead of the FCA's full consultation on disclosure had created confusion. 'This short-term sticking plaster is causing unintended consequences,' he added.

## Vested interests?

Ros Altmann, who campaigned alongside fellow House of Lords member Sharon Bowles to resolve investment trust cost disclosure, suspects vested interests have driven the platforms' actions.

'The retail platforms make extra profit when investors buy an open-ended fund, and they don't seem to want to admit that closed-end companies, especially at large discounts, could offer much better value for investors than open-ended funds,' Altmann said.

The 'extra profit' is the custody fee that platforms receive when a customer holds open-ended funds. She believes it is wrong to perpetuate misleading disclosures.

'It is most disappointing that platforms seem to be exploiting their market power to browbeat investment trusts,' she said. 'The boards of these companies are being told to make up some numbers because the platforms reject zero. There is no ongoing direct consumer charge but forcing companies to pretend there is prolongs the market dysfunction, which has already done great harm.'

## Time to update

Gravis Capital initially saw two of its investment companies – GCP Infrastructure Investments and GCP Asset Backed Income – barred from taking new investments on Hargreaves Lansdown after it put zero ongoing charges on their EMTs.

Bill MacLeod, managing director of Gravis Advisory, said: 'We're caught in a world where "computer says no."'

He puts this down to platforms' systems having no time to adapt after the Treasury's surprise forbearance statement. If a fund or investment trust puts zero on the EMT, systems are programmed to stop new investments coming in.

**"If you present investment trusts accurately, remove an impediment to purchasing them and make them more attractive to buy, you give them a fighting chance to recoup some of the lost ground."**

MacLeod notes that significant reprogramming is required for systems to interpret the difference between a fund and an investment company, as well as there being no ongoing charges for trusts.

The firm has decided to put in an average bid-offer spread over a five-year period as a cost on its EMTs, amounting to a small number of basis points. MacLeod says this is 'genuinely the only way you could say there's a cost to the shareholder of buying and selling these shares'.

Now there is no longer zero on the EMT, both trusts can take on new investments on Hargreaves.

## FCA must step in

Much is riding on whether the FCA formally confirms it is acceptable for investment trusts to publish zero ongoing charges.

One industry insider, who preferred to remain anonymous, pointed to the FCA's oral evidence during a Treasury select committee in May, when the regulator's chief executive, Nikhil Rathi, said he did not agree that investment trust costs are zero.

The insider said: 'It is unlikely there will be zero in the end-game regimes, so bear that in mind as you think through this temporary arrangement.'

MacLeod disagrees. He points to comments by FCA chair Ashley Alder at the Financial Services Regulation Committee meeting on 13 November, where Alder agreed that ongoing charges are not deducted from the share price.

Richard Stone, chief executive of the AIC, said the FCA's consultation on CCIs can't come soon enough, adding 'we need that steer'.

Conway suspects the new disclosure rules are at least a year away from being implemented and is concerned the current confusion will perpetuate, with investment trusts taking different approaches to cost disclosure.

'We're arguably in a worse state because everybody is doing different things,' he said.

## New template for costs

One solution put forward by Abrdn and adopted by others is for investment trusts to publish a statement of operating expenses (SOE). It hopes this will become a new template for disclosing investment trust expenses.

The SOE includes recurring expenses such as the management charge, as well as directors' and auditors' fees. These are totalled and expressed as a percentage of the average NAV and compared with the previous year.

Abrdn has published these statements for most of its trusts, but its factsheets still include an ongoing charges figure. Christian Pittard, head of closed-end funds at the firm, said this was an 'unfortunate reality'.

He said the SOE had been received well so far, with the only criticism being that it may be too detailed.

## “We’re caught in a world where ‘computer says no’.”

'It's a good place to start,' he said. 'Too much disclosure feels much more comfortable to us than having a single number.'

He notes that, during this interim stage, some asset managers are concerned about devoting time and effort to publishing SOEs only for them to be replaced with a different template when the new rules come in.

He feels comfortable putting in the additional work now in the hope of creating clarity and consistency in the industry.

Conway would like to see the SOE replace the KID for investment trusts.

'The hope is that the SOE is accepted as the industry template and then somehow the platforms have to oblige,' he said.

The AIC has not formally endorsed the SOE as the best way forward but has no issue with it as a potential solution. Stone notes that it provides investors with granular information on expenses, so they can make informed investment decisions.

## Fighting chance of recovery

If investment trusts no longer have to double count their costs, could this facilitate a rerating in the shares of closed-end funds?

'It would prevent further selling and discounts widening,' said Conway, 'but it will take a very, very long time for the demand that has left the market to come back.'

MacLeod expects to see wealth managers and funds of funds return to the market and is encouraged to see some have already adopted zero-cost disclosure in their information.

'There's absolutely no suggestion that cost disclosure fixes the pricing or the discount anomalies we see market-wide,' he said.

‘One is not the cause of the other, but if you present investment trusts accurately, remove an impediment to purchasing them and make them more attractive to buy, you give them a fighting chance to recoup some of that lost ground.’