

# A Charter for Churners

(From Update 2003/5)

by Stephen Wynn

*"We have decided that we will not bring forward proposals to require the disclosure of portfolio turnover."*

The Financial Services Authority

But the *Investors' Chronicle* (March 14th) reported: "The Financial Services Authority estimates that 100% portfolio turnover costs funds 1.5-1.8% on average, including stamp duty." That is per cent of capital per annum. The FSA describes these costs as 'undisclosed' and yet is explaining how to calculate them! 'Undisclosed' in fact means undisclosed on fact sheets at the point of sale, and on its Comparative Tables. The FSA has been persuaded that disclosure of portfolio turnover at these sensitive moments would cause concern and discourage sales.

We can distinguish between disclosure on fact sheets, comparative tables, and accounts. Portfolio turnover is given as a percentage in the accounts of mutual funds in the US but not those of unit trusts and oeics in the UK.

The FSA has been consulting on this topic asking: 'Should product providers be required to publish data on portfolio turnover as a partial substitute for dealing costs?' Fitzrovia ([www.fitzrovia.com](http://www.fitzrovia.com)) saw this as an opportunity to extend the data it provides on total expense ratios

(TER) to portfolio turnover. Fitzrovia has produced a report on 'Portfolio Turnover of UK Funds', containing comparative tables of turnover ratios for unit trusts and oeics.

Following their consultation the FSA came to the conclusion at the head of this article. The FSA is saying that portfolio turnover need not be disclosed by 'product providers'. But it is actually being disclosed in the case of unit trusts and oeics by Fitzrovia.

## The Fitzrovia Report

Turnover ratios for surveyed funds range from 0.6% to 685.5%. The average of the funds of different asset management companies, range in the case of actively managed equity funds from 7.0% for Wesleyan to 176.2% for Artemis. Funds invested abroad generally have higher turnover. The average for South Korea is 120.4 % which is more than twice the 53.7 % for the UK. Average values have been increasing with time.

The turnover ratios in the Fitzrovia report should be compared with investment performance. There seems to be a correlation with TERs. Funds with high explicit charges tend to have higher turnover – that is high undisclosed charges. So investors are hit with a double whammy. I can send any UKSA members the list of asset management companies showing the average values for their equity funds – such as MGM 22.4%, Legal and General 109.1%.

The Fitzrovia report should be extended from unit trusts and oeics to the life insurance industry.

The 1% cap on charges is a cornerstone of government policy for retail investors. But the 1% cap of stakeholder pensions does not include dealing charges, nor does the 1% cap of the proposed 'stakeholder products' or the 1% cap of ISA CAT standards. This is unfortunate since, for example, the FSA states that personal pensions 'tend to have high portfolio turnover and high undisclosed charges'.

### **A worldwide problem**

There is an enormous literature on the web on the topic of portfolio turnover and dealing costs (e.g. [www.plexusgroup.com](http://www.plexusgroup.com)). It is a worldwide problem. In the US, the average turnover of mutual funds has increased from less than 20 % in the 1950s to over 100 % today. On my website [www.comparativetables.com](http://www.comparativetables.com), I quote John Bogle who complains about: 'the change in the central ethic of the mutual fund industry from the profession of investing – the stewardship of shareholder assets – to the business of marketing – gathering assets and creating whatever "products" it takes to do so.'

Nevertheless the government does not want retail investors to concern themselves with dealing costs! And yet following the Myners Review, it says that the trustees of occupational pension schemes 'should have a full understanding of the transaction related costs they incur, including commissions'.

If investors have to consider dealing costs or at least portfolio turnover, it implies that fund managers cannot be trusted not to make unnecessary trades and stakeholder products are not 'simple' and 'low cost' as claimed.

'People will increasingly need to look after their own financial interests for themselves.'  
This statement of government policy implies that the government wants more people to be individual investors, that is either private shareholders or purchasers of the 'products' of the financial services industry.

The charges of the 'products' of the industry are like payment of a fee-for-service basis. This method of payment is expensive. It is a reason why the health service in the US is more expensive than our NHS.

The fund management industry, that is the part of the financial services industry concerned with fund management – life assurance companies and fund management companies – seems to be costing about £1000 per person per annum. Such a high cost results from charges for retail savings 'products', rather than occupational pension schemes which are much cheaper to administer.

People should either be private shareholders or their capital should be looked after by trustees, like the trustees of occupational pension schemes, because they do not work on a fee-for-service basis. In conclusion, people are being encouraged to buy the 'products' of the financial services industry. The FSA is not encouraging the disclosure of portfolio turnover. Stockbrokers' commission and stamp duty are outside the 1% cap on charges. This is a charter for churners.