

Cost disclosure: issues and progress

Update

Reforming cost disclosure remains a priority. The AIC is lobbying policymakers and regulators as well as engaging with stakeholders on this issue. Progress is being made but the pace of reform is constrained by the political and regulatory realities of achieving reform.

Our headline position

The AIC has been seeking improved disclosures for many years. Meaningful progress is now within sight as Packaged Retail Insurance and Investment Products (PRIIPs) Key Information Documents (KIDs) are to be abolished and the FCA is expected to implement a wider reform of cost disclosure.

We are supportive of efforts to highlight and address cost disclosure by excluding investment companies from the AIFM Directive, which are being brought forward in the House of Lords. This initiative emphasises the importance of reform and the need for urgent action. Exclusion from AIFMD would not, in and of itself, necessarily relieve investment companies from making some form of cost disclosure. We are therefore also continuing to emphasise the importance of reforming the cost disclosure framework and arguing for better cost disclosures as set out below.

- **Underlying fund costs:** Where an investment company or fund portfolio includes collective investment vehicles (closed or open-ended) no costs related to that vehicle should be disclosed. This treatment would apply whether the portfolio is held by an investment company or another fund. The exception would be where the underlying cost is managed by the same manager and there is no rebate to the holding vehicle.
- **Ongoing charge:** The management fee and other costs associated with running the investment vehicle should be the only cost disclosed by client-facing firms to the end investor. The same costs would be disclosed in relation to open-ended funds etc., creating a fair disclosure.
- **Incidental costs:** These are the expenses incurred in the (successful) delivery of the investment strategy. These would be disclosed by an investment company or open-ended fund, e.g. alongside the ongoing charge, in the KID (or its successor).

These changes would be applied to the cost disclosures for all collective investments.

What would a revised cost disclosure framework look like?

The impact of the AIC's proposals can be seen using a hypothetical investment company, *TrustCo*. It holds other collective investments in its portfolio. *TrustCo* is **currently disclosing 2% charges** in its Key Information Document (KID). The same figure is being disclosed by firms distributing to retail clients in accordance with their MiFID obligations.

These costs are set out in its KID as below:

One off charges	N/A	0%	
Ongoing costs	Portfolio transaction costs	0.5%	
	Other ongoing costs	1%	Inc: 0.5% management fee 0.25% underlying fund costs (paid to another manager) 0.15% gearing 0.1% other ongoing costs associated with operating the company e.g. director and audit fees
Incidental costs	Performance fees	0.5%	

Under a revised disclosure framework:

- Firms (wealth managers, platforms etc.) making onward cost disclosures to retail clients as a function of those clients' direct holdings or when distributing products to those retail clients would **disclose a cost of 0.6%** (the ongoing charge, comprised of the management fee 0.5% and the other ongoing costs 0.1%) in respect of holdings in *TrustCo*.
- *TrustCo's* KID/successor disclosure would show a headline ongoing charge of 0.6% (as above), with a separate disclosure of incidental charges of 1.15% (comprised of transaction fee 0.5%, performance fee 0.5% and gearing charges 0.15%). Each of these elements would be shown as line items, as below.

Ongoing charge	0.6%	Management fee	0.5%
		Other ongoing costs	0.1%
Incidental costs	1.15%	Transaction costs	0.5%
		Performance fee	0.5%
		Gearing	0.15%

Costs of underlying funds managed by the same manager would be included in the ongoing charge (except where an appropriate fee waiver is in place).

Focussing on the ongoing charge in client facing MiFID disclosures will reduce the negative impact of disclosure on members, while also recognising the regulatory objective of using cost disclosure to support competition between providers.

Disclosure of all costs, excluding synthetic (or underlying) costs, in the KID responds to the demand that costs should be transparent to the end investor. In many respects these disclosures are like those already made in the annual report and accounts.

Supervising the boundary of cost disclosure

The AIC's approach alleviates the most harmful aspects of the current cost disclosure framework. The perennial issue of the regulatory 'boundary' remains. That is, the fact that some investments have cost disclosures attached while others, such as trading company shares, do not.

The boundary issue affects all collectives, not just investment companies. The AIC's proposed framework will alleviate its worst impacts as the disclosable costs would be lower. This will allow the sector to better compete on its merits.

Regulators should ensure that the boundary is properly supervised. For example, current rules require funds outside UK and EU disclosure requirements to have costs attributed to them. This requirement should be enforced. Other steps, to minimise the perverse impact of cost disclosure, should also be taken to ensure client interests are protected.

Excluding investment companies from the AIFMD

Baroness Altmann will introduce private legislation to the House of Lords (on 22 November) to exclude investment companies from the scope of the Alternative Investment Fund Managers Directive (AIFMD). We welcome these efforts and support the bill albeit we have yet to see its text.

This proposal highlights the importance and urgency of the issues. However, given the interaction of PRIIPs and MiFID as well as the broader regulatory expectations around product cost disclosures, the enactment of this Bill may still mean that investment companies will still be required by regulation or market practice to make some cost disclosures. If this is the case, they should be reformed in the manner set out above. This bill should, at the very least, help accelerate the process of reform.

A broader policy question arises in relation to other regulatory issues (i.e., not cost disclosure). Currently investment companies are not regulated – and maintaining this status has been, and remains, a key objective of the AIC. This is supported by the current regulatory framework which imposes obligations on the AIFM (which usually is an external firm) and the Listing Rules.

Changing the regulatory architecture that sits around the investment company sector may have other implications and we will work with the government and FCA to address any issues should they arise.

The success rate for private members bills is limited and hinges heavily on government support. We will be writing to the minister to express our support for the bill. We will also be continuing to press our case for reform and for a comprehensive review of the retail cost disclosure framework.

Milestones in achieving reform of cost disclosure

Aside from Baroness Altmann's Bill, the next key milestone in addressing industry concerns will be the publication of HM Treasury's draft legislation to give the FCA powers to change the cost disclosure framework. This is expected in the next few weeks. It should be enacted in H1 2024. In comparison, equivalent draft legislation, to reform the AIFMD, is not expected

until later next year. The fact that reform of cost disclosure is more advanced indicates that this route is likely to offer the swiftest way to achieve meaningful change.

We are pressing HM Treasury to give the FCA the widest possible powers to reform cost disclosure. This should facilitate changes to pre-sale disclosures (Key Information Documents) and within the distribution chain (including the MiFID disclosures).

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To discuss the issues raised in this paper please contact:

Guy Rainbird, Public Affairs Director. guy.rainbird@theaic.co.uk