

**BAILLIE GIFFORD**

# Costs and Transparency

*CIPFA*

September 2016



# **Aim**

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**To raise awareness as to the costs  
associated with investing**

**Understand why this matters**

**Think about what questions you should  
be asking of Fund Managers**

# Investment Management: Hidden vs Visible Costs

	Explicit Fees	Total Costs
Edelen et al (2013)	1.19%	2.63%
Khorana et al (2008)	0.63%	1.25%
Railpen (2014)	£70m on £20bn ~0.35%	1.4–1.75% £280–350m

**‘20% of our assets gave rise to two-thirds of our costs’** (Railpen).

Sources:

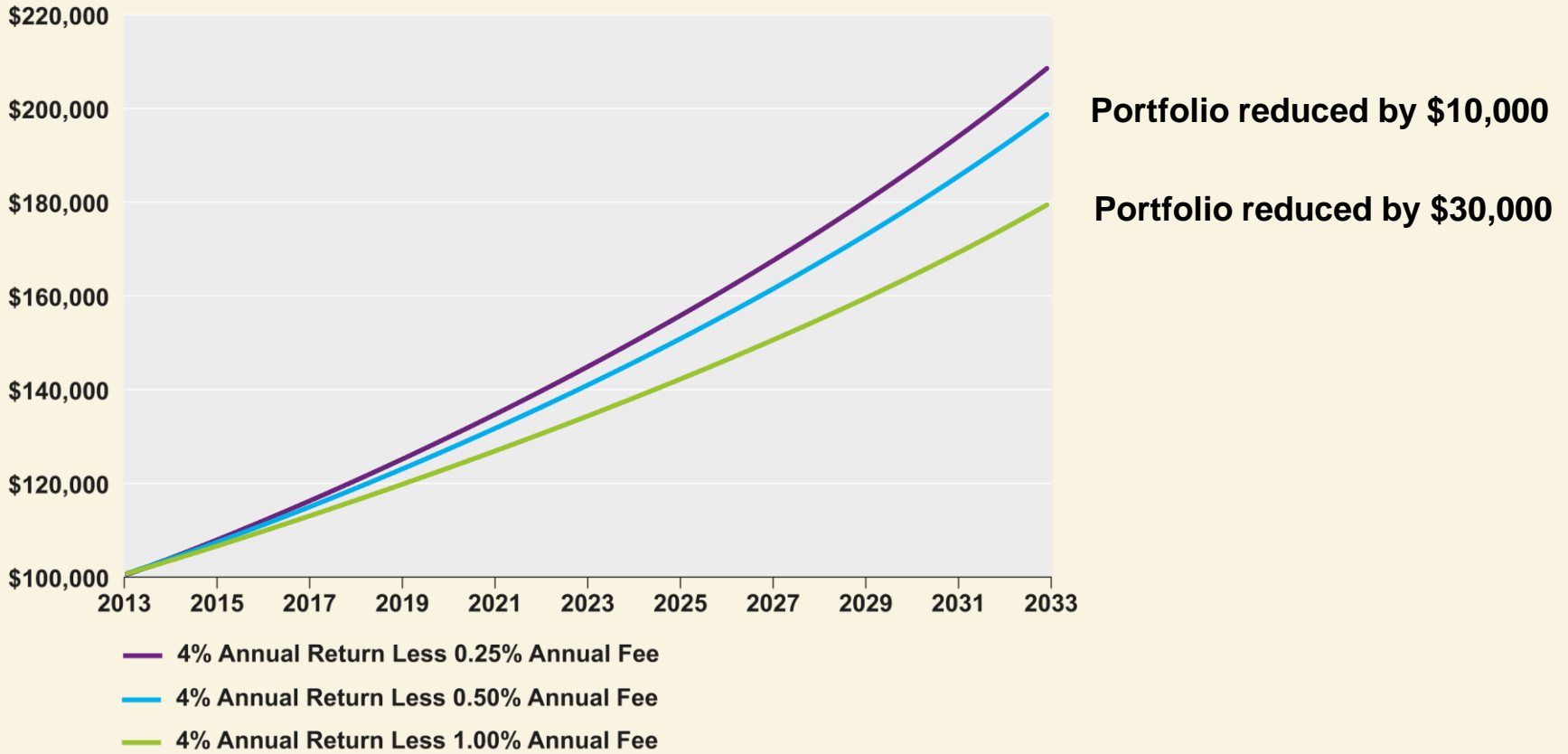
‘Mutual Fund Fees Around the World’ 2008; Ajay Khorana, Henri Servaes, Peter Tufano.

‘Shedding Light on “Invisible” Costs: Trading Costs and Mutual Fund Performance’ 2013, Roger Edelen, Richard Evans, Gregory Kadlec.

Railpen Investments 2014.

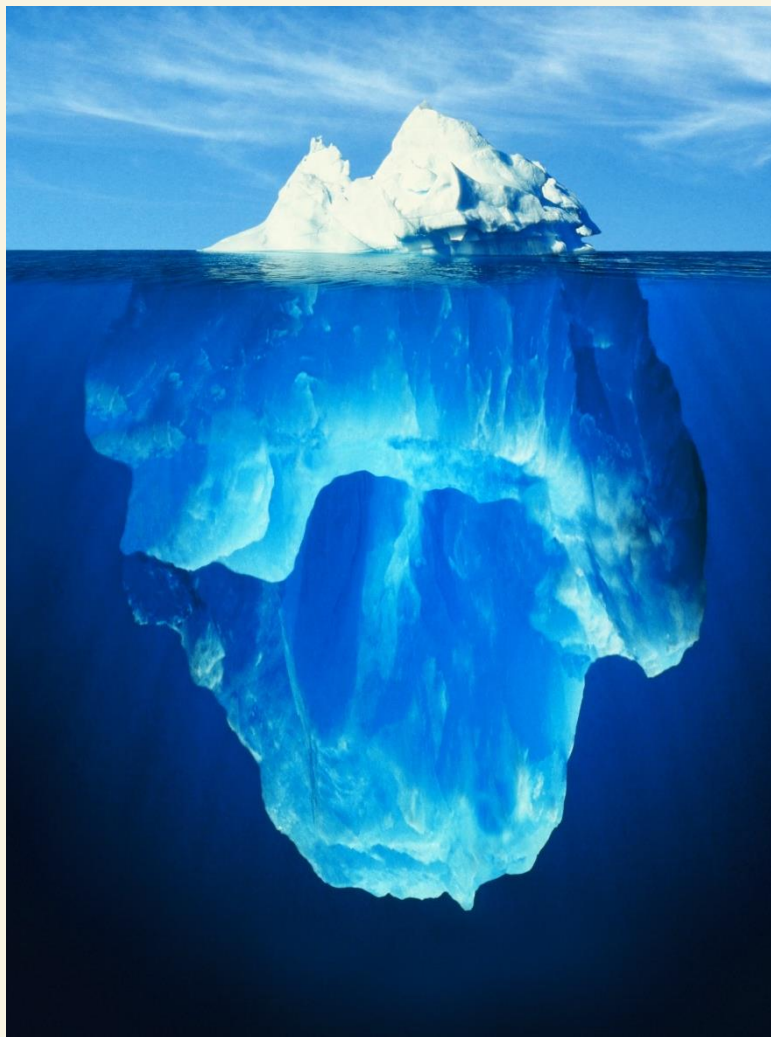
# Why Costs Matter

## Portfolio Value From Investing \$100,000 Over 20 Years



Source: SEC.

# What Are The Costs?

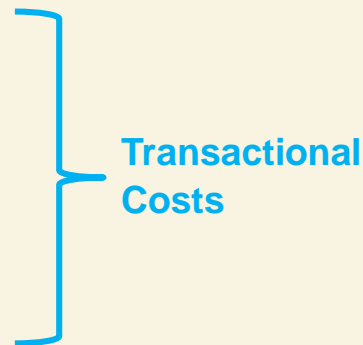


## Explicit costs

- Annual Management Charge
- Custody Charge
- Accounting, Admin & Legal Costs

## Hidden costs

- Broker's Commission
- Bid/Offer Spread
- Market Impact
- Stamp Duty/FTT
- Exchange/Clearing Fees
- FX Costs



## Other costs

- Carry
- Performance Fees
- Broker Research Costs
- Transition – Manager Hire/Fire

# Worked Example of Dealing Costs

## Buy 1m shares in EasyJet

Bid/offer spread	1196–1198p	Buy high sell low
Broker's commission	0.07%	Varies by market
Stamp duty/FTT	0.50%	Varies by market
Market impact (i)	0.02–0.03%	Impact over one day (VWAP)
Market impact (ii)	0.2–0.5%	Impact over several days ('arrival price')
=> Total costs per trade	c.0.3–0.7%	
=> Total round-trip cost	c.1%	How often does your manager trade?

# Example From Other Markets

## The Netherlands

- Recommendations on Administrative Costs first issued in 2011 by the Federation of Dutch Pension Funds
- >90% of Schemes reporting administrative and transaction costs
- Dramatic fall (>90%) in Schemes reporting total costs >1.5% pa
- Anecdotal evidence that costs have fallen by 20–30%

# **Transparency Initiatives**

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## **Kay review**

### **CIPFA**

- Implementation of 2014 Guidelines
- 2016 Guidelines

### **MIFID II**

### **PRIIPS**

### **UK DC workplace pension scheme reporting requirements**

### **SAB/LGA/IA**

- Code of Transparency



# Proposed Investment Association Cost Template

## Code of Transparency

FUND MANAGER COST COLLECTION TEMPLATE							For use with investments in pooled funds	
<i>All figures in % of average NAV pa unless specified</i>								
<b>Fund Manager</b>								
Fund name								
Share class name								
Date of report								
<b>Investment return (% pa)</b>								
	1 year	3 years	5 years	10 years	Since formation			
Net return								
<b>Investment activity (£'000)</b>								
	Total	Equity	Bonds	Property	Pooled funds	Other (specify)		
Opening assets	0							
Closing assets	0							
Purchases	0							
Sales	0							
Turnover (% pa)	%	%	%	%	%	%	%	%
<b>Ongoing charges</b>								
	Total							
Managers fees								
Other fees								
Indirect fees								
<b>Total ongoing charges</b>	<b>0.00%</b>							
<b>Performance fees</b>								
Performance fees								
<b>Transaction costs</b>								
	Total	Equity	Bonds	Property	Pooled funds	Derivatives	Foreign exchange	Other (specify)
Transaction taxes	0.00%							
Broker commission	0.00%							
Market spread cost	0.00%							
Market impact cost	0.00%							
Entry/exit charges	0.00%							
Indirect transaction costs	0.00%							
Exchange fees	0.00%							
Other transaction costs (specify)	0.00%							
Anti-dilution offset	0.00%							
<b>Total transaction costs</b>	<b>0.00%</b>	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
<b>Stock lending (if applicable)</b>								
Gross income								
Less: income shared (name recipient)								
Less: other costs								
Income retained by pooled fund	<b>0</b>							

All explicit costs

Transaction and other costs

Explicit and Implicit

‘Voluntary’ standard

# Conclusions

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**Costs are known – future returns are not**

**The impact of even small costs over time is enormous**

**Transparent information leads to better decision making**

**Investment returns net of costs are what matter**