TACIT Investment Management

defaqto 2019

3D 2019 TACIT INVESTMENT MANAGEMENT AWARDED BY ARC

Insights & guide into DFM Services from a DFM

Understanding the different DFM approaches, costs, risk & performance

November 2020

What you will learn

Objective to develop a clearer insight into the key aspects of the DFM industry

- Support a clear understanding of the different approaches to accessing discretionary investment management –

    - Bespoke
    - Managed v tailored
    - Platform MPS V Unitised DFM.

- Advantages and disadvantages of using discretionary investment management.
- Where and who has the on-going suitability responsibility with regard to the underlying client?.

- Is volatility a good measure of risk?.

- True costs in each approach and how this impacts on outcomes – gross & net variations.

- Measuring outcomes – some common and less common DFM benchmarks.

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DFM investment approaches & services

INVESTMENT APPROACHES

DIRECT, FUNDS OR HYBRID

It is very common for a DFM to operate a hybrid investment model. This means that the UK core equity element will be direct UK stocks and invariably the balance will be either investment trusts, ETFs or open ended funds to gather both international and alternative asset class exposures.

Traditionally, **managed portfolio services (MPS)** portfolios are general a portfolio of funds with the most effective combination being a hybrid combing investment styles (growth, momentum, value, large and small cap, alternatives) to adopt the most efficient investment outcomes accounting for both economic and market cycles. *(An example of style rotation on slide 5).*

Whilst a **passive** approach has become more prevalent it is important to consider active managers universe within the respective market sectors that generally offer consistent outperformance within inefficient market sectors as this may offer highly an effective outcomes over time.

The underlying focus should potentially lean towards a combination of all these factors or a hybrid high conviction asset allocation which has historically over timeframes of 5 years or longer offered some stronger optimal results.

Style Rotation – Value vs Growth, Size & Asset Class Performance

Annual Nominal Returns in GBP

1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Small Cap 42.75	UK Gilt 8.08	UK Gilt 6.21	Gold 12.59	Small Cap 42.43	Small Cap 23.95	Gold 31.40	Small Cap 25.13	Gold 27.73	Gold 43.86	Small Cap 54.29	Gold 32.77	Gold 10.45	Small Cap 30.01	Small Cap 36.60	Mid Cap 6.97	Small Cap 14.81	Value 26.56	Small Cap 21.04
Mid Cap 35.50	Gold 2.14	Gold 5.24	UK Gilt 6.58	Value 27.38	Mid Cap 21.49	Small Cap 27.55	Mid Cap 24.39	Growth 14.18	UK Gilt 9.18	Mid Cap 40.02	Small Cap 30.95	Value 5.30	Mid Cap 23.54	Mid Cap 25.26	Gold 4.36	Growth 9.20	Gold 28.52	Growth 12.80
Large Cap 20.13	Small Cap 1.69	Small Cap -0.99	Large Cap -21.77	Mid Cap 23.39	Value 16.57	Mid Cap 26.41	Value 17.38	Large Cap 9.65	Large Cap -27.47	Growth 32.63	Mid Cap 18.60	UK Gilt 3.09	Value 13.43	Growth 21.16	UK Gilt 1.75	Mid Cap 4.96	Large Cap 22.80	Mid Cap 12.78
Value 18.89	Mid Cap 0.09	Mid Cap -9.32	Mid Cap -22.27	Large Cap 16.83	Large Cap 9.04	Growth 21.25	Large Cap 12.22	UK Gilt 6.94	Value -28.10	Large Cap 25.69	Growth 16.50	Large Cap -1.28	Large Cap 7.95	Large Cap 17.21	Growth 1.49	UK Gilt 0.59	Growth 9.22	Large Cap 11.50
Growth 13.01	Value -3.36	Value -10.84	Growth -23.23	Growth 9.97	Growth 6.39	Large Cap 19.94	Growth 11.65	Value -0.76	Growth -29.30	Value 21.53	Large Cap 11.03	Mid Cap -5.11	Growth 7.32	Value 16.05	Small Cap 0.17	Large Cap -3.87	Mid Cap 6.91	Value 10.85
Gold 4.73	Growth -5.78	Growth -13.18	Value -23.47	Gold 7.05	UK Gilt 4.62	Value 19.07	Gold 6.73	Mid Cap -7.21	Mid Cap -33.55	Gold 9.38	Value 7.20	Growth -6.86	Gold 1.42	UK Gilt 0.00	Value -0.35	Gold -5.71	Small Cap 6.86	Gold 3.02
UK Gilt 2.90	Large Cap -6.38	Large Cap -13.46	Small Cap -26.70	UK Gilt 3.41	Gold -2.25	UK Gilt 4.92	UK Gilt 3.02	Small Cap -11.49	Small Cap -39.64	UK Gilt 3.17	UK Gilt 2.71	Small Cap -11.77	UK Gilt 0.44	Gold -29.98	Large Cap -0.80	Value -9.46	UK Gilt 1.47	UK Gilt -0.42

1. **In the UK, small cap stocks have dominated the market over the last 18 years**
2. **They also have the largest drawdowns during crises and uncertainty**
3. **Important to understand the market cycle & position accordingly**

Note: Small cap returns based on MSCI UK small cap index, mid cap returns based on MSCI UK middle index, large cap returns based on MSCI UK large cap index, growth returns based on MSCI UK growth index, value returns based on MSCI UK value index, UK gilt based on BBGBarc UK gilt 1-3-year index and Gold based on S&P GSCI TR index. Data sourced from Morningstar Workstation. Past performance is not a reliable indicator of future results.

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DIFFERENT WAYS OF APPROACHING DFM

A clear understanding of the options in accessing DFM services

- Bespoke
- Tailored / Managed Portfolio Service
- Platform Managed Portfolio Service
- Unitised DFM / Multi-asset
- Consultancy
- Specialist: ESG, AIM-IHT.

BESPOKE

Features

This is a commonly associated term for discretionary investment management services as it offers the connotation that an investment strategy will be created specifically for the clients requirements, being unique in this respect. Additionally there is often a perception that direct equities may be held as a part of the portfolio construction.

The reality is that whilst investment mandates can accommodate specific investment needs and requirements it is common to find a range of similar investment portfolios that meet underlying suitability requirements whilst allowing for a clients investment bias or wish to be accommodated, such as a cherished holding or legacy tax constrained position.

This is based principally on the economic limitations of the allocation of asset various asset classes to meet suitability requirements, or "a simple law of diminishing returns" in terms of marginal gains in creating a wide range of uniquely different portfolios which ultimately is uneconomical and can generate higher risk levels would be impractical.

It is often more appropriate that outcomes that can be measured more effectively through common asset classes and holdings for many of the same clients based on their underlying investment and risk requirements.

However the bespoke service element is still a feature which offers greater direct interaction with an experienced investment director, decision maker for both adviser and client.

Some benefits:

- Portfolios can accommodate a wider range of unique requirements.
- Dedicated investment specialist relationship which develops stronger understanding of clients investment needs
- Clients influences more broadly incorporated with highly specific and technical investment mandates being provided
- Tax management and cashflow management incorporated into overall portfolio investment planning.
- Generally higher value thresholds for enhanced service offering which limits the number of investment / client relationships with the investment professional.

TAILORED / MANAGED PORTFOLIO SERVICES

Features

Probably the more appropriate term for many discretionary investment portfolios. Traditionally created around several asset allocation models to accommodate clients underlying suitability requirements which can be more effectively managed and monitored to meet on-going outcomes and underlying capacity for loss through respective investment time horizons.

Alongside a range of portfolio models clients wishes can be tailored into the underlying portfolio construction to accommodate, cherished holdings, capital gains tax constraints, ethical or other investment biases with adjustments being made with the asset allocation and portfolio holding construction to ensure the suitability of the investment mandate.

Portfolio construction can incorporate direct equity positions and funds or may be a hybrid of fund styles to achieve similar mandate outcomes.

Invariably the service level will with be with a qualified investment professional, traditionally this has been more of a feature within private bank discretionary services although it has been adopted with many wealth managers in more recent years.

Some benefits:

- Similar client outcomes offering greater clarity for the adviser and client.
- Individual influences can be addressed to some extent on behalf of a client.
- Interaction with an experienced investment professional, a centralised investment process which offers greater overall control of consistency.
- DFMs will manage portfolios across respective tax wrappers in the most effective manner at both a portfolio and relationship level.

PLATFORM - MANAGED PORTFOLIO SERVICES

Features

A further distillation of the tailored / managed portfolio approach but more commonly the portfolio construction is focussed on funds whether one style or a range of styles, such as ETF, ETC, closed and open ended. This allows for greater flexibility in transferring and managing underlying portfolios within the platform environment to create more effective access and control for the adviser community.

Currently there are an average of 8 platform partners for DFM MPS providers utilised by the advice community (Defaqto research) but this can range up to 18 in some cases.

Some benefits:

- Decisions taken by third party investment specialist in creation of the underlying investment model.
- The DFM is accountable for performance and investment mandate suitability once selected by the adviser.
- This is an arms length relationship ensuring that the adviser and client aren't encumbered with the additional DFM interactions.
- Importantly, it is perhaps advantageous to clients that their assets will be looked after full-time by an investment specialist. This can result in a positive shift in the client/adviser dynamic in that both parties are working together to find the best solutions.
- The DFM will not know who the client is but will manage the underlying investment mandate whilst the adviser is free to spend more time focusing on the client while maintaining responsibility for the suitability and due diligence.
- Advisers can select most effective platform environment to match the clients financial planning requirements.

UNITISED DFM – MULTI-ASSET FUNDS

Features

Over the last several years many investment organizations to include discretionary investment managers have created multi-asset fund offerings which are risk graded to meet clients underlying suitability requirements.

Typically the underlying assets are either direct equity or more commonly a range of funds held within an oeci structure. The rationale is simple in that these are transparent investment structures, tax efficient and delivered under a defined corporate governance structure through KIDD disclosures and the use of an ACD.

Some benefits:

- Costs are transparent through the on-going Chargeable Fee (OCF) definition.
- Accessible on a majority of platforms.
- Non-vatable as not a service proposition.
- Investment changes within the oeic structure does not give rise to a taxable event for capital gains tax which offers more efficiency as an investment structure.
- Performance and other comparisons are more readily available and highly transparent and simpler for adviser and client assessment.
- Risk rated through the appropriate risk profiling agencies
- Generally lower total costs due to the efficiencies of scale and structure.
- Commonly blended within advisers central investment propositions from a range of alternatives to reduce a single DFM / Asset management risk
- Rebalancing is on-going
- Time requirement is relatively low in monitoring for the adviser
- Fund switching and re-weighting is relatively simple

The drawbacks:

- These are not service orientated so limited investment specialist support
- ***Demonstrating value under the FCA guideline for a selection of multi-asset funds may become more of a challenge with regard to an accrual based advice fee for investment management.***
- Additional investment implications and management of capital gains and other specific investment requirements, respective tax wrappers etc is limited
- Clients are pooled within a strategy so lacks personal link to clients investment circumstances
- Strategy is defined under mandate and cannot be varied for personal preferences

CONSULTANCY - INSOURCING

Features

An alternative to the more traditional methods of accessing DFM services has been the growth of DFM consultancy services to support existing advisers central investment propositions and where DFM permissions have been adopted by respective advisers to support "white label" investment process and committee insights and inputs.

The growth in applications for DFM permissions amongst the advice community has presented this alternative for DFM support in terms of providing segmented specific investment input and management on behalf of the advisers DFM proposition. (PFS / Netwealth Study 2019 indicates 16% of adviser firms), although only 6% with an adviser universe of 1-6 advisers which highlights the underlying opportunity for adviser firms)).

Some benefits:

- Aids in evidencing and supporting the value for accrual based fee income for the FCA in terms of having a defined an effectively managed investment process.
- The DFM lends their core expertise and disciplines in managing and maintaining effective investment processes through consultancy services.
- This is non-conflicting to the advisers business as the underlying DFM operates within the boundaries of "white labelling" allowing the adviser to continue to build both brand and relationships.
- Fixed costs are defined from the outset allowing the adviser to: a) Demonstrate value to the FCA for their investment proposition; b) The adviser can generate a more effective margin within the underlying knowledge that services are being offered at a fixed and defined cost; c) reduces underlying fixed costs within an advisers business I respect of supporting staff and systems; d) Imports significant investment experience and discipline which aids in reducing underlying investment risk and monitoring for the underlying investment business.
- Generates broader investment insights and perspectives without increasing headcount, whilst allowing for more time to be focussed on managing underlying client relationships and growing the AUM and profitability. This helps sharpen the underlying adviser proposition.

SPECIALIST DISCRETIONARY SERVICES

Features

Dedicated discretionary investment service featuring a specific investment mandate where the underlying investment is secondary to the overall portfolios prime directive / requirements.

Common specialist discretionary services are principally:

- Alternative Investment Management – BPR qualifying portfolios
- Environmental, Social & Governance (ESG)
- Qualifying Business Property Relief investments
- Enterprise Investment Schemes
- Venture Capital Trusts
- Ethically biased mandates

RECAP

Six key reference points

6 Key methods of accessing a DFM.

1) Bespoke

2) Tailored / Manged

3) Platform MPS

4) Unitised DFM

5) Consultancy

6) Specialist DFM

advantages & disadvantages

ADVANTAGES & DISADVANTAGES

Some advantages:

- Main advantage is focus on financial planning and strategy without the need to having to continually monitor investments and investment administration.
- Combining expert financial planning with a specialist investment manager can offer stronger value to an underlying client.
- DFMs are highly experienced investment professionals in manging client's capital.
- Portfolios are constantly monitored alongside markets optimising the chance of maximising returns within agreed risk parameters.
- Dedicated and experienced research and investment resources.
- Access to wider range of investments, institutional and founders fund classes.
- Selection from a broader range of investment opportunities.

Some disadvantages:

- Cost are often higher in utilising a DFM proposition.
- Demonstrating value can be difficult to quantify over the short term.
- It can be difficult to make clear comparisons in terms of services and true underlying costs, including fees, charges, custody and portfolio construction.

suitability & risk

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SUITABILITY

Responsibilities for advisers - PFS Guidance & Observations

“There are different ways in which an adviser firm (Adviser) and a discretionary investment manager (DIM/DFM) can work together to provide a discretionary investment service to the end investor but confusion with the terminology, the different nuances and the answer to ‘who is the client?’ have significant implications for Advisers. The act of an Adviser using the services of a third-party investment manager is often referred to as ‘outsourcing’ but in the FCA rule book only Advisers who have discretionary permissions can truly outsource to a DIM. So, if you are not outsourcing, what are you actually doing?”.

Diminimis observations:

“Diminimis has worked with the Personal Finance Society to help clarify who is responsible for what in the different operating frameworks. It is clear Advisers are unaware of the issues whilst many DIMs continue to promote their services with no clear understanding of the legal and regulatory requirements that need to be met. Research and due diligence is flawed if these issues are not considered. If you have signed an intermediary agreement with a DIM, based on the agent as client rule, but have not read and understood the terms and checked your client agreements meet with the requirements, you may have inadvertently left yourself vulnerable to future claims. This covers a lot of the MPS on platforms as well as some ‘bespoke’ solutions.

Why might some Advisers have unintentionally over-stepped the mark? You may have signed a legal document, the intermediary agreement, giving an undertaking to the DIM you have a level of authority from the end investor to; • Act as agent, in a legal capacity, with the power to commit and bind the client to specific actions. This will include the authority to appoint a DIM. If a standard advisory agreement is in place between you and your client, you are unlikely to have such a level of authority and have therefore exceeded your client’s authority. As such this may lead to DIMs not being properly appointed by you as you do not have the legal power to do so”.

Outsourcing:

This is a common term in respect of the use of DFM proposition but in truth can only be applied if the adviser has the binding authority to utilise an external DFM.

AGENT AS CLIENT, AGENT OF CLIENT OR RELIANCE BASED?

What is the impact to an advisers business

Agent as Client:

The **DFM** treats the advisory firm as the **client**, and considers that the firm is acting as the **agent** of the end investor. The adviser firm must have the appropriate authority from their **client** to be able to commit and bind them to the discretionary management agreement and thereby to appoint the **DFM**. Effectively the adviser will have the legal entitlement to act and apportion the clients affairs and will be recognized as holding the responsibility by both the DFM and the client in this arrangement. This is a common arrangement in the use of platform based DFM MPS services this may result int the loss of FOS protections for the underlying client if the DFM treats the adviser in this relationship as a 'per sa professional client'

Agent of Client:

The end investor is the client of the DFM; the adviser is acting in an advisory capacity for the client but the underlying DFM has responsibility for the suitability.

Reliance on others:

In many respects this is very similar to how services are delivered under the agent as client model. The main operating difference is ensuring a strong interaction between the adviser and DFM at the outset as both firms have a legal and regulatory duty of care to the same client. As such it is in the interests of both parties to ensure the solution provided to the client is suitable and that everyone, including the client, is clear about who does what. You and the DIM have the same regulatory responsibilities when taking on a new client and ongoing. As they are both regulated entities the DIM can rely upon your work to conduct all the client facing work and assessments.

The responsibilities under this relationship are clearly defined from the outset and FOS protection to the underlying client remains in place.

Please see further detail in the link below from the PFS Diminimus guide:

PFS agent as client

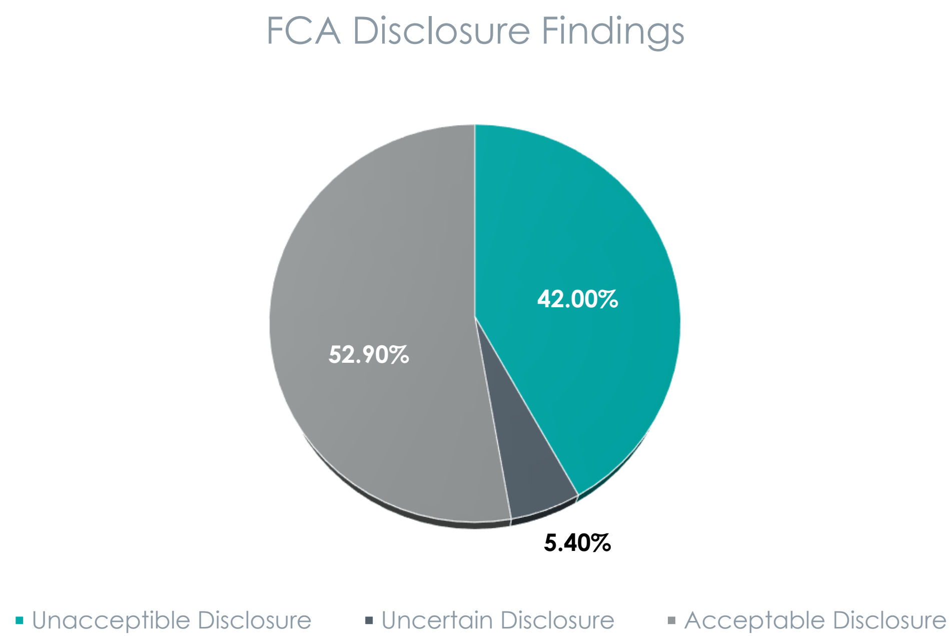
SUITABILITY FOR ADVISERS

FCA thoughts 1:

“I’m glad that I paid so little attention to good advice; had I abided by it I might have been saved from some of my most valuable mistakes.” we are unsure who said this first, but the Financial Conduct Authority appear to have adopted this thought - against themselves.

In 2019 the FCA reassessed the guidance on disclosure rules as it wanted to identify potential trends for adviser and clients these are the comparatives with the last study in 2017.

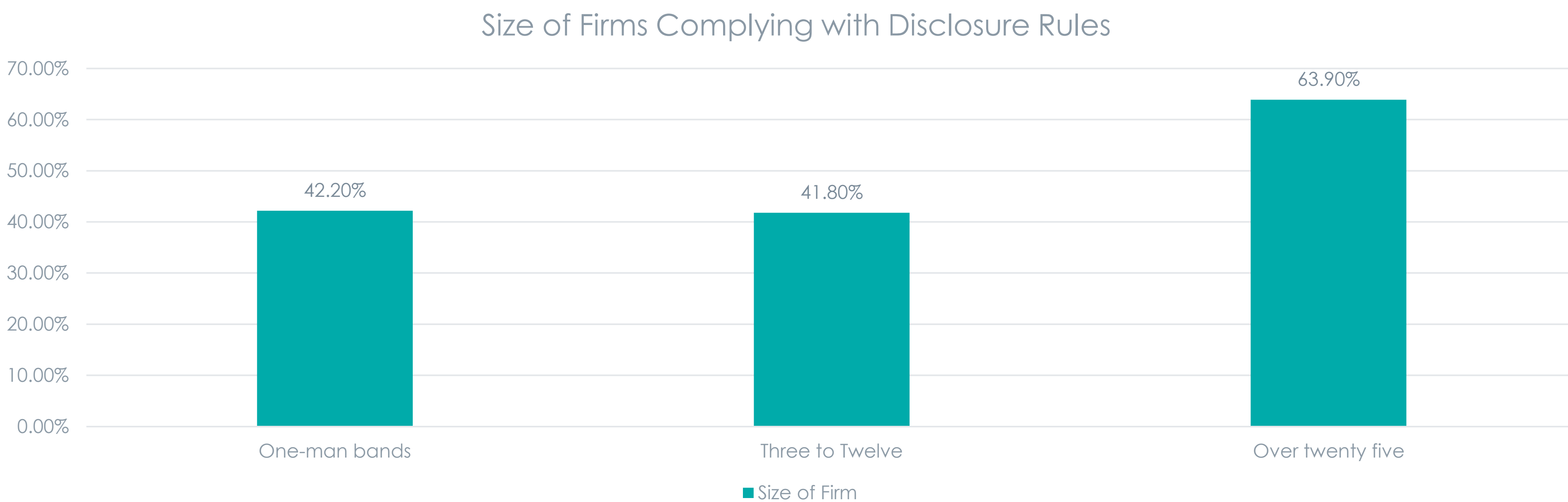
The study assessed 1,142 cases in 656 firms through 2018/2019 and said it was "disappointed" to find the advice sector provided "unacceptable disclosure" in 41.7% of those it studied. And discovered "uncertain disclosure" in 5.4% of other cases.



SUITABILITY FOR ADVISERS

FCA thoughts 2:

Small independent firms it declared fared worse. According to the FCA, one-person bands were complying with its disclosure rules in 42.2% of cases. While those with between three and two dozen advisers did so 41.8% of the time. Larger firms with more than 25 advisers tended to be more consistent. They met the regulator's rules 63.9% of the time.



Overall, independent firms met the FCA's disclosure rules in 39.5% of cases, while restricted firms did better with 75%.

The FCA said: "In 2019 we intend to reassess the suitability of advice. Comparing the results of that review to the results published in May 2017 will help us identify potential trends in numbers of customers who are at risk of this harm."

At Tacit Investment Management our experience tells us that investment suitability and support of clients' portfolios has its greatest need where advisers want to use investment outsourced solutions.

SUITABILITY FOR ADVISERS

Concluding thoughts

Quantitative risk calculations create a guidance environment but they're not definitive in terms of generating the **most appropriate outcomes** for underlying clients. Debt of course must be paid back allowing investors to be compensated by interest payments. Equity meanwhile isn't required to be paid back so investors are compensated by share price appreciation or dividends. Both have cash flow benefits depending on the individual investor.

This creates much debate regarding volatility and risk. And the importance of outcomes for the client is varied. For smaller adviser businesses initial and on-going investment suitability is challenging.

Capacity for loss and a greater understanding of volatility and how this might be managed may be as significant contribution in the adviser relationship with their underlying clients.

RECAP

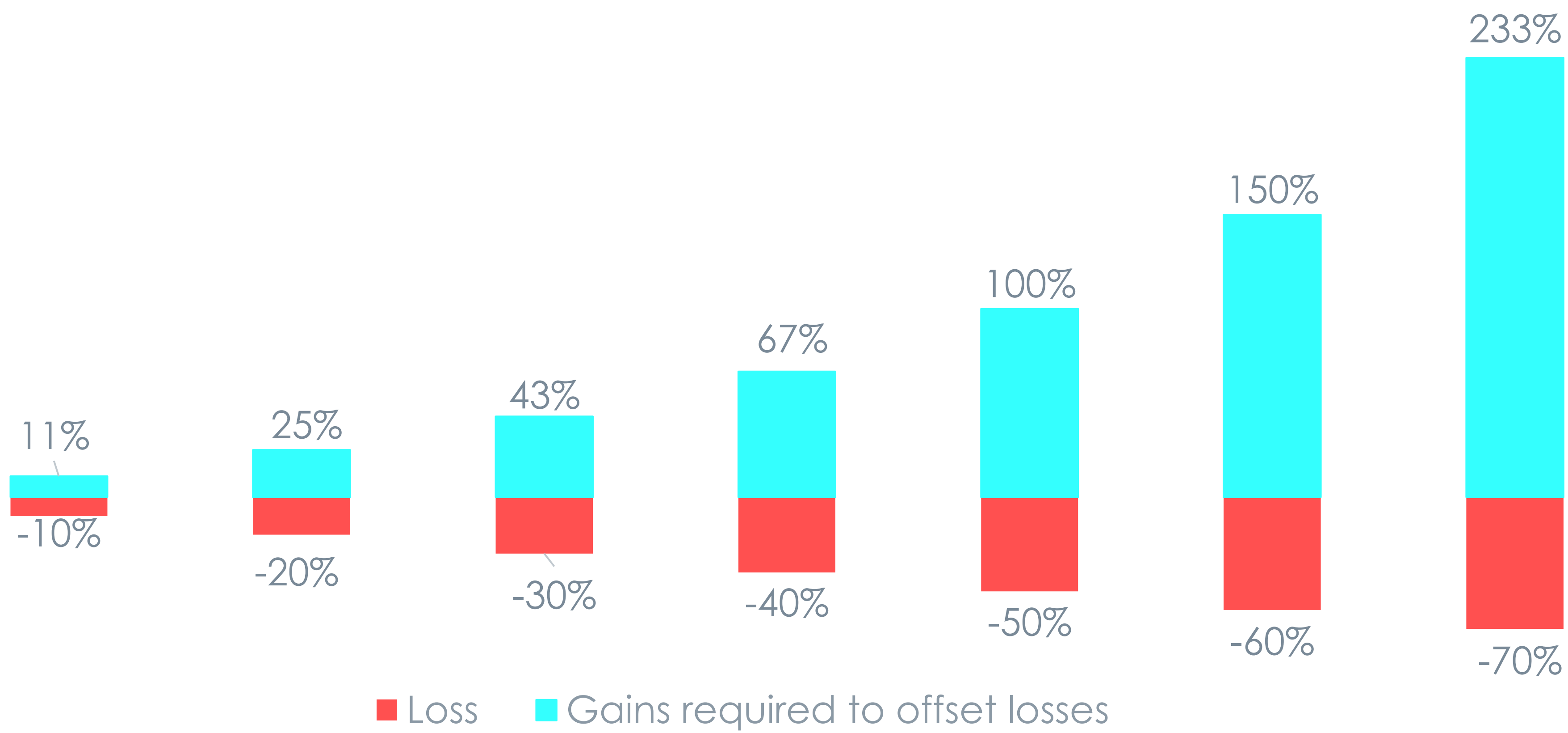
Three core DFM relationships for an adviser

- Agent as client
- Agent of client
- Reliance on others

CAPACITY FOR LOSS – IMPAIRMENT OF CAPITAL

Controlling actual drawdowns in capital is critical in managing long term returns

Investment losses are not symmetrical. For every linear increase in losses, the gains required to erase those losses increases asymptotically to infinity. It is therefore important to focus on limiting losses.



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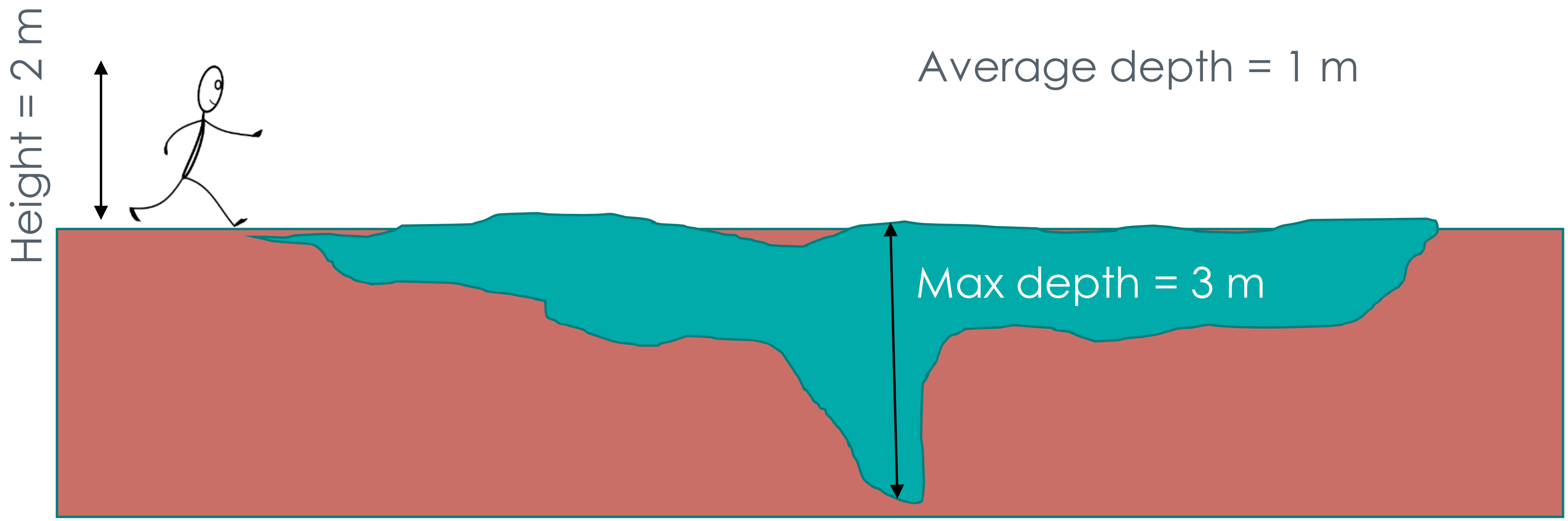
VOLATILITY - THE PROBLEM WITH AVERAGES

NEVER CROSS A RIVER THAT IS 1 METER DEEP ON AVERAGE



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THE PROBLEM WITH AVERAGES

How many risk rating systems measure volatility

- Risk profilers typically calculate the volatility of a portfolio by taking the weighted average volatility of the individual holdings.

- This is computationally easy and convenient to do. It is however mathematically wrong.

- Holdings do not exist in isolation in a portfolio. For example, **gold will have a high volatility on it's own** – it is a commodity with dollar exposure. However, it's role in a portfolio dampens overall volatility and ***increases the diversification benefit.***

- **Please see example below in terms of a weighted measure of volatility against actual.**

A TOTAL RETURN STRATEGY

ACTUAL AND WEIGHTED AVERAGE VOLATILITY

TACIT **Source**: Tacit IM - Morningstar Workstation. Data up to 30/09/2019

A TOTAL RETURN STRATEGY

DIVERSIFICATION & IMPORTANTLY CORRELATION BENEFITS

Holdings	Correlation with portfolio	Diversification Benefits
Equity holding 1	0.53	0.47
Equity holding 2	0.8	0.2
Equity holding 3	0.78	0.22
Equity holding 4	0.53	0.47
Equity holding 5	0.75	0.25
Equity holding 6	0.78	0.22
Equity holding 7	0.88	0.12
Equity holding 8	0.84	0.16
Equity holding 9	0.84	0.16
Equity holding 10	0.16	0.84

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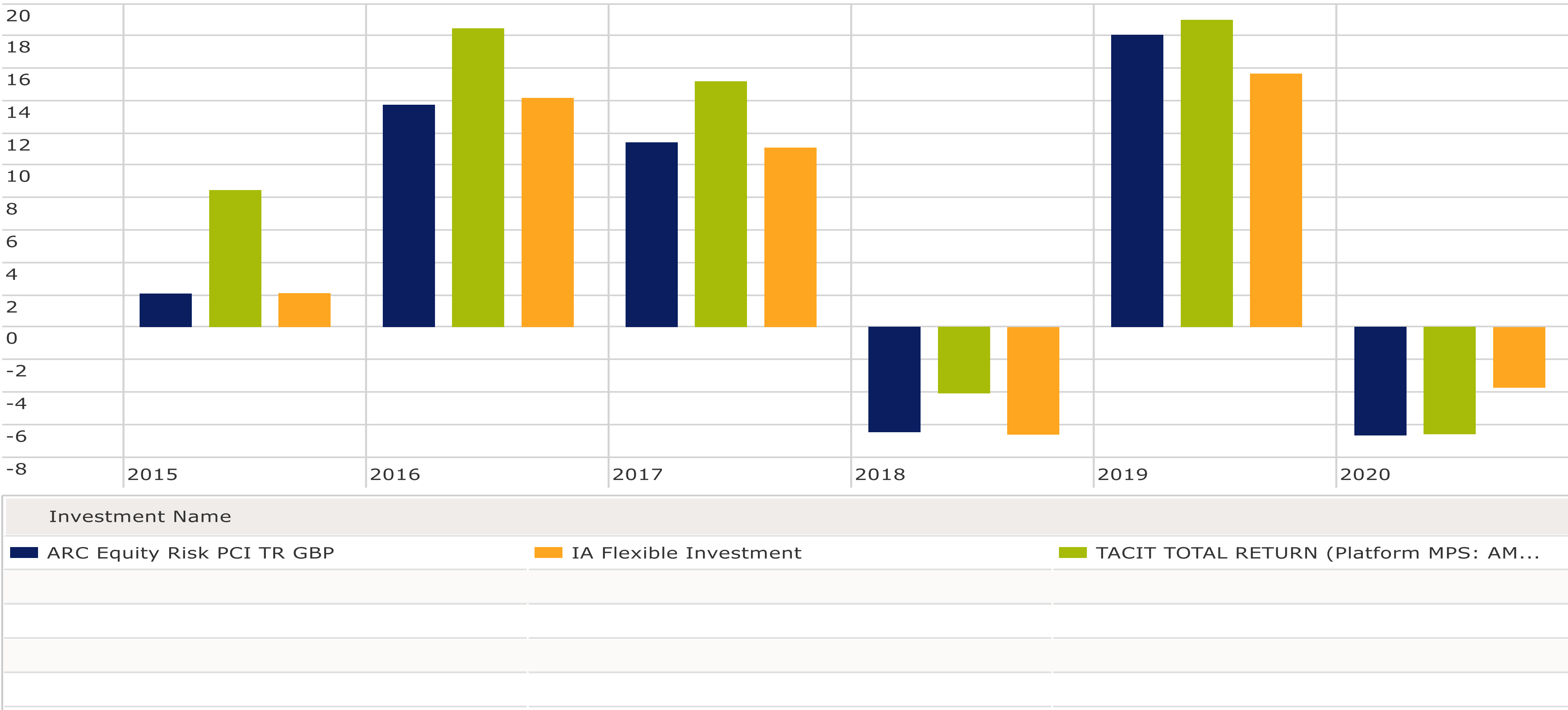
Source: Tacit IM Morningstar Workstation. Data up to 30/09/2019. Holdings have a 3 year track record

HOW DOES THIS IMPACT PERFORMANCE OVER TIME

Movements through 5 years



Source: Morningstar Advisor Workstation **Data period 1st Jan 2015 to 30th July 2020**

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Volatility v correlation

- Actual v average volatility
- Correlation v volatility
- Real risk - capital impairment

costs

WHAT SHOULD A DFM PROVIDE?

Menu of services that should be included for bespoke / tailored / managed services

- Direct investment relationship with investment director
- Personally aligned to client objectives and required outcomes
- In-specie transfers
- No charge for transactions, in-specie or any transfers out
- Provision of risk mapping to adviser choice of RP
- CGT management
- Cherished & legacy holdings management
- Auto-ISA facility
- Access to adviser and client friendly investment portal
- Recognized custodian
- Pre-populated account opening paperwork – account management team experienced working with financial advisers and clients
- Optimised tax management across investment portfolios, GIA, ISA, SIPP & investment bonds
- Ad-hoc (on-demand) & regular investment communications
- External investment portfolio reviews & risk assessment
- Management of unique income requirements
- Portfolios managed at relationship, group or family level as required
- Quarterly client reporting
- On-line access advisers clients and underlying client – 3 way
- On demand reporting & storyboards for ad-hoc adviser client meetings
- Option of full suitability management
- Portfolio valuations to end of previous business day – segregated or combined.
- Weekly, monthly, quarterly & annual market commentary

BESPOKE / TAILORED / MANAGED – COSTS & CHARGES

Range of typical costs

Service cost	Description	Comment
Annual management charge	Fee for investment management – ad valorem percentage based on periodic AUM of portfolio.	Often a headline AMC might be highlighted but it should be confirmed that all other charges highlighted below are accounted for if one fee is presented.
Suitability Charge	Some DFMs charge for suitability separately to ensure clarity to the client and adviser who has underlying on-going suitability responsibility (see suitability)	Suitability charges may be incorporated within the AMC for many DFMs but advisers should ensure that this is the case within Intermediary Terms of Business to clarify underlying suitability responsibility.
VAT	Applied to vatable service fees	Discretionary services are defined as vatable by HMRC, where invariably advisory services currently are not.
Custody Charge	Nominee facility / custody costs / overseas depository holding charges for offshore assets.	This may be incorporated with the core AMC fees but ensure that all custody costs are accounted for if this is the case.
Underlying Fund Charges (OCFs)	Money weighted attribution of the OCF of the underlying funds held within the portfolio	Its is important to attribute all funds both internal and external closed ended (investment trusts) as well as open ended funds and ETFs. Any initial costs should be incorporated as well where applicable.
Transaction costs	Execution and dealing costs or bargain charges	Transaction or bargain charges can often be found as small charges with portfolio costs but an can accrue over time if the portfolio turnover is high, an additional £25 charge for example for a purchase and sale can add up over the course of the year.
Transfer costs	Cost of transferring assets in and out of a portfolio	Common for transfers out rather than transfers into a portfolio but small charges are often applied per transfer.
Stamp duty	Applied to purchases at 0.5% for equities and similar acquisitions.	HMRC taxable cost for the purchase of equities and investment trusts principally, although ETFs are exempt as are new issues this applies to the secondary market.
FX transaction cost	FX brokerage charge for non-sterling based assets	Applied for non-sterling transaction costs
Additional service costs	Capital gains tax statements, tax reports, additional valuations etc	Commonly these services will be provided as apart of the overall service AMC but should be checked.

PLATFORM MPS – COSTS & CHARGES

Range of typical costs

Service cost	Description	Comment
Annual management charge	Fee for investment management – ad valorem percentage based on periodic AUM of portfolio.	Within platform MPS this will be a DFM fee. Common AMC charging structure 0.30% to 0,35%
Suitability Charge	Some DFMs charge for suitability separately to ensure clarity to the client and adviser who has underlying on-going suitability responsibility	Suitability charges are non-applicable as suitability is the advisers responsibility due to the DFM not knowing the underlying client.
VAT	Applied to vatable service fees	Discretionary services are defined as vatable by HMRC, where invariably advisory services currently are not. However current European legislation may vary the application of VAT TO platform or pooled services.
Custody Charge	Nominee facility / custody costs / overseas depository holding charges for offshore assets.	Platform charge 0.15% to 0.40%
Underlying Fund Charges (OCFs)	Money weighted attribution of the OCF of the underlying funds held within the portfolio	Defined and illustrated by the DFM
Transaction costs	Execution and dealing costs or bargain charges	Platform or Transaction or bargain charges can often be found as small charges with portfolio costs but an can accrue over time if the portfolio turnover is high, an additional £25 charge for example for a purchase and sale can add up over the course of the year.
Transfer costs	Cost of transferring assets in and out of a portfolio	Platform common for transfers out rather than transfers into a portfolio but small charges are often applied per transfer. This is an important consideration for critical yield calculations for pension transfers.
Stamp duty	Applied to purchases at 0.5% for equities and similar acquisitions.	Platform applies to transactions on rebalances and switches
FX transaction cost	FX brokerage charge for non-sterling based assets	Platform applies for non-sterling transaction costs
Additional service costs	Capital gains tax statements, tax reports, additional valuations etc	Dependent on platform

UNITISED DFM / MULTI-ASSET – COSTS & CHARGES

Range of typical costs

Service cost	Description	Comment
Annual management charge	Fee for investment management – ad volerum percentage based on periodic AUM of portfolio.	oeic AMC charge
Suitability Charge	Some DFMs charge for suitability separately to ensure clarity to the client and adviser who has underlying on-going suitability responsibility	N/a - adviser responsible for suitability
VAT	Applied to vatable service fees	N/a – oeics do not attract vat
Custody Charge	Nominee facility / custody costs / overseas depository holding charges for offshore assets.	A platform cost will be applicable to acquire the respective fund
Underlying Fund Charges (OCFs)	Money weighted attribution of the OCF of the underlying funds held within the portfolio	This is accounted for within the documented OCF of the underlying oeic
Transaction costs	Execution and dealing costs or bargain charges	This will only be applicable within platform switching costs
Transfer costs	Cost of transferring assets in and out of a portfolio	Platform transfer costs will apply for both transfers in and out
Stamp duty	Applied to purchases at 0.5% for equities and similar acquisitions.	N/a as applied in the OCF of the oeic
FX transaction cost	FX brokerage charge for non-sterling based assets	N/a as applied in the OCF of the oeic

CONSULTANCY / INSOURCING – COSTS

Range of typical costs

Service	Description	Comment
Investment committee support	Structured review and inputs based on meeting cycle – total IC input management –Investment professional can be incorporated within the IC from DFM.	Fixed monthly or quarterly charge.
Research	DFM research process and documentation input – extraction and dissemination of structured overview and evidencing for investment process.	Fixed monthly fee linked to adviser business requirements
Economic & investment commentary	Frequency linked to adviser requirements	Fixed monthly or time costed.
Execution of white label services – DFM permissions required	More extensive and risk based input	Bp rate relationship
Investment model setting and monitoring	Design and monitoring of adviser investment models – end to end process	Bp rate service cost – transparent cost charging model
Custody management	DFM presents an alternative platform environment to offer “white label” adviser alternatives – designed to proposition.	Bp rate service cost – service level enhanced underlying costs competitive.
Total service – all of the above	All of the above	Higher bp rate linked to total service proposition.

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TRUE COSTS COMPARISONS

Comparing "like for like" costs

Cost	Bespoke / Tailored / Managed	Platform MPS	Unitised DFM / Multi-Asset
AMC	✓	✓	✓
VAT	✓	✓	✓
Custody / Platform	✓	✓	✓
OCF	✓	✓	✓
Transaction Costs	✓	✓	✓
Transfer Costs	✓	✓	✓
Stamp Duty	✓	✓	✓

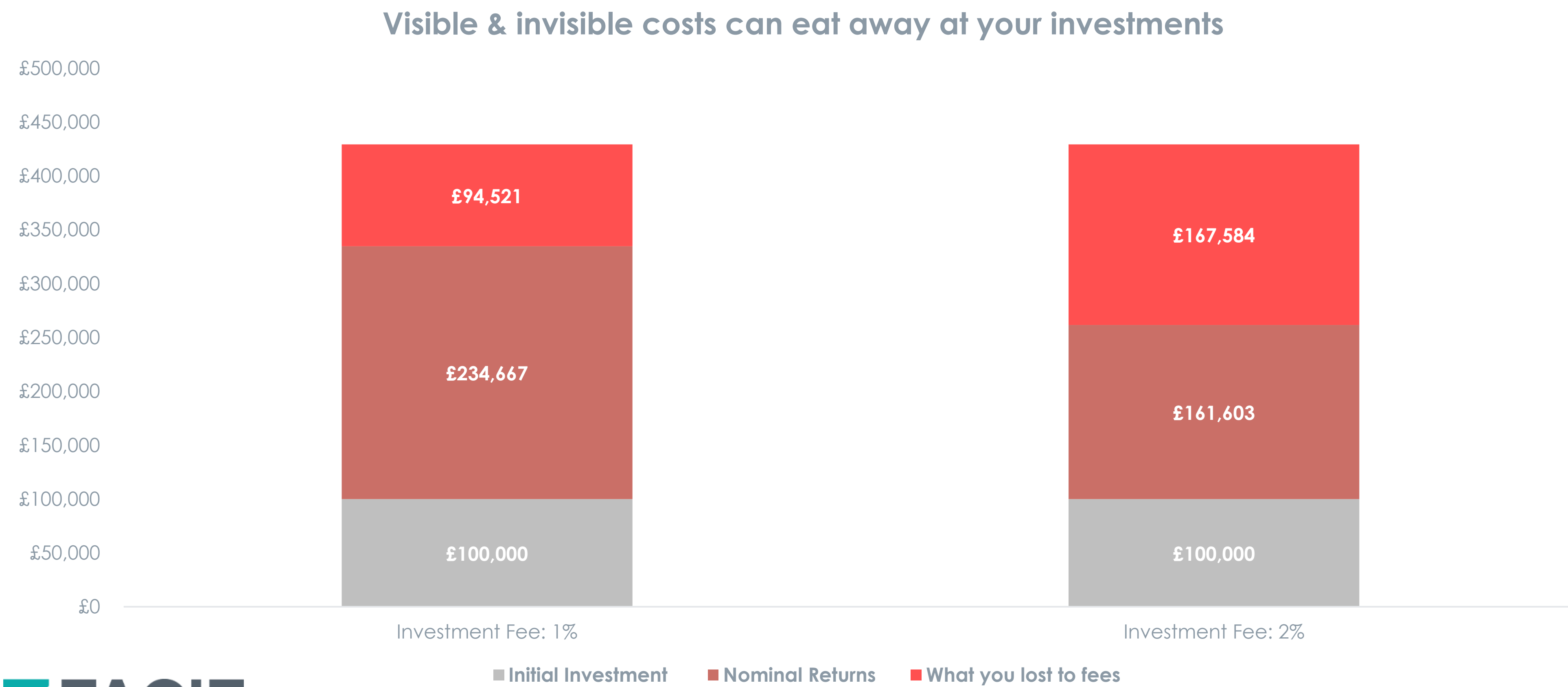
Full Disclosures:

Importantly under MIFID II disclosure criteria it is important to consider all these respective costs within the outcomes for a client to ensure a true like for like comparative. Additionally the level of service within a central investment proposition should be considered under PROD guidelines to meet appropriately segmented client services and financial planning needs.

WHO HAS EATEN YOUR LUNCH!

Why are costs important?

- The lost opportunity of nominal fees paid out can compound just like returns
- Case study - **£100,000** investment growing at **6% nominal annualised** rate for 25 years



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RECAP

What are the key comparative costs for DFM service options?

1) AMC
2) VAT
3) Custody / Platform
4) Transfer
5) Transaction
6) Other additional services

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measuring performance & offering value

COMMON DFM BENCHMARKS - 1

How do you show value to your client?

- **Asset Risk Consultants Private Client Indices: (ARC PCI) – Independent performance.**

The PCI provides an accurate reflection of the actual returns that a private client should expect for a given risk appetite. This approach leaves investment managers free to use any and all investment strategies, vehicles and structures in the pursuit of the maximum return per unit of realised volatility.

The PCI are a peer group comparison tool designed to provide an understanding of the performance generated by discretionary private client investment managers. The Indices are based on real performance numbers provided by participating investment managers and focus on high quality data with no model or synthetic data being used. Currently there are over 100 DFMs within the members and associate members categories contributing data for principally four core PCI benchmarks:

Cautious:	Equity risk 0-40%
Balanced:	Equity risk 40-60%
Steady Growth:	Equity risk 60-80%
Equity Risk:	Equity risk 80 – 120% - (120% can be achieve through gearing)

Data is published for each calendar quarter, although due to the collation timeframes from ARC actual data factsheets are provided up to 6 weeks beyond the calendar quarter end.

The PCI are mean weighted with four quartile rankings are created to demonstrate performance against the respective average for the DFM peer group.

Strengths:

ARC are an independent research agency the configuration of the PCI provides clarity for advisers in assessing a genuine comparison based on risk, actual client data, the mean average creates a respective universe for similar risk investment strategies and has become a more standardised request to DFMs from advisers for performance and risk comparatives. ARC is commonly used for assessing the top quintile DFMs for various industry awards based on appropriate risk / reward. Importantly this focusses on segregating the actual risk adjusted performance from any other measure and creates a level comparative playing field.

Weakness:

Not all DFMs provide data this is due to cost and other factors in providing the data to ARC additionally it remains a peer group comparative and doesn't provide data insights to an adviser on other respective alternatives.

COMMON DFM BENCHMARKS - 2

How do you show value to your client?

- **Investment Association (IA) indices:**

The IA is the trade body and industry voice for UK asset managers. The UK investment management industry plays a major role in the economy, helping millions of individuals and families achieve their life goals by helping grow their investments (mainly through workplace pensions). In fact, 75% of UK households use an investment manager's services (knowingly or unknowingly).

Collectively the IA members manage over £7.7 trillion of assets* on behalf of their clients in the UK and around the world. That is 13% of the £59 trillion global assets under management.

The IA mixed share sectors :*

- **Mixed shares 0-35%:**
  - AUM: £10.7b
  - Funds: 57
- **Mixed shares40-85%**
  - AUM: £61.7b
  - Funds: 177

Mixed shares 20-60%

AUM: £50.8b
Funds: 173

Flexible

AUM: £28.5b
Funds: 147

Strengths:

- Offers the flexibility and effective efficiencies of the oeic structure – tax and cost advantages.
- Broad asset management peer group.
- Highly transparent comparatives.

Weakness:

- Arms length pooled investment mandates and non service related difficult to define value add to client in a service relationship.
- Broad equity tolerance risk ranges within sector universes.

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*** IA data June 2020**

COMMON DFM BENCHMARKS - 3

How do you show value to your client?

- **PIMFA / MSCI Wealth Management Association Private Investor Indices:**

The Personal Investment Management and Financial Advice Association (PIMFA) is the UK's leading trade association for firms that provide investment management and financial advice to everyone from individuals and families to charities, pension funds, trusts and companies.

Historically the underlying benchmarks have transitioned from the Association of Private Client Investment Managers (APCIMS) to the Wealth Management Association (WMA), and now the Personal Investment Management and Financial Advice is a UK-based trade association representing 180 wealth and investment firms managing £760 billion, MSCI act as the sole authorised provider of its Private Investor Index Series, which started from 1 March, 2017. This series consists of five composite indices designed to represent the weightings and show returns of selected multi-asset-class strategies, determined by the WMA Private Investor Indices Committee: The WMA Private Investors Indices Committee meets on a quarterly basis to track performance, and modify allocations if required, to ensure the indices remain illustrative of strategy performance and can best reflect the changing investment landscape for private investors

The MSCI WMA Private Investor Index Series strategy tracking indices are the longest-running private investment price series in the UK. The Balanced, Income & Growth indices offer historical data going back to 1997, while the Conservative and Global Growth indices have data from 2011. The five indices track different multi-asset investment strategies with corresponding risk-reward profiles.

Each strategy index includes varying weightings of asset classes such as equities, fixed income, 'cash', real estate, and 'alternative investments'.

MSCI WMA Private Investor Conservative Index
MSCI WMA Private Investor Income Index
MSCI WMA Private Investor Balanced Index
MSCI WMA Private Investor Growth Index
MSCI WMA Private Investor Global Growth Index

Strengths:

- Focus is on private client wealth management industry
- Data is provided by MSCI

Weakness:

- Composite created from within the private wealth industry and operated on a consensus basis
- External overview is limited – not wholly independent in this respect

COMMON DFM BENCHMARKS - 4

How do you show value to your client?

- **Outcome benchmarks:**

Commonly RPI / CPI linked or composites created for defined outcomes characteristics over time. Generally these aren't comparative benchmarks but more of a measure against the required outcomes over respective investment timeframes as such they are becoming more of a feature in terms of financial planning with regard to cashflow modelling and decumulation investment planning.

- **RPI / CPI:**

Inflation is considered the critical focal point with regard to overall investment planning. In basic terms the key return within the investment management premise is that it offers the opportunity of providing a real return above inflation over a long term time horizon balanced against the reflected level of risk and offsetting investment and financial planning costs.

Outcome based approaches may reference either RPI or CPI with a plus factor in terms of the percentage return above this level. This might be illustrated for example as RPI + 2% as the benchmark level net of costs, indicating that over time the benchmark performance is seeking to achieve RPI (circa 3% since 1949) plus 2% or a total annualised return of circa 5%.. However since 2004 CPI has been the recognized outcome benchmark for inflation globally.

- **Composites:**

Designed to optimize risk adjusted outcomes the composite benchmark is the optimal considered measure of the risk to return for the underlying client requirements. External risk data agencies such as Moody's and S&P are often tasked in creating the underlying composite models and benchmarks.

Strengths:

- Defined risk return pathways providing clarity to adviser and client in terms of reaching underlying financial goals
- Generally optimised for risk making outcome benchmarks more efficient
- Real outcome measures such as inflation more meaningful in financial planning

Weakness:

Composites can be opaque and lack clarity in terms of comparatives
Requires a long term perspective in meeting the required outcomes

RECAP

What are the common discretionary investment management benchmarks?

1) ARC PCI
2) Investment Association Mixed Shares
3) PIMFA / MSCI Wealth Management Association Indices
4) Outcome benchmarks

structured Q&A

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Final thoughts

Further questions

- Many of the services and approaches will be familiar to many advisers, hopefully some of the information will have added to your underlying knowledge. If you have any further question please contact us, in the first instance Leigh Stephens.

- We would be pleased to discuss some of these approaches as we act as both **consultant** discretionary investment managers as well as **bespoke**.

- We appreciate your time and attention with regard to this CPD.

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