



SCM PRIVATE

**SCM PRIVATE RESEARCH REVEALS UK RETAIL FUND MANAGERS CONTROLLING OVER £241 BILLION, CAN LEND OUT UP TO 100% OF FUNDS YET INVESTORS ARE KEPT IN THE DARK**

**London 1<sup>st</sup> September 2011: Research from SCM Private, the actively managed passive investment firm, found the practice of Stock Lending within the UK retail fund management industry is widespread, with analysis of 20 UK retail fund manager prospectuses highlighting the following key findings:**

- Levels of disclosure, transparency and protection within current legislation are totally inadequate
- 19 out of the 20 UK retail fund managers analysed are allowed to lend up to 100% of clients' funds - these 19 managers are responsible for £241 Billion of UK retail savings
- At least 50% of these 20 retail fund managers were found to have participated in stock lending – the amount of funds under management of these fund managers is currently £143 Billion. (Not all of this £143 Billion of funds is necessarily currently involved in stock lending)
- On average just 66% (where shown) of the gross income derived from stock lending was retained by the fund after fees; although investors potentially bear 100% of the risk
- Just 35% of managers analysed specified the split of fees between the fund and the fund manager/stock lending agent within their full prospectuses

**Background**

The FSA has recently commented on counter-party risk within synthetic Exchange Traded Funds (ETFs) making them “not appropriate for retail investors” as they may not “adequately understand the risks”. This prompted SCM to analyse the similar counter-party risk which exists within many mutual funds. These risks are also prevalent within the £20 billion retail Absolute Return funds sector, the £42 billion “structured products” sector and the spread betting and “contracts for difference” industry.

Stock Lending is a common and legal practice within many UK retail unit trusts as it is with hedge funds, pension funds and "physical" ETFs. The fund loans a stock, derivative or other security in exchange for a fee and collateral from the borrower.

The main risk, highlighted by the Bank of England, is that the borrower becomes insolvent and the value of the collateral falls below the cost of replacing the securities that have been lost (Source: Bank of England, Securities Lending: An Introductory Guide. September 2010).

Commenting on the research, Gina Miller, co-founder of SCM Private said:

“We believe that many investors will not be aware that certain retail funds are legally permitted to potentially risk 100% of their savings through stock lending. Clear and full disclosure regarding stock lending should be mandatory to protect investors. In our opinion, the minimum levels of disclosure and protection for retail investors contained within UK legislation are totally inadequate. SCM believes that the FSA needs to address the key issues of risk and transparency across the whole retail investment industry so retail investors can make fully informed educated decisions.”

Current UK legislation (<https://fsahandbook.info/FSA/print/handbook/COLL/5/4>) allows a wide range of assets as collateral – so long as it is cash, a certificate of deposit, a letter of credit, a readily realisable security, some forms of commercial paper or a qualifying money market fund. It has been estimated that as recently as July 2011, on average just 20% of this collateral is in the form of cash in the UK, versus 90% in the US (Source: Data Explorers).

Despite these dangers, current UK legislation does not require retail fund managers to disclose the risks of stock lending in their investor marketing materials or to lend less than 100% of their assets. They are not required to publish daily individual fund stock lending exposures, the names of the largest borrowers or the precise makeup of the collateral backing these loans. In fact, based on recent FSA comments that where investors are unable to understand the risks, such products are not “appropriate for retail investors”; SCM estimates that up to half the UK mutual fund industry would be deemed inappropriate for retail investors.

Significantly, one UK fund manager, Legal & General, does not participate in any stock lending as:

**“It is not easy for retail clients to understand the associated risks...There are also risks associated with stock lending that make the practice unattractive to us for the UK market, such as counterparty risks.”**

(Source: Legal & General Indexation Guide)

To protect retail investors, SCM Private calls on regulators to require fund managers to reveal:

- Risks associated with stock lending in factsheets and other marketing materials
- The total exposure to stock lending by funds on a daily basis
- The names of the largest counterparties by fund on a daily basis

- The breakdown of the actual collateral received by the fund on a daily basis
- The percentage of the gross stock lending income retained by the fund rather than the fund managers and/or the stock lending agents.

ENDS

#### **Notes for Editors**

**SCM Private** is a specialist investment management company established in June 2009 with a unique, modern approach to managing money. The company offers investors an actively passive management solution that combines passive investment instruments - Exchange Traded Funds (ETFs) - that are genuinely and continuously actively managed – but with much lower dealing costs, commission, price spreads and taxes when compared to traditional funds. As specialist ETF managers, Alan Miller who is the co-founder and investment manager uses his vast active stock picking experience to conduct ‘under the bonnet’ research by investigating thoroughly how indexes are constituted.

**In terms of fees and costs**, SCM Private is amongst the fairest in the industry and publishes all fees in full, with no hidden charges and 100% transparency. All direct clients are treated the same, i.e. private investors, institutions or charities; with the only discount available being on the amount invested. Since inception SCM Private has delivered well above average performance at well below average costs.

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