FT Money

Merryn Somerset Webb Investing

Fund managers are having far too much fun

When I was a junior stockbroker in Tokyo my boss told me he had a problem with me. It wasn't the fact that I was late to work almost everyday. It wasn't the way I took cigarette breaks every 25 minutes with a handsome young man from the trading desk. Rather more oddly, it wasn't about the fact that I appeared to know absolutely nothing at all about the Japanese stockmarket (this was quite a long time ago).

It was about my expenses. They were too low. Much, much too low. All the other brokers on the desk were producing much higher expenses than I was, he said—something that rather suggested that while I was watching telly and eating noodles with my old mates from language school after the markets shut for the day, they were out wining and dining clients and drumming up business.

Was it fair criticism? Sort of. I wasn't spending as much as the men (they were, of course, all men). But also I couldn't. Why? Lapdancing and golf. These were the favoured activities of our clients at the time. They were both really expensive. And not really my thing.

I could just about manage the odd trip to a lapdancing club (it's very peaceful if you are neither a man nor a dancer). But golf? No. Just no. So even if I'd taken my (few) clients out to drink their body weight in champagne every night my final expenses would never have matched up. Trust me, I tried.

You will think this sounds ridiculous. But that's how it worked then. Almost everyone got a large percentage of their commissions from clients they took out: a big night out would often result in a big order the very next morning. Money out. More money in.

Now what happened in Tokyo mostly stays in Tokyo (deflation and monetary policy aside) but that doesn't mean that the rest of the world doesn't appear (inexplicably) to fancy a little golf too.

This week, the Financial Conduct Authority took issue with the fund management industry for taking their clients to play golf, something that it deems (alongside rugby and the like) as not "capable of enhancing the quality of service to clients as they were either not conducive to business discussions or the discussions could better take place without these activities".

The industry won't agree (those in doubt need only look at the comments under the news story on the matter). But the FCA is right. Good relationships between product provider and client are important. But they shouldn't be too close — once a contact becomes a friend, the trouble starts. It's distorting stuff.

But this isn't just about that. It's about cost too. Forging a slight social knowledge of each other over coffee (which should be the most you need) costs about £5 for two.

A day out on a good golf course costs rather more. And what the end client, the one not actually invited to the golf days with the managers, pensions advisers and independent financial advisers, wants is low costs. If we've already invested in a fund, what possible reason could we have for thinking it is all right for some of our management fee to be spent at Sunningdale or Secrets? None.

So here's what I'd like us to do. I'd like us to help the FCA. I hate the idea of them having to churn out all this

regulatory and dire warning stuff all the time (Lord King points out in his new book that, between them, the FCA and the Prudential Regulation Authority have 10,000 pages worth of regulation). So let's work together to make sure that our fund managers stop playing golf by making it impossible for them to afford to play it, unless they are stunningly good at what they do.

A start has been made. The FT reported this week that $15bn has been pulled out of high-cost hedge funds in the past quarter and, according to investment platform RPlan, investors are paying 20 per cent less in fees than they were in 2013, due to a shift to cheap passive funds and cuts to charges. The average fee on the top 100 funds bought on RPlan has fallen from 1.32 per cent to 1.03 per cent.

That's not enough. Add in other charges from the manager as well as your platform fees and it is perfectly possible for half of your returns to vanish in costs. So we need to keep shifting to cheap passive funds. Note that research just out from Bank of America Merrill Lynch confirms that most active funds are useless: just 19 per cent of those investing in large cap stocks in the S&P 500 outperformed the index in the first quarter of this year.

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When we do go active we need to support firms that really get the way the market is changing. I've written here before about a few funds that are testing outperformance fee-only models. But the one that has taken it to its most extreme is Orbis Access. They charge you nothing on their funds (they have two — Global Equity and Global Balanced) if they aren't outperforming. No custody fees, management fees, admin, entrance or exit fees. Nothing. Instead they charge you 50 per cent of any performance over their benchmark when they beat it and pay you that money back when they don't.

The calculations of this aren't 100 per cent simple and there is an enjoyable debate to be had about whether 50 per cent is too much or not. But you see the basic point: Orbis Access really don't make anything unless they do well for a reasonably long time.

Letitia James, New York City advocate, suggested this week (with reference to the city's pension scheme) that overcharging managers who fail should have to "sell their summer houses and their jets" and return the fees they have taken from investors. That's pretty much what Orbis is promising to do. It is also offering a little bonus at the moment: no fees on anything put into a junior Isa this year for the next 18 years.

I met one of Orbis's directors briefly this week. We talked about all of this. Just as I headed for the door (leaving him with the bill — I had a glass of water so I'm feeling fine with my moral boundaries), I turned back and asked: "Do you play golf?" "No," he said. "Never." Right answer.

Merryn Somerset Webb is editor-in-chief of MoneyWeek. The views expressed are personal.
merryn@ft.comTwitter: @MerrynSW