HOW MUCH SHOULD AFFLUENT INVESTORS PAY TO INVEST?

A COMPREHENSIVE GUIDE ON HIGH CHARGES

AES WEALTH

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INTRODUCTION

> "You can't control the markets, but you can control your costs.
>
> Burton Malkiel, A Random Walk on Wall Street

In the world of investing, nobody knows if and by how much your money will grow. The only certainties are the charges you pay.

The problem is that often these charges are completely hidden and reduce the returns you would otherwise enjoy.

Even worse, they come in the form of commissions and are often used to incentivise salespeople to give risky and incorrect advice.

Currently international financial services isn't a profession but an industry where products are manufactured and then sold.

For the most part, financial regulatory protections simply don't exist.

In the absence of strong regulators, most banks, insurance companies and investment brokers continue to hide fees and commissions.

This often means you only get half the story about costs, and sometimes, less than a third of the returns you should receive.

As a high-performance executive, you're investing predominantly for one of three reasons. Either you're:

- Wanting peace of mind
- Looking to take care of the people you love
- Worried about making life-changing mistakes

Whatever your reason, you want to make sure your money is working for you.

You certainly don't want your wealth to be eroded by hidden charges, chipping away at the future you're working so hard to secure.

In this guide, I hope to reveal where hidden costs can be found so you know what to look out for.

To illustrate this, let's look at a product senior international professionals are typically sold, and its complex cost structure…

Sam Instone,
CEO & Founder
AES

AN OFFSHORE INVESTMENT OR INSURANCE BOND

International investors are typically sold this product, yet not every investor needs one.

They are simply ‘tax wrappers’ which, if set up the right way, can be a perfectly appropriate investment.

However, for many, the tax savings are largely irrelevant - and other options will often provide more flexibility at a lower cost.

For example, if you live in a high-tax jurisdiction, you may find the tax benefits of the bonds valuable.

Conversely, if you live in a low or no-tax jurisdiction such as the UAE, investing through a bond makes little or no difference.

In fact, you could be building up a large future tax liability.

We often find high-performance executives are sold a bond within a pension, a tax wrapper inside a tax wrapper, which is completely unnecessary and only done because the adviser is regulated by the Insurance Authority.

This means they are only able to offer an insurance product such as an offshore bond, making it the product of choice for most commission-based salespeople.

It is sold due to its purported tax benefits.

Depending on the charging structure used – it can provide a commission of up to 8% of the amount you invest which is paid upfront by the insurance company to the adviser on the first day you begin the plan.

It’s then recouped through deductions from your plan over the next 5 to 10 years.

Ask about the costs and you may get told:

> 66 You just pay 1% pa for 10 years and then nothing else – so we are much cheaper than a fee-based adviser who charges 1% pa forever.

But it isn't true...

It's likely that the overall cost of the camouflaged solution adds up to 5% or more each year.

Even worse, you end up paying bigger costs to suffer terrible performance and a lack of service.

There are, in fact, a startling number of separate charges that aren't easy to see following the payment of each premium into the policy.

It's often expressed quarterly to make it sound less. Annualised examples include:

- 1.2% for the lifetime of the policy
- 1.4% pa for 8 years after each premium is paid in
- 2.1% pa for 5 years after each premium is paid in

Note: The premium establishment charge applies to <u>each</u> top-up into the plan. This means that putting further funds into your policy can be both expensive and create a further 'lock-in period' with exit penalties.

As an example, if your establishment fee is 1.4% for 8 years, this means 11.2% (1.4% x 8 years) is deducted from your money over that period of time.

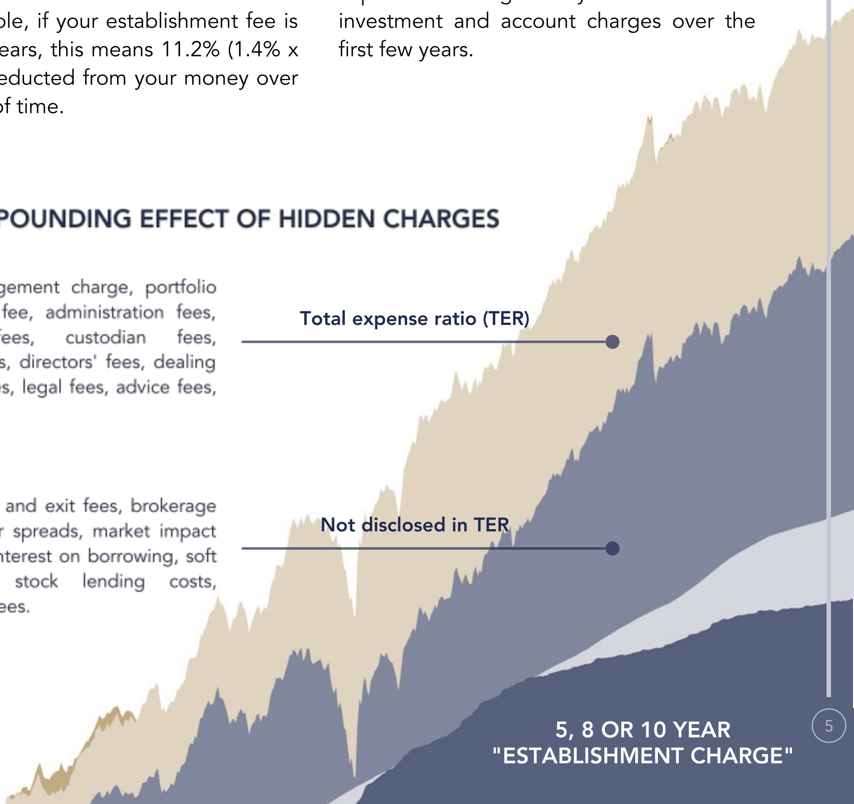
This is used by the product provider to fund the initial distribution cost and pay the hefty commission to the salesperson.

Commission payments are often far from explicit and gradually deducted as investment and account charges over the first few years.

THE COMPOUNDING EFFECT OF HIDDEN CHARGES

Annual management charge, portfolio management fee, administration fees, regulatory fees, custodian fees, marketing fees, directors' fees, dealing fees, audit fees, legal fees, advice fees, other fees

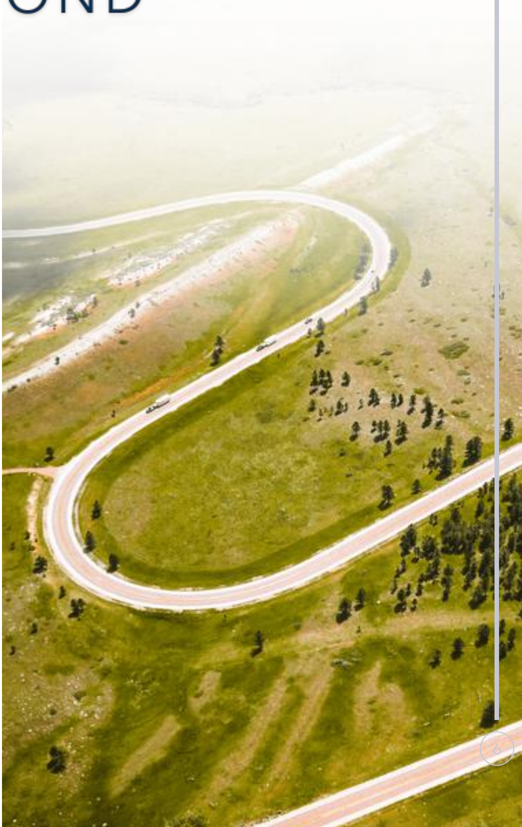
Initial charges and exit fees, brokerage fees, bid offer spreads, market impact costs, taxes, interest on borrowing, soft commissions, stock lending costs, performance fees.



THE TYPICAL COST FOR AN OFFSHORE INVESTMENT BOND

- 0.5% - 1.5% annual charge to the pension or bond provider
- £400+ fixed annual fee to the bond provider
- 1.5% a year establishment charge for the first 5-10 years
- 3% - 8% initial commission on the investments held in the bond
- 1% - 3% annual charge on investments (this could be much more, and more opaque, if you are invested in structured products)

You would need staggering performance year after year, just to cover them.



SO WHERE DOES YOUR MONEY GO?

Charges are either directly deducted from your original investment or back-end loaded so you can't see them.

A back-end load, also known as a contingent deferred sales charge, means the fee is charged when an investor redeems the mutual fund.

The fee usually starts at 5% for investors who redeem shares within a year and declines by a percentage point each year after until the fee is eliminated. After selling the product, the broker or 'adviser' is unlikely to receive any further commission.

This means they don't benefit or suffer if your investments grow or fall in value.

Quite simply, their interests are not aligned with yours.

WHO ARE THE MAIN OFFSHORE INVESTMENT BOND PROVIDERS?

The main providers are typically the offshore arms of large international insurance companies. These include:

- AEGON (Previously Scottish Equitable)
- AXA Wealth International
- Canada Life International
- Hansard International
- Utmost Worldwide (Previously Generali International)
- SEB
- RL360 (Incorporating Scottish Provident International, Royal London, Friends Provident International and Clerical Medical)
- Quilter (Previously Old Mutual)
- Zurich International

OTHER CHARGES TO LOOK OUT FOR

ALLOCATION RATES

An allocation rate is the percentage of your money that is used to buy investments.

A 103% allocation rate means that for every £250,000 you invest, the insurance company invests £257,500.

A salesperson may sell this idea by saying...

> 66 103% of your money is invested and working for your benefit from day one.

This might sound amazing, but this locks you in to years of high charges that will decimate your returns.

It's better to get a 97% allocation rate, pay £7,500 in charges and buy better funds with lower costs and more liquidity.

DOWNSIDES OF 103% ALLOCATION

There can be several. The main issues are that it can hide fees and reduce returns.

As a result, you can incur high penalties for moving your money. The effects of this include:

- Unsuitable investment selection based on commission-generated (and therefore poor) performance
- Lack of flexibility due to back-end loading
- Reduced returns based on high costs
- Reduced transparency, and many nasty surprises along the way
- No alignment of interest or on-going service = further poor performance

Performance problems tend to start appearing around the 1-2 year mark, when the plan hasn't made any returns.

Around the 3-4 year mark when the plan still hasn't made any money, you'll get frustrated and try to take your money out, but you'll be reminded of the remaining 6 years' worth of financial penalties which apply.

It's at this point when investors will desperately seek a second opinion to salvage what they can of their investments. This is how we've come to meet so many investors who've fallen victim to these types of schemes.

EARLY WITHDRAWAL CHARGES OR EXIT PENALTIES

These can apply to both the product (insurance bond) and the funds within that product. These are caused by the levels of initial commission taken by the salesperson. As an example, if you selected an 8-year charging structure on the product, the exit penalty would be 11.2% on day 2 decreasing by 1.4% pa to nil after 8 years.

On a fund, they are normally back-end loaded starting from 5% in year 1, decreasing by 1% to nil over 5 years. However, certain types of investments such as structured products or alternatives may be even more expensive and illiquid. Both illiquidity and withdrawal penalties are bad, entirely unnecessary and can be avoided if you make the right choices.

HOW 1% FOR 10 YEARS TURNS INTO 5% P.A.

LET'S LOOK AT AN EXAMPLE:

David has a £1,000,000 UK pension.

His offshore financial salesperson told him he should move it into a QROPS and then invest it in an offshore investment bond.

The salesperson recommends he uses a pension provider in Gibraltar, which incepts the bond and then invests 50% of it in structured products, 25% of it in a blended broker fund, and the last 25% in a range of alternative investments.

Let's see the charges:

Pension trustee set up fee	£500
Pension trust annual fee	£500
Bond set up fixed fee (Establishment charge paid over initial charging period, usually 5-10 years)	8%
Annual bond policy management charge	1.5%
Annual bond management charge	£500
Structured product built-in commission (generally have a maturity period of 6 years)	4-6%
Alternative investment fund commission (typically a front-end load – the cost required to enter the fund) + ongoing charges figure	6.5% (5% initial front-end load, 1.5% OCF)
Mirror fund (typically a front-end load – the cost required to enter the fund) + Fund management charge added to fund ongoing charges figure (OCF)	7.5% (5% mirror fund front-end load, 1.75% fund management charge, 1% fund OCF)
Annual adviser management fee	1%

At the end of year 1, David has paid an equivalent of 9.98% of the initial value of his pension in fees, leaving his total pension worth £927,225.57 with an assumed return of 3%.

We generally see investments such as the above perform poorly, rarely achieving more than 3% annual return, given they are invested in alternative funds.

At the end of the 10-year period, David's pension is now worth £791,607.83, losing over £200,000 in value as his pension has been crippled by ongoing annual charges equalling a reduction in yield of over 4.5% and growing. This all means that unfortunately David's pension is losing more in value as a percentage every year.

Here's the value of his pension over time:

YEAR	PENSION VALUE £	REDUCTION IN YIELD	REAL ANNUAL RETURN
0	1,000,000		
1	927,225.57	9.98%	-6.98%
2	911,748.95	4.53%	-1.53%
3	896,375.93	4.55%	-1.55%
4	881,105.81	4.57%	-1.57%
5	865,937.91	4.58%	-1.58%
6	850,871.54	4.60%	-1.60%
7	835,906.02	4.62%	-1.62%
8	821,040.67	4.64%	-1.64%
9	806,274.83	4.66%	-1.66%
10	791,607.83	4.68%	-1.68%

THE EFFECT OF THESE CHARGES

The total amount you pay in charges impacts the return you receive. This is called a Reduction in Yield (RIY).

This term 'RIY' is a way of expressing the impact of all charges on a savings, investment or pensions policy over a period of time. It sets out the reduction in the return that would otherwise have been enjoyed if the policy carried no charges at all.

Reduction in yield is an excellent way of judging which policies are good value, but within the international marketplace this RIY figure can be buried to the point of invisibility.

Over the long term, compounding costs can make a huge difference to your wealth. The problem is, it's hard for international investors to find out how much they actually pay and to discern the charges for each service. Even some financial professionals often can't see the wood for the trees.

THE ODDS ARE STACKED AGAINST YOU

You need exceptional investment performance over a long time to have any growth left after paying extortionate charges.

In many cases, the salesperson's answer is to recommend riskier investments that on paper look as though they could deliver fantastic performance.

However, the racier the investments, the higher the risk of them falling. If that happens within the first few years, there might be a chance to recover.

But what if it happens a couple of years before you want access to your money? A couple of years before retirement?

These types of investments often attract much higher charges. So, typically a salesperson profits even more.

This does not mean highly risky investments should always be avoided. They can play an important role as part of a well-balanced and diversified portfolio, subject to in-depth research and continuous monitoring.

IF YOUR PORTFOLIO LOSES...	TO BREAK EVEN YOU NEED...
-10%	+11.1%
-20%	+25%
-30%	+42.9%
-40%	+66.7%
-50%	+100%
-60%	+150%
-70%	+233.3%

COMPARING THE MARKET

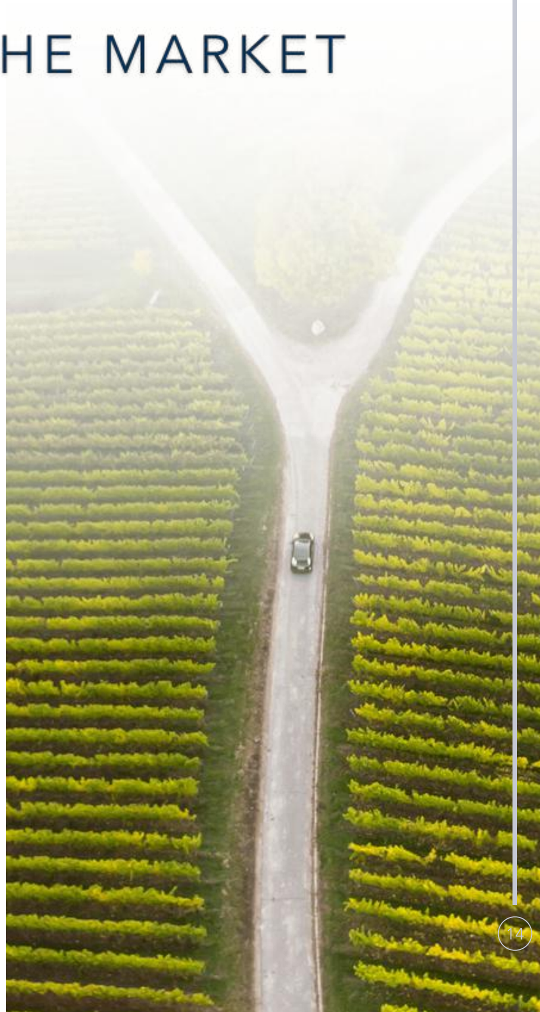
A recent analysis by SCM Direct of 10 well-known online investment managers found how a single firm revealed the aggregate cost and charges of their services including the full transaction costs within the products in which they invested.

Most firms argue that it is hard for them to express a price for their services on a website because each client chooses different services.

However, the absence of a way to compare costs accurately almost certainly leads to a poor deal for many.

According to accountants Grant Thornton, someone in the UK with around £100,000 would pay 2.56% per year, on average, for financial planning and the costs of holding products.

This is down from 2.86% in 2012 when the UK Government introduced rules to introduce greater clarity. Within the international market, no such rules exist and typical annual costs for the same investor are between 4 and 6% per year.



WHAT ARE REASONABLE COSTS?

This is subjective and depends on a wide number of factors. However, it is more ethical to use fee-based financial planners as they have fewer conflicts of interest and are therefore more trustworthy. This means that you should agree a set fee (either a single amount or calculated on an hourly basis) for initial financial planning and modelling work. In terms of financial planning, I would suggest up to 1.25% pa is value for money if you deal with a large, international 'new model' advisory firm.

FOR THIS VALUE, YOU SHOULD EXPECT:

- An iron-clad investment process: deep expertise from a central research team who have a clearly documented investment philosophy which makes sense and involves low cost, low risk and 'boring' solutions – that work.
- Wise counsel: a planner who can help you develop a rational perspective that's focused on achieving long-term goals, rather than responding to short-term market events.
- A whole team focussed on you: exceptional levels of service from a safe and secure ensemble organisation – not a one-man band.
- Goal-based financial planning: a plan that's tailored to you and your goals that takes into account your appetite for risk, investment horizon, financial obligations and family objectives.
- A flexible, diversified, systematic investment process: your portfolio should be invested in global markets and adjusted as your investment objectives change.
- A clear and simple Personal Financial Plan: constructed according to your personal needs taking into account your objectives, time horizon, cash flow forecast and other factors specific to you.
- Planners who understand you: as well as your career, your life and financial trajectory who consider your holistic position – not just the assets 'on platform'.

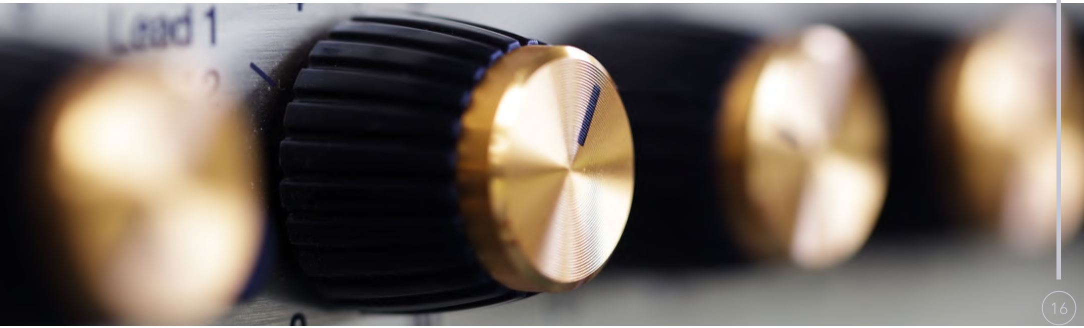
HOW TO BRING COSTS DOWN

#1 Removing mouths
Choose a firm that provides a comprehensive service leaving one single point of contact with substantial cost and efficiency savings.

#2 Opting for a systematic investment approach
In addition to the cost of advice, investors need to be aware of the costs of different investment products. An active management approach run by professional stock pickers will attract additional charges.

#3 Cost control
By reducing investment costs, your money can compound/grow quicker. A firm that supports this aligns their interest with yours.

#4 Minimise tax
A good planner will be able to help you consider your future tax liabilities, such as capital gains tax, income tax and inheritance tax through personalised advice on appropriate structures and timing.



IN SUMMARY

You invest to make money. The charges you pay are the most controllable part of your investment, and often the most important factor determining its success.

If you have even the slightest concern that you have been sold an expensive product, look into it.

Ask yourself:

- How much am I paying in charges and what charges am I paying?
- Where is my money invested? I want to see a full breakdown of all the investments in my bond.
- How have the investments performed to date? And how does that compare to the relevant benchmark?
- How diversified is my portfolio? I want to see what exposure I have to different asset classes, sectors and geographical regions.
- How risky is my portfolio? I want to make sure the risk profile matches my appetite for risk.

- Are there any alternatives that offer lower costs, better potential returns, or ideally both?
- What are the charges or penalties if I were to change my investments or transfer out of the bond?

Don’t take what you are told at face value. Always check the facts and understand how these structures work.

Fee-based advice is the most transparent way of charging for the initial work undertaken to understand your needs and create a plan.

Finally, do your research, demand transparency and use this information to make sure you get the advice you deserve.

WELCOME TO BETTER

For a better you and better business, subscribe to AES Education.

IMAGINE IF YOUR PENSIONS & INVESTMENTS WERE 100% UNDER CONTROL...

We ask just 3 questions of you to see if we are the right fit for each other:

1. Do you have over £500,000 in pensions or savings (£650,000 for pension transfers)?

2. Do you value personal service and an equal relationship between us both?

3. Do you want a 12-month, risk-free, money-back service guarantee, so you have peace of mind with your investments?

When you've answered YES to all 3, we'd love to help you along your financial journey. It's now just one small step away. Simply get in touch today.

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RISKS

Investment involves risks. The investment return and principal value of an investment may fluctuate so that an investment, when redeemed, may be worth more or less than the capital invested. Past performance is not a guarantee of future results. There is no guarantee strategies will be successful.