At last, a clearer picture of your investment fees

WILL HAMILTON

Two major regulatory changes have been introduced to the Australian funds management industry.

Both changes will have an impact on you — the end investor. In both cases there is a genuine change under way to reveal the true costs of making investments.

Disclosure

The first is the Australian Security & Investment Commission's RG 97 — disclosing fees and costs in product disclosure statements along with periodic statements. These are the key documents that you get when you subscribe to investments in our market such as managed funds.

This came into effect yesterday. ASIC has said that these changes have been made to clarify "fees that are not deducted as transactions from the members accounts, but rather (get introduced as) a reduction in the unit price".

> They are not new costs ... but existing costs now being disclosed for all to see

These are costs that have and will continue to be incurred. They are not new costs or transaction costs, but are existing costs that are now being disclosed for all to see. This is a good outcome.

Crucially, these are implicit rather than direct costs. While ASIC does not specifically recognise implicit costs, it categorises these transaction costs as the difference between the purchase and the immediate sale of an asset.

From now on ASIC is requiring:

- Disclosing "implicit costs" in a PDS as indirect costs.
- Reporting all fees and costs separately and consistently.
- Providing an explanation of these fees and charges.

In July, MLC issued a circular to the market explaining the change: "There are no new fees or costs, and no changes to the way fees and costs are charged. The only change is to the way fees and charges are disclosed. The RG97 changes may mean some increases in the amounts of fees and costs disclosed. However, members won't pay any more and there will be no impact on the impact of their investments."

In other words, these are existing fees and costs previously undisclosed now being disclosed, so it is about awareness and transparency.

However, when it comes to PDSs under the new regime, let's hope it does not get used as a reason to lift fees further. We are already operating in an environment where fees for retail investors by domestic Australian equity managers (running both domestic and international strategies) are high relative to global peers. I would not want to see them increase further in the context of a regulatory change such as this.

One key effect of RG 97 is that it will force those of us in the wealth management sector to further examine the costs of a manager, especially considering their after-fee performance.

Reduced costs

The second regulatory change that will impact investors positively by way of reduced costs is the markets in financial instruments directive MiFID II, which comes into effect on January 3, 2018.

This European Union regulation directly affects any EU-based institution or organisation that operates in the EU.

It is being adopted globally as best practice, including by many US fund managers and many of our own domestic Australian industry superannuation funds.

This regulation is designed to end the fund management industry's opaque practice of lumping together the fees it pays an investment bank or broker for research and trading.

As a result, asset managers will have to start paying directly for investment research to demonstrate they are not being induced to trade.

It's the real impacts of MiFID II that should be focused on. Its benefits include driving greater market efficiency and competitive pricing. In addition, we should expect to see:

- Growth of independent research firms.
- Higher quality outcomes for fund managers.
- Reluctance by fund managers to pay for research and the consequent contraction in the number of fund managers.
- Potential reduction in quality research for small to mid-cap companies.

Some fund manager have signalled they will absorb all research costs to coincide with the new legislation. We will need to wait and see.

While this is an EU regulation it is already having an impact in Australia.

Recently I contacted two European investment banks who did provide me with some equity research at no cost; however, I also approached a US investment bank and was told they now must charge me for the material. It will be interesting to see the flow-through impact for our own retail broking industry come 2018.

Increased transparency to investors is always a positive development. These new regulations are major changes initiated both by our own regulator ASIC and indirectly from the EU. They are increasing transparency for investors.

Hopefully, all investors will make themselves fully aware of the changes and that the benefit will be the ability to make more informed decisions with lower costs.

Will Hamilton is the managing partner of Hamilton Wealth Management, a Melbourne-based independent wealth manager.

will.hamilton@hamiltonwealth.com.au

Cheap SMSF audits can cost a pretty penny in long run

Most ATO concerns occur where fees are less than $400

MONICA RULE

It's the time of the year when the nation's one million DIY fund members generally get around to doing their returns. As part of that process you must have your accounts audited.

But how much do you pay? If it's more than $2000 you are in a select group of less than 3 per cent of all SMSFs. In fact, if you are in that group the assumption might be made that your fund is pretty complex and you have a good idea of what you are doing.

It is the other end of the spectrum that causes concern. If you are among the one in three getting your fund done each year for a couple of hundred dollars, are you really getting value?

Tax Commissioner Chris Jordan said earlier this year that the tax office identified several problems with audits being done by auditors who charge less than $400. The ATO found corners were being cut, some auditors not having a written audit plan, representation letters not being obtained from the trustee, and, worse still, some auditors failing to conduct an adequate audit that complied with standards.

The cost of an SMSF audit will depend on factors such as: the number of investments held, the complexity of the investments, whether the SMSF is paying a pension, and whether the SMSF has members both in accumulation and pension phases.

Most audit fees range from $700 to $1000. The fees do not include preparation of the SMSF's tax return. You need to distinguish between audit and fees charged by accountant for the preparation of your tax return. These must be conducted by two different people.

An SMSF audit must be done by a person who does not hold any financial interest, or have a close relationship with members of the SMSF and who also did not prepare the SMSF financial accounts.

When selecting an auditor, you should inquire as to who will do the audit. A good quality SMSF audit should provide trustees with value for money where:

- The auditor is independent;
- In conducting the audit the auditor uses a high level of professional judgment combined with good audit technology;
- The audit approach is customised for the specific risks relevant to the SMSF;
- The auditor provides a detailed management letter that not only notifies the trustees of their findings but contains recommendations for any rectification action that is necessary; and
- Trustees can contact the auditor directly at any time.

In the year ended June 30, 2015, the average audit fee was $754 and the median was $550.

Remember the basics: Your SMSF auditor must be a person who is registered with the Australian Securities & Investments Commission and they must have completed the minimum competency requirements in order to conduct SMSF audits. Auditors registered with ASIC are issued with an SMSF Auditor Number, which must be included on your SMSF's annual tax return.

Your auditor's job is to examine your SMSF's statements and assess compliance with superannuation law. Your auditor will advise if there are contraventions. Then depending on the contravention type, your auditor may be required to report the contravention to the tax office.

I would advise SMSF members to avoid cheap audits, as a good auditor can save you money by identifying mistakes quickly so you can rectify them sooner rather than later. The cheaper option may save you money in the short term, but if the audit is not carried out correctly it could cost you more in the long run.

Monica Rule is an SMSF specialist and author of The Self Managed Super Handbook.

www.monicarule.com.au

Giant investment houses keep companies on their toes

TONY KAYE

Australian shareholders will soon be gathering in droves as the bulk of our public companies host their annual general meetings.

The boards of most of the top 200 companies will take centre stage between mid-October and December, giving investors the opportunity to ask questions, voice concerns and vote on resolutions including director appointments, executive pay and capital raisings.

But the heavy lifting for investors will have already been done well before the AGMs, thanks to the world's biggest institutional shareholders.

They include ETF and index fund players such as BlackRock, Vanguard and State Street, which have billions invested in the local market. Collectively they control more than $US15 trillion ($19.2 trillion) in funds globally, and rank as the top three passive investment houses in the world by virtue of their domination of the index-tracking exchange-traded funds sector.

Yet the ETF product giants are anything but passive when it comes to protecting their investment interests. Each has active "investment stewardship" teams that have enough financial clout to open boardroom doors.

Pru Bennett, who heads BlackRock's Asia-Pacific investment stewardship team from Hong Kong, says engagement at the board level is important to ensure companies are adhering to the highest corporate governance standards and making good decisions.

Along with her team, Bennett visits Australia regularly to meet with the chairs and CEOs of Australia's largest listed companies.

"It's important we build a relationship with those boards, because we are long-term shareholders and selling is not an option, unlike an active manager," she says.

Vanguard chairman and CEO Bill McNabb drew on the same long-term perspective when he penned an open letter to thousands of public company directors at the end of August, thanking them for their role in overseeing his firm's "sizeable investment" in their company

"At Vanguard, a long-term perspective informs every aspect of our investment approach, from the way we manage our funds to the advice we give our investors. Our index funds are structurally long-term, holding their investments almost indefinitely."

McNabb says Vanguard's evaluation of corporate governance practices focused on the board, including gender diversity, structures, appropriate remuneration and risk oversight.

"Our focus on corporate governance and investment stewardship has been and will continue to be a deliberate manifestation of Vanguard's core purpose: to take a stand for all investors, to treat them fairly, and to give them the best chance for investment success."

Like all long-term relationships, sometimes there can be rocky patches, especially when it comes to voting.

"We have a policy of engaging with a company before we vote against any particular proposal, so there are no surprises. And I think that's responsible, given the sizes of the holdings that we have," says Bennett. Data from BlackRock shows that in the year to June 30, the fund manager voted against one or more management recommendations at 37 per cent of AGMs it participated in globally over the year. BlackRock voted on more than 53,000 company proposals in the Asia-Pacific region last financial year.

Shareholder activism is certainly nothing new in Australia, but it is on the rise.

US hedge fund Elliott Management has been on the attack against BHP Billiton since earlier this year, castigating management over the company's underperformance. That stems from a long line of questionable asset purchases, including the company's $US20bn investment in US shale assets in 2011, and further investments of $US20bn into the same assets, followed by a string of heavy writedowns.

With a 5 per cent stake in BHP's Britain-listed shares, it's expected that representatives of Elliott will turn up to the "Big Australian's" annual meeting at Margaret Court Arena in Melbourne on November 16.

Bennett notes that on a global scorecard basis, Australian companies are doing quite well in terms of governance structures, and in tailoring executive compensation packages that are more aligned to operational outcomes.

But having longer-term outlooks is still a work in progress for many large companies.

"I pick up the average annual report from the ASX 200 companies. Very, very few, when you read the chairman's statement or the CEO's statement, are really talking ... beyond six months."

Tony Kaye is the editor of Eureka Report, which is owned by financial services company InvestSMART.

www.investsmart.com.au

BRITTA CAMPION

Vanguard Group CEO Bill McNabb says the firm aims to treat all investors fairly

FLOAT WATCH

Digital ad pioneer aims for influence

engage: BDR
ASX code: ENI
Shares on offer: 30 million
Listing price: 20c
Market capitalisation: $45.9m
Listing date: October 6

SIMON HERRMANN

MySpace co-founder Tom Anderson had over 350 million "friends" at one point.

Most internet users know him as "Tom from MySpace" — he was automatically assigned as your first "friend" upon creation of a new profile on the original MySpace social media site.

Anderson hasn't changed his pixelated profile photo to this day and he is arguably one of the first and biggest "influencers" of our time.

One of his co-workers at MySpace was marketing strategist Ted Dhanik, who played a key role in launching the brand in the early days. Nearly 10 years after his departure, the two advertising gurus will now sit together on the board of a soon-to-be listed company on the Australian Securities Exchange — but this time Ted Dhanik will be the man at the top with Tom Anderson playing a supporting role.

The US advertising and media company, engage: BDR, is seeking to raise up to $6 million from investors to develop the company's digital advertising business, which is supported by its own proprietary technology.

The company's technology conducts up to 40 billion dynamic online advertising auctions each day (yes, that is billion, not million) and claims to have many potential new clients in the pipeline.

engage: BDR was initially established to monetise advertising on MySpace and has now reached a respectable size with a pre-money valuation of nearly $40m.

The Australian IPO marks the first time the company raises external capital — an impressive track record.

Revenues have historically been lumpy, falling from $36.9m to $21.8m in 2016 after the company replaced salespeople with technology.

As a result margins improved significantly but management has to demonstrate sustainability in the financials.

Programmatic advertising needs to be of high scale to generate a profit and while engage: BDR is operating in an ever-changing marketplace, management will be the single most important factor in determining the fate of the business and its stakeholders.

Simon Herrmann is an investment analyst at wise-owl.com.