The Home of Exchange Traded Funds®

Article 33 (Oct 10th)

Revisiting ETF Costs

Mike Brown, Managing Director, etfSA.co.za

There are two costs associated with all the ETFs available in South Africa and traded through the JSE:

- Total Expense Ratios (TERs); and
- Transaction Costs

Total Expense Ratios (TERs)

TERs are the costs incurred by the issuer of the ETF, the "product supplier" in Financial Services Board (FSB) speak, in managing and administering the ETF product. These TER costs include: asset management and portfolio administration fees; custodian, trustee and banking charges; index tracking and JSE listing license fees, etc. etc. The product supplier also charges a management fee, to pay their staff costs, advertising, and to provide a margin. This management fee is included in the TER.

The administrator of the ETF accrues for the TER on a daily basis and publishes each day on the product suppliers' website (also available daily through the etfSA website, www.etfsa.co.za) the net asset value (NAV) of the ETF, which includes the accrued TER. The price of the ETF on the JSE trades at its NAV. In other words, the price of the ETF on the JSE is net of the TER.

This is only fair, because the trader, who buys an ETF one day and sells it the next, should at least pay up one day's TER expense, which they do because the price of the ETF is embedded with this one day's incremental TER.

As the price of the ETF is already traded net of costs (TERs), there is no need to deduct the TER as an additional cost when tabling up total costs – this would be **double-counting**.

Most South African ETFs have TERs of between 20-45bps (0,2% to 0,45%) per annum. An examination of the BlackRock Research on the 4000 or so ETFs listed around the world, indicates that South African ETFs are at the lower end of the average cost scale, particularly for emerging markets.

Transaction Costs

ETFs are traded in the "secondary market" i.e. on an exchange such as the JSE. ETFs are not bought and sold through the "primary market" i.e. the issuer or product supplier. There is a sufficient pool of ETFs available in the secondary market to meet normal supply and demand and there are market makers to provide liquidity when needed.

"Over-the-counter" products, such as unit trusts, hedge funds, etc, have to be bought and sold through the issuer (primary market), which can be very expensive as the product supplier has to create or redeem new units daily and does their own back-office administration , as there is no centralised electronic settlement, clearing, registration and custodian systems for such over-the-counter products.

This is not the case for ETFs which trade through the stock exchange, as the JSE has centralised electronic systems for trading, clearing, settlement and the STRATE/CSDP system provides centralised electronic registration, custodianship and transfer services. These JSE services are all part of the transaction costs of the ETF.

Investors can transact in ETFs through the retail market, i.e. directly with stockbrokers, or wholesale through the Investment Plan platforms.

Stockbrokers – charge commissions, which are negotiable, but for retail clients, range from 0,4% to 1,8% per transaction. JSE clearing, settlement fees and the annual STRATE/CSDP fees also need to be paid.

Two areas to be kept in mind with stockbrokers are that each transaction is a separate trade, so if you are switching from one ETF to another, this is regarded as two separate trades and full fees are accrued on each leg. Also, stockbrokers have minimum cash trade costs, normally about R100 or more per trade, so small trades, like reinvesting dividends, can be ruinously expensive.

Investment Plans such as Satrix Investment Plan and the etfSA Investor Scheme™, "bulk" the transactions charges by utilising Category III FSP Administrators, who are authorised by the FSB to do such bulking. This means that the brokerage commission and JSE clearing and settlement charges are bulked amongst all investors trading on the day, which bumps the brokerage commission down to 0,1% per trade and JSE SETS charges to a few cents per investor. There are also no minimum charges per trade.

The Administrator of the Investment Plan platforms, charges an annual management fee (0,45% to 0,80%, depending on the size of the investment), and these charges are exactly the same for the Satrix and etfSA Investment Plans. The annual management fees cover custodianship, registration, client account admin, reinvestment or payment of dividends, tax certificates, statements, etc.

The average Investment Plan investor does multiple transactions per year (12 monthly debit orders, 4 reinvestments of quarterly dividends, transfers, switches, additional investments, sales, etc.) and the administration costs of these are all bulked in the single annual administration fee and not charged as separate and individual trades, as in the case of stockbrokers.

The "bulking" of changes provided by Investment Plans, makes sense for any active investor doing multiple transactions in ETFs/ETNs no matter what the size of their investment.

The Investment Platform accrue their annual management fees on a daily basis and deduct these fees from any income flows into the clients' accounts, i.e. dividends and debit orders. The net cash, after costs, is then invested on behalf of the client. That is why the Investment Plan platforms run two accounts, a cash account and a securities account for each client, to fully account for every cent of the clients' monies.

On final example of confusion is that many investors believe that if you buy Satrix ETF securities through a stockbroker or through etfSA Investor Scheme™, you need to pay the Satrix Investment Plan fees of 0,45% to 0,80% per annum. This is, of course, not the case ,as the stockbroker or administrator of etfSA will buy the Satrix securities directly in the secondary market and therefore does not deal with Satrix. The Satrix Investment Plan fee is only payable by clients who deal directly with this platform for transactions in Satrix securities.

If you eliminate these examples of double, or is it triple-counting, ETFs are very competitive cost wise particularly if the bulking functions of the Investment Plan platforms are utilised. What is now required, is for the product suppliers, other than ETFs, to disclose their costs, on a line by line basis, so we can really do proper cost comparisons.

Please contact the undersigned should you require any further detail or information:

Mike Brown	Telephone:	011 561 6653
	Email:	mikeb@etfsa.co.za
	Website:	www.etfsa.co.za