

For professional / qualified investors only

What are transaction costs?

Eddie Barstow
Graham Finlay

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Established 1817	45,000 employees globally	\$852 billion in total assets
191-year Dividend record* <small>* Longest in Canada</small>	Aa2 Credit rating ¹	8th largest bank in North America by assets ²
 2019 World's Most Ethical Companies – Ethisphere Institute, recognised 2nd year running	 2019 Bloomberg Gender-Equality Index 4th year running	 America's Best Employer for Women 2019 – Recognised by Forbes Magazine

Source: BMO Annual Report 2019

1. Moody's Senior Unsecured Debt credit rating as of 12/31/2019. 2. Source: Bloomberg as of October 31, 2019; total assets (reported) most recent filing.

Our bold commitments



- 
For a sustainable future > **Mobilising \$400billion** for sustainable finance by 2025
- 
For a thriving economy > **Doubling** support for small businesses and for women entrepreneurs
- 
For an inclusive society > **Reducing** barriers to inclusion for employees, customers and stakeholders partnering with BMO

Learning objectives

By the end of the session attendees will be able to:

1. Understand the key elements required under MiFID II cost disclosure requirements
2. Investigate the differences between 'Explicit' and 'Implicit' cost and charges within the transaction costs
3. Understand the 'Arrival price' methodology when calculating implicit costs

Background to transaction charges - **cost disclosure**

PRIIPs / MiFID II – January 2018 - Key Adviser Impacts

- Inducements
- Conflicts of interest
- 10% drop reporting
- Changes to suitability rules
 - **Costs and charges disclosure requirements**
 - PROD/target market
- Record keeping training and competency requirements



MIFID II – costs and charges

Article 24(4) of MiFID II and Article 50 of the Delegated Regulation

The regulatory intent of MiFID II and PRIIPs to enable investors to see and understand fully all the costs involved in investing in a fund



- Disclose costs and charges on an aggregated basis
- Disclosed in both £ and %
- Must include product and service costs and any third party payments

Source: Annex II of MiFID Delegated Regulation - Article 24(4) of MiFID II and Article 50 of the Delegated Regulation. <https://www.piqsels.com/en/search?q=cost>

FCA Reviews – cost and charges



The screenshot shows the FCA website header with the logo and navigation tabs for 'About us', 'Firms', 'Markets', and 'Consumers'. The breadcrumb trail is 'Home / Publications / Review on disclosure of costs by asset managers'. The main heading is 'Review on disclosure of costs by asset managers'. Below the heading, it says 'Multi-firm reviews | First published: 28/02/2019 | Last updated: 28/02/2019'. The introductory text reads: 'We have reviewed how asset managers calculate and disclose transaction costs and how effective overall cost disclosures are.'



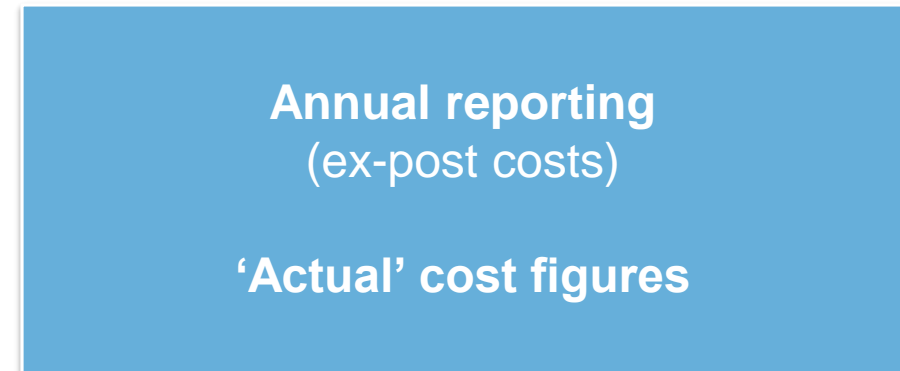
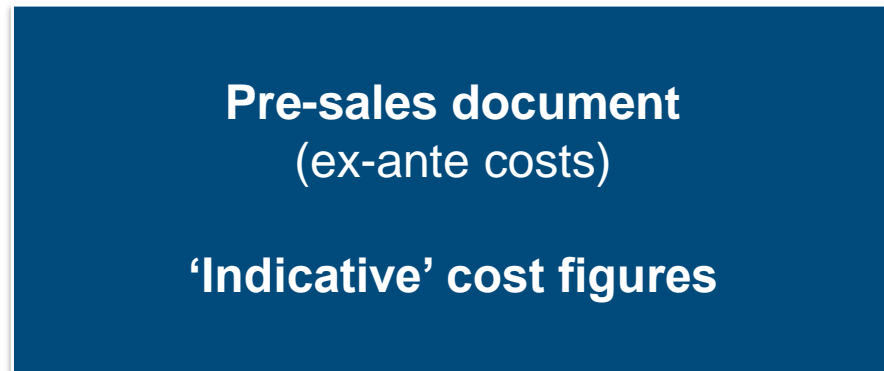
The screenshot shows the FCA website header with the logo and navigation tabs for 'About us', 'Firms', 'Markets', 'Consumers', 'News', and 'Publications'. The breadcrumb trail is 'Home / Publications / MiFID II costs and charges disclosures review findings'. The main heading is 'MiFID II costs and charges disclosures review findings'. Below the heading, it says 'Multi-firm reviews | First published: 28/02/2019 | Last updated: 28/02/2019'. There are icons for 'Print Page' and 'Share page'. The introductory text reads: 'As part of our supervision work, we looked at the costs and charges disclosures of a sample of 50 firms authorised as MiFID investment firms in the retail investments sector. We wanted to understand if firms were complying with the new rules and what challenges they found in doing so.'

- Calculation and description of transaction costs
- Inconsistencies
- Advertising low costs
- Missing data
- Presentation of performance scenarios
- Wide interpretation of rules
- Firms better at disclosing own costs
- Showed as % only
- Hampered by lack of available data

Source : <https://www.fca.org.uk/publications/multi-firm-reviews/mifid-ii-costs-and-charges-disclosures-review-findings> <https://www.fca.org.uk/publications/multi-firm-reviews/review-disclosure-costs-asset-managers>

How must costs be disclosed?

Costs must be disclosed before a sale (ex-ante) and then reported to the investor annually (ex-post), based on the investor's own level of investment



Source: FCA COBS 6.1ZA

Disclosure of costs and charges

What costs does a fund need to disclose?



One-off charges

(Paid when entering an investment)

Ongoing charges

(Taken annually for managing the fund)

Incidental costs

(Ad-hoc charges)

Transaction costs

(Trading underlying investments)

Capturing the 'real' cost and charges of a trade

What are the transaction costs?

All costs and charges as a result of the acquisition and disposal of underlying investments within the fund



Explicit cost

(Incurred)

Implicit cost

(Implied)

Anti-dilution

(Incurred)

Source : TISA – Approach to implementation for MIFID II – Cost & Disclosures 30.09.2020 Version 4.1

Transaction costs - **explicit**

Explicit costs

Cost charged to and paid directly by the fund to purchase and sell financial instruments.

Result of decisions made by the fund manager to buy and sell investments to improve returns:

- **Broker commission**
- **Taxes and levies**

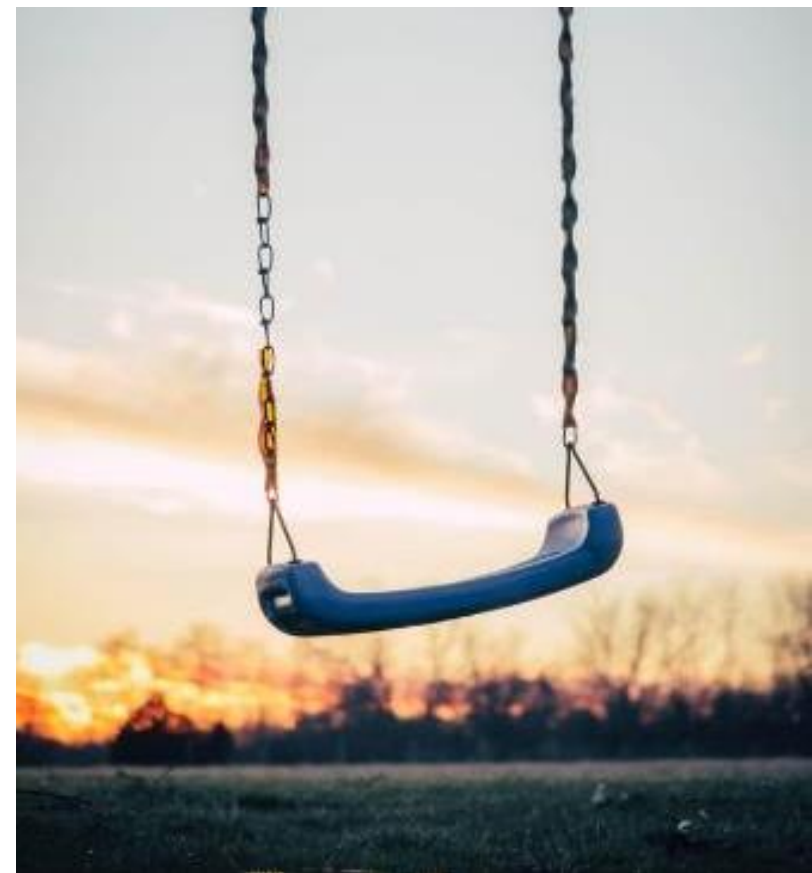


Transaction costs - anti-dilution

Anti-dilution / Swing impact costs

The cost credited to the fund via a swing in the net asset value when the volume of flows is above the threshold trigger.

- **Costs borne by all investors**
- **Anti-dilution mechanism**



Source : <https://unsplash.com/s/photos/swing>

Transaction cost – implicit

Implicit transaction cost (or direct transaction or slippage cost)

Important - implicit transaction costs are a result of operating in the financial markets and are not an actual physical charge made by an asset manager.



10:50 MOSCOW/SVO
11:05 EDINBURGH
11:05 LONDON/LHR
11:10 BUCHAREST/OTP
11:30 KIEV/BORISPOL
11:35 DUBLIN
11:45 EAST MIDLANDS
12:15 SOFIA
12:30 LONDON/LGW
12:30 NEWCASTLE
12:40 ST PETERSBURG
12:40 LONDON/LGW
12:45 MANCHESTER

‘Arrival cost’ represents the difference between :

- ‘Arrival price’ - the price of a security when a transaction is instructed
- ‘Execution price’ – the price when the sale of the security is executed

Transaction costs - price volatility

What factors can create the differential between the arrival price and the execution price?

A difference between the price at which an order to trade is given and the price at which it is executed can result for a number of reasons:

- **Trade/market impact**
- **Opportunity cost**
- **Delay**

Note : The implicit cost can be either positive, negative or zero



Source : <https://unsplash.com/s/photos/difference-in-price>

Summary of differences between explicit cost and implicit cost

Explicit cost	Implicit cost
Objective cost – occurs	Subjective – occurs indirectly
Have to pay cost to utilise asset	Opportunity cost of utilising asset
Out-of-pocket	Imputed cost
Easily calculable	Difficult to calculate

Statement of costs and charges

All significantly supported retail Multi Asset funds

Each fund has a different investment strategy

Fund Name	Initial Charge	Ongoing charge figure (OCF)	Rebate, which reduces the OCF	Transaction costs	Performance fees (other incidental costs)	Total Cost and Charges		Asset Allocation	Investment Strategy
A	0.00%	0.29%	-	0.32%	-	0.61%	£30.50	Active	Active
B	0.00%	0.22%	-	0.04%	-	0.26%	£13.00	Static	Passive
C	0.00%	0.30%		0.14%		0.44%	£22.00	Active	Passive
							£65.50		

Source : BMO GAM – Illustrative purposes only

Transaction cost – comparing funds

Comparing fund transaction costs

There are many factors that might affect transaction costs and in particular the strategy and objectives of the fund should be considered.



- 1. Funds dealing in less liquid securities**
- 2. Funds with a high turnover**
- 3. Negative transaction costs**
- 4. Price availability**

Source : <https://unsplash.com/s/photos/comparing>

Transaction cost – impact of investment strategies

Higher transaction costs



Active investment strategies

Passive investment strategies

Lower transaction costs

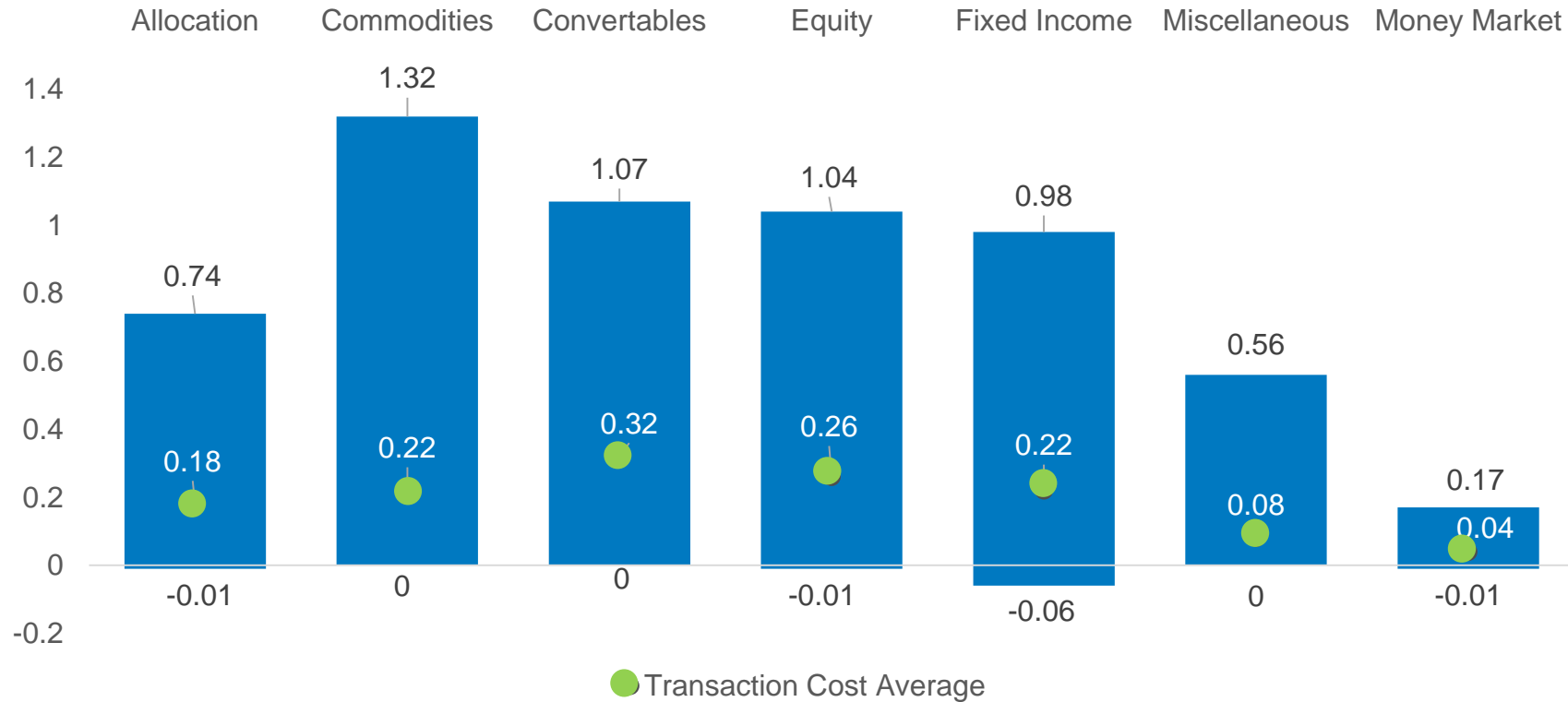
- Target alpha and active risk
- Significant trading activity
- Higher per-trade spread cost

- Lower per-trade spread cost
- Minimal trading activity
- No target alpha and limited risk

Source : <https://ukfinancialservicesinsights.deloitte.com/post/102g6ml/passive-investment-strategies-and-transaction-costs> : Blackrock - Disclosing-transaction-costs-need for a common Framework - August-2018

Transaction costs - disclosed

Disclosed total transaction costs differ significantly from fund to fund, even within the same investment strategy



Source - Deloitte – PRIIPs + MIFID 2 - transaction costs for funds – behind the scenes of the drama – Performance Magazine Issue 29

Transaction costs - different methodologies

What are the different methodologies for the calculation of implicit transaction costs?

PRIPs describes in detail how actual transaction costs must be calculated and ESMA implies that this method must also be applied when calculating costs and charges for certain MiFID II services.

-
- **Opening price**
 - **Closing price**
 - **Fixed fee table**



Source : ESMA Questions and Answers on MiFID II and MiFIR investor protection and intermediaries topics, dated 18 December 2017. Chapter 9, a.o. question 8 and 12. <https://unsplash.com/s/photos/waterfalls>

Transaction cost – fixed fee - ‘new PRIIPS methodology’

Category	Half bid-ask spread (bps)
Small-cap shares (emerging markets)	10
Large-cap shares (developed markets)	2.7
Mid-cap shares (developed markets)	6.9
Listed derivatives	0
Government bonds (ratings AAA-A)	4.3
Government bonds (ratings below A)	4.5

Source :https://www.handbook.fca.org.uk/techstandards/PRIIPs/2017/reg_del_2017_653_oj/annex06.html?date=2021-01-01

Transaction costs - calculation

Mathematics behind the calculation of transaction costs

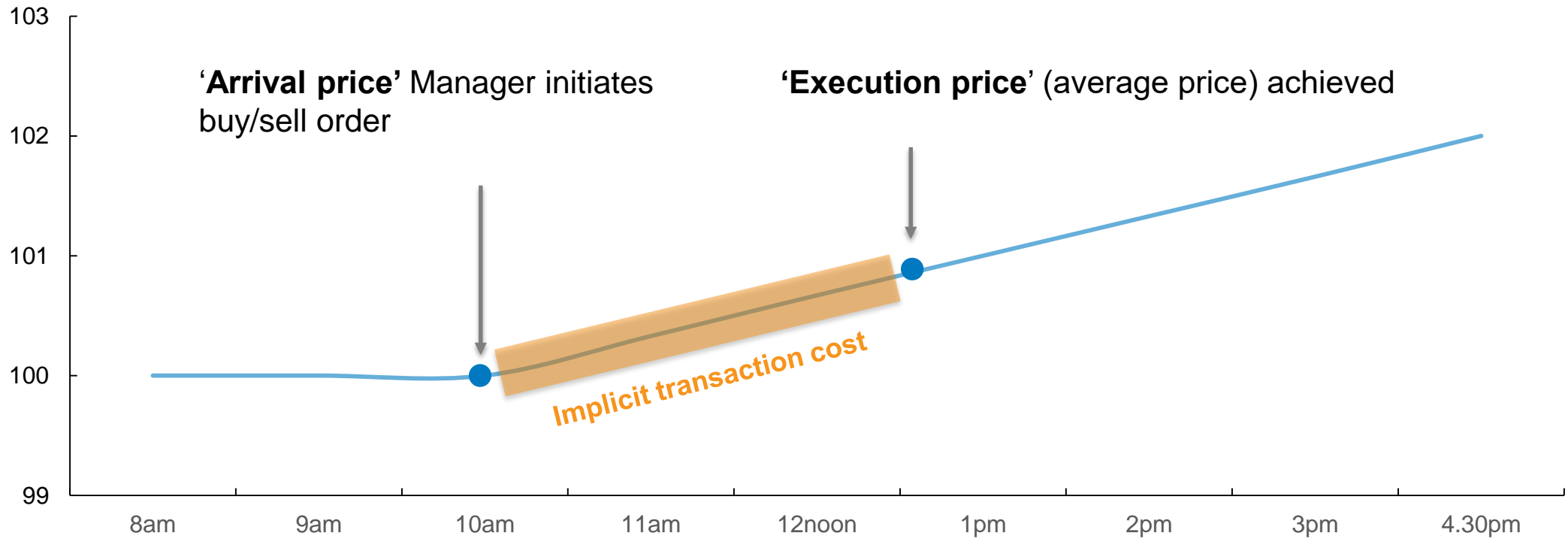
Implicit costs + explicit costs – anti-dilution/swing benefit

Average 3 year fund AUM*

Source : Annex VI of the Commission Delegated Regulation * METHODOLOGY FOR THE CALCULATION OF COSTS Point 21

Transaction cost - 'arrival price' (slippage) methodology

Method used to determine implicit transaction costs - 'arrival' price methodology



Source : BMO GAM – Illustrative purposes only

Case study 1 : transaction costs into context

Buying on positive news on a stock

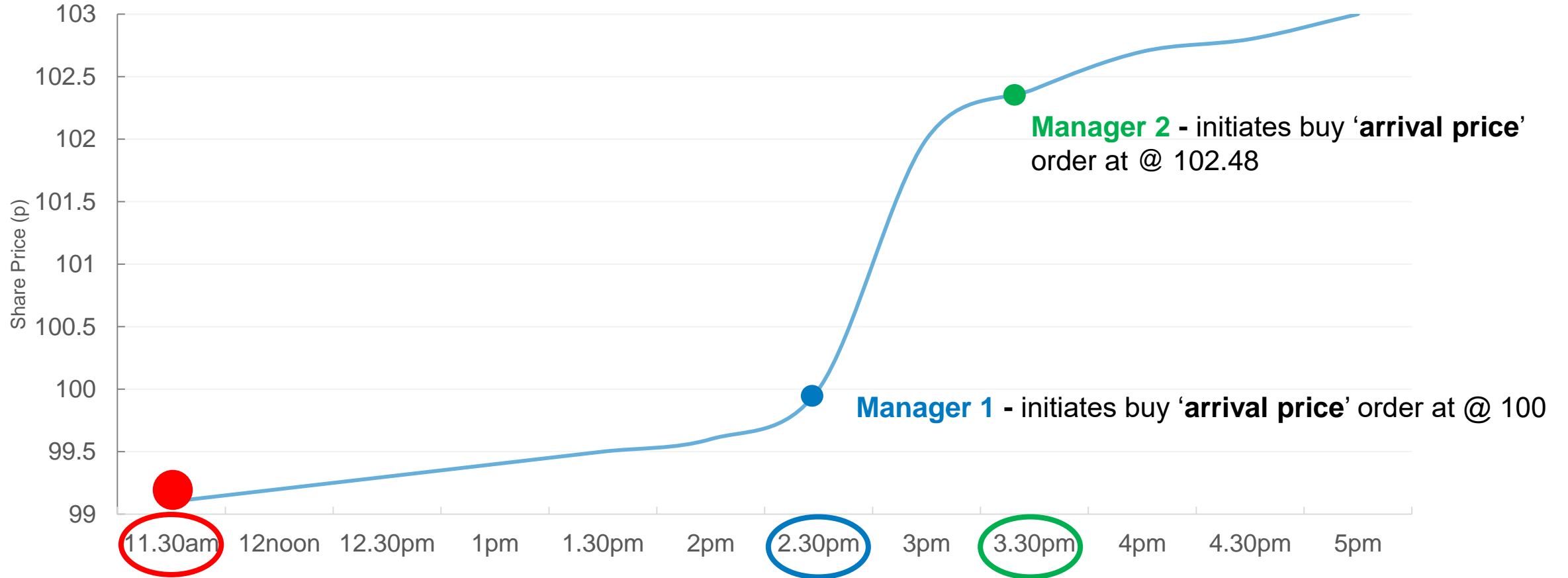
- **Two fund managers react to POSITIVE news on a stock**
- **Share price of stock is likely to INCREASE**
- **Both managers come to the same decision - BUY the stock**



Source : BMO GAM – Illustrative purposes only; <https://unsplash.com/s/photos/pharmaceutical>

Case study 1 : transaction costs into context

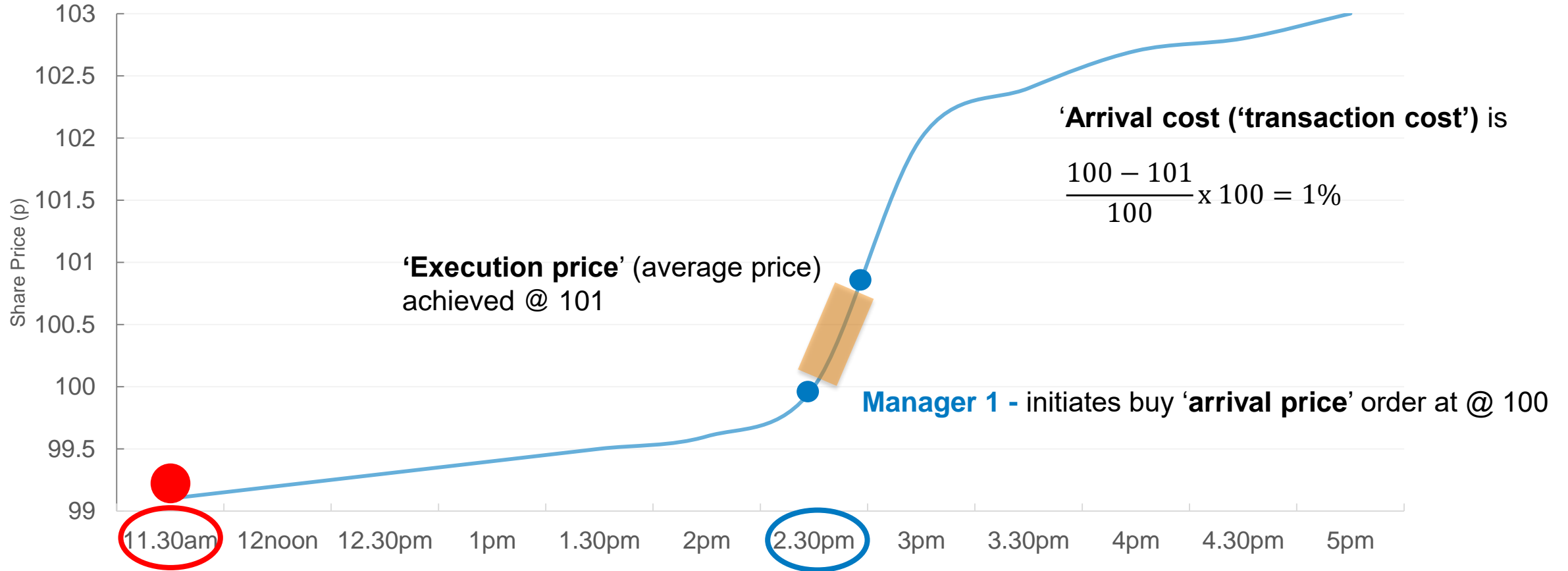
Buying a stock on positive news flow



Source : BMO GAM – Illustrative purposes only

Case study 1 : transaction costs into context

Buying a stock on positive news flow



Source : BMO GAM – Illustrative purposes only

Case study 1 : transaction costs into context

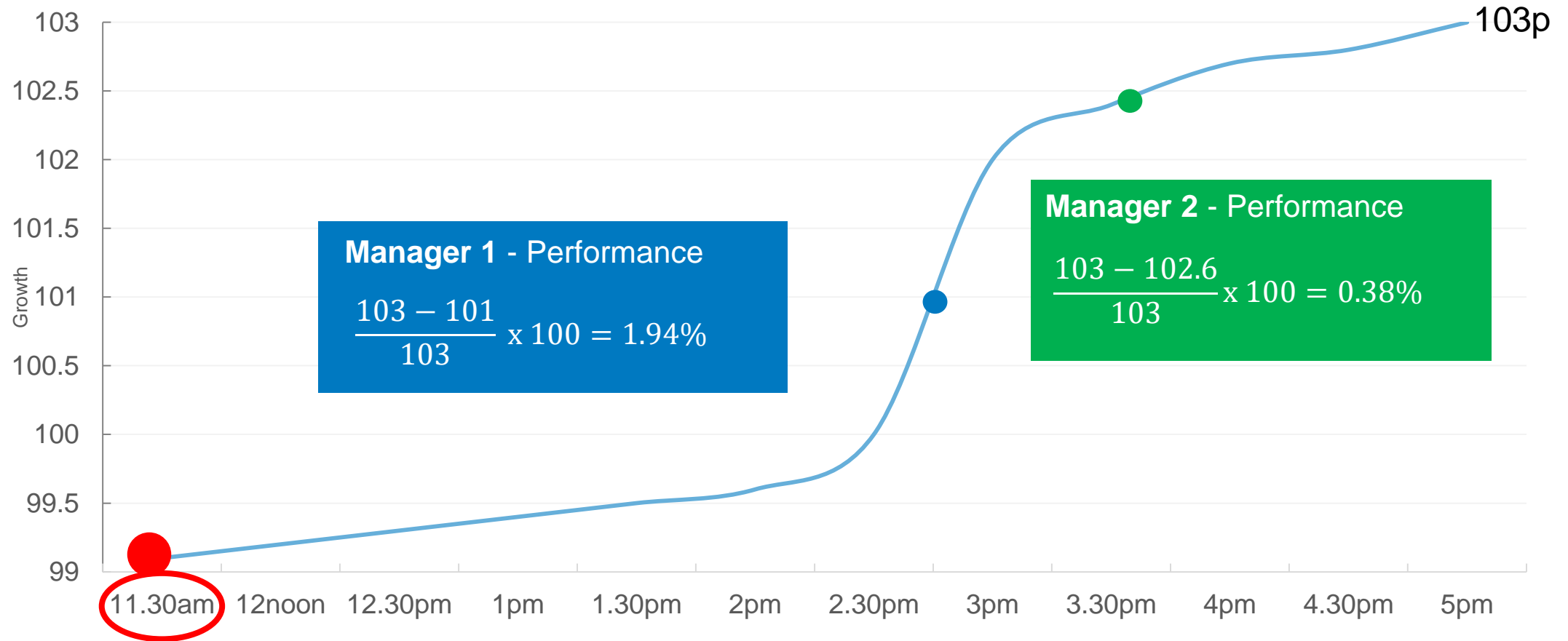
Buying a stock on positive news flow



Source : BMO GAM – Illustrative purposes only

Case study 1 : transaction costs into context

Buying a stock on positive news flow



Source : BMO GAM – Illustrative purposes only

Case study 1: transaction costs into context

Summary : Buying a stock on positive news flow

	Manager 1	Manager 2
Order start time	2.45pm	3.45pm
Arrival price	100	102.48
Execution price	101	102.60
Arrival cost - implicit cost	1%	0.117%
Performance	1.98%	0.38%

Source : BMO GAM – Illustrative purposes only

Case study 2 : transaction costs into context

Selling on negative news on a stock

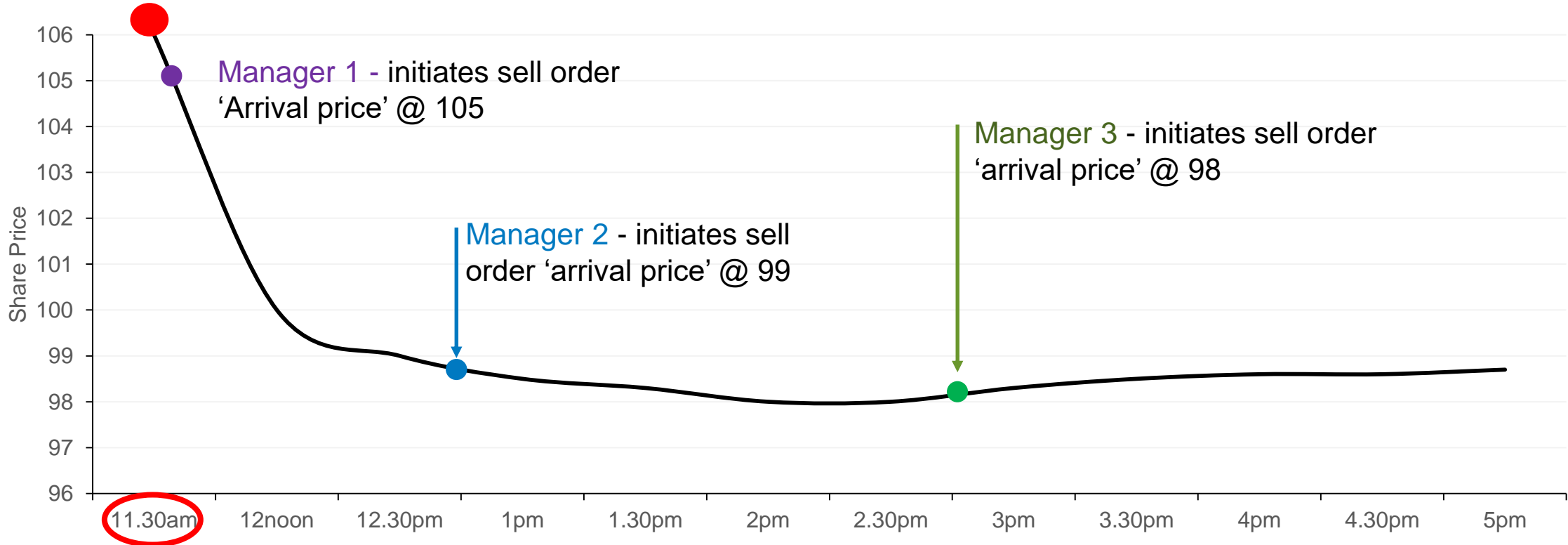
- **Three fund managers react to some NEGATIVE news on a stock**
- **Share price of stock is likely to FALL**
- **All three managers come to the same decision - SELL the holding**



Source : BMO GAM – Illustrative purposes only

Case study 2 : transaction costs into context

Selling a stock on negative news flow – ‘arrival price’



Source : BMO GAM – Illustrative purposes only

Case study 2 : transaction costs into context

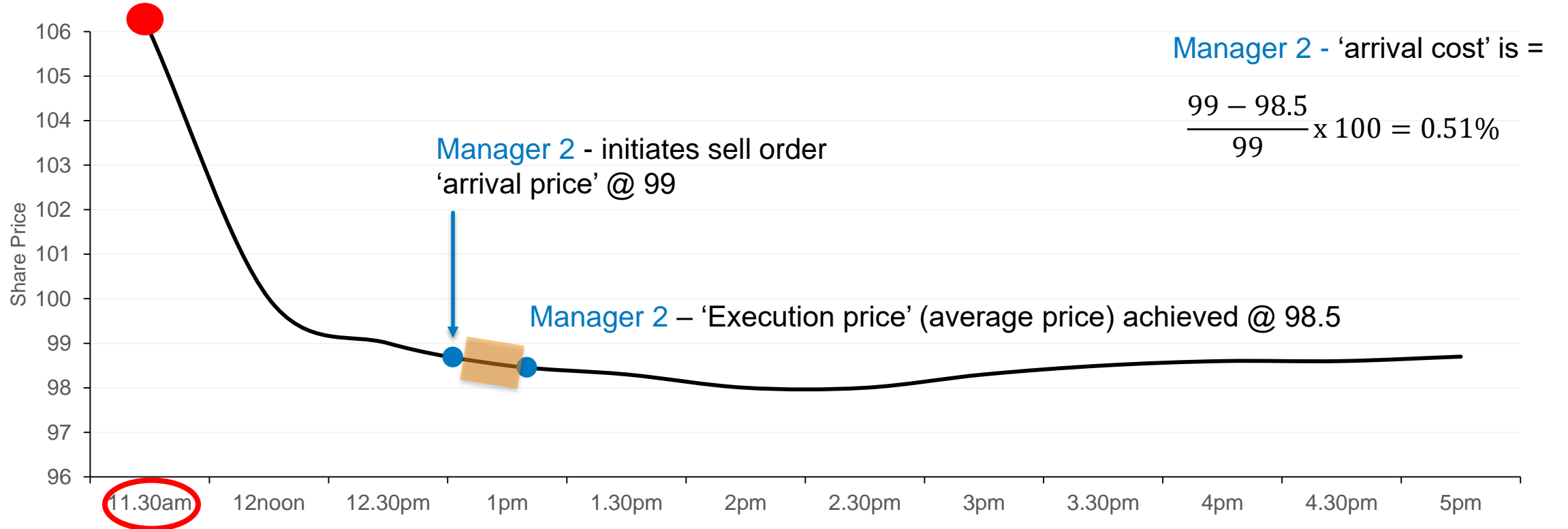
Selling a stock on negative news flow



Source : BMO GAM – Illustrative purposes only

Case study 2 : transaction costs into context

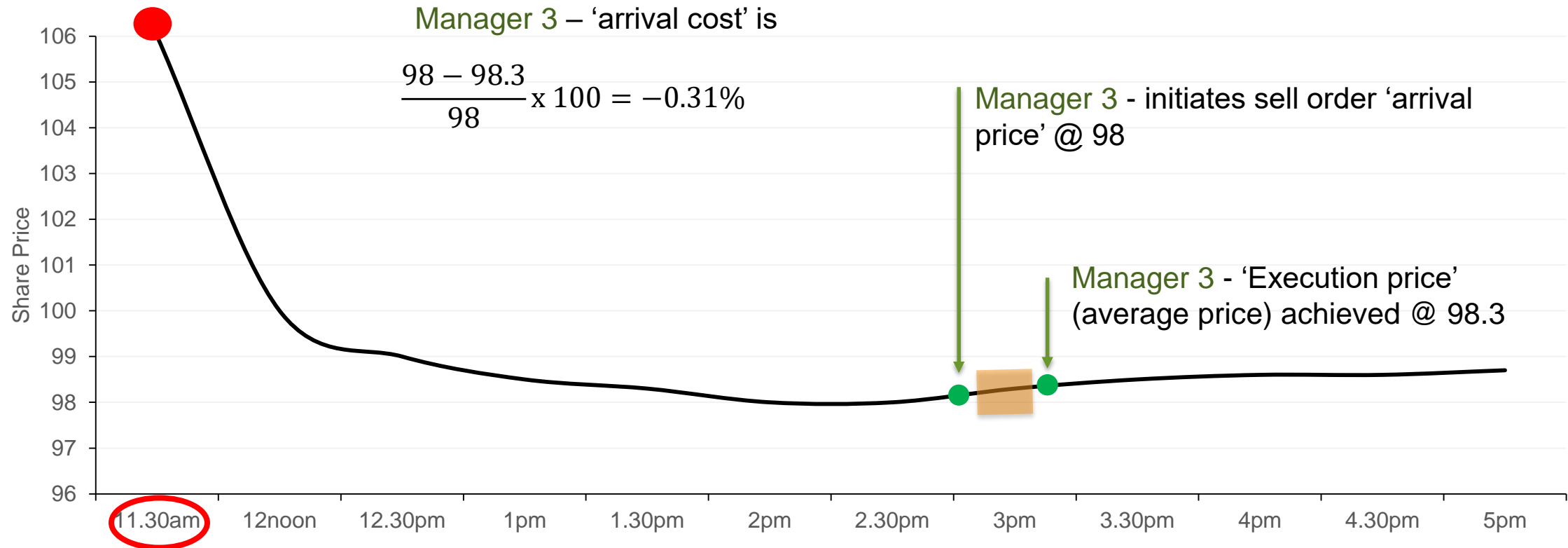
Selling a stock on negative news flow



Source : BMO GAM – Illustrative purposes only

Case study 2 : transaction costs into context

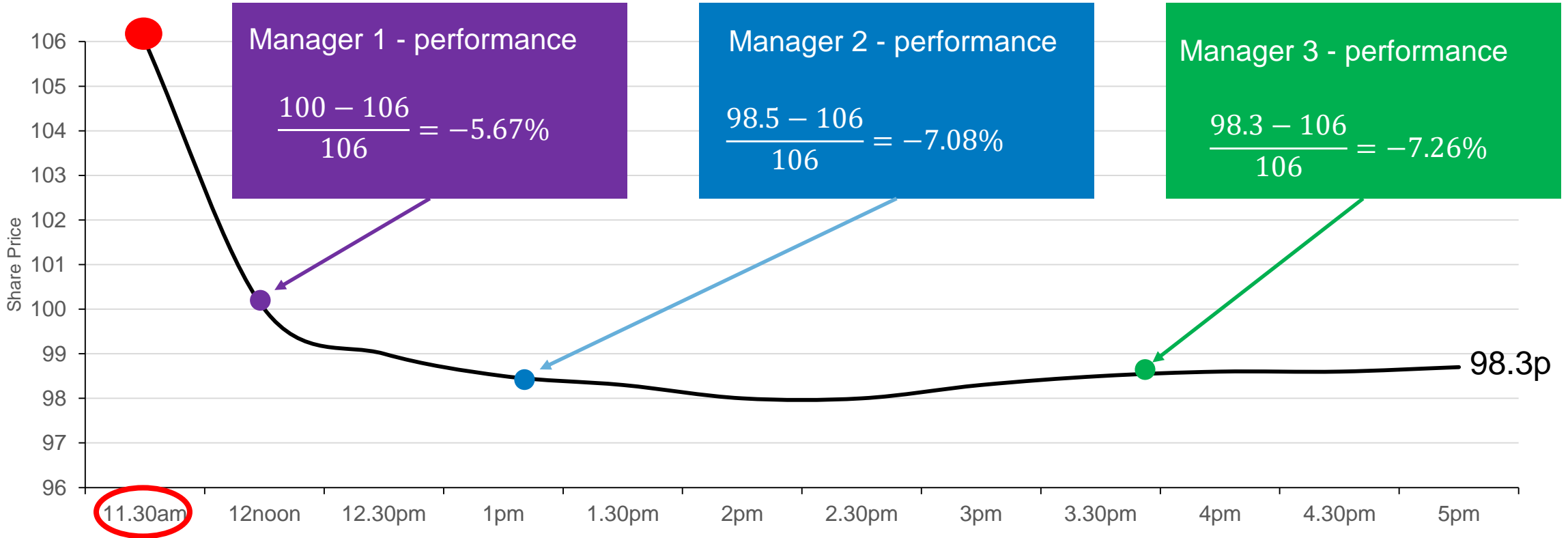
Selling a stock on negative news flow



Source : BMO GAM – Illustrative purposes only

Case study 2 : transaction costs into context

Selling a stock on negative news flow



Source : BMO GAM – Illustrative purposes only

Case study 2 : transaction costs into context

Summary : Selling a stock on negative news flow

	Manager 1	Manager 2	Manager 3
Order start time	11.45am	1pm	2.45pm
Arrival price	105p	99p	98p
Execution price	100p	98.5p	98.3p
Arrival cost – implicit cost	4.76%	0.51%	-0.31%
Performance	-5.67%	-7.08%	-7.26%

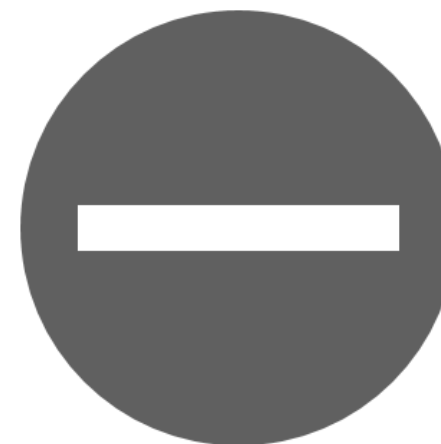
Source : BMO GAM – Illustrative purposes only

Transaction cost - why do some funds show a negative figure?

Negative transaction cost

Indicates that transacting has resulted in a net revenue rather than a net cost for the fund

-
- Pricing
 - Timing



Transaction cost - why do some funds show a zero?

Zero transaction cost

Indicates that transacting has resulted in a net revenue rather than a net cost for the fund.



-
- **Funds of funds**
 - **Transaction activity of fund**
 - **Unknown or poor data quality**

Conclusion: look beyond the headline figures

In summary

- Explicit costs are costs charged to, and paid directly by, the fund to purchase and sell financial instruments
- Implicit transaction costs are a result of operating in the financial markets and are not an actual physical charge made by an asset manager
- Lower transaction costs do not necessarily result in the best outcome for the client



Learning outcomes

By the end of the session attendees will be able to:

1. Understand the key elements required under MiFID II cost disclosure requirements
2. Investigate the differences between 'explicit' and 'implicit' cost and charges within the transaction costs
3. Understand the 'arrival price' methodology when calculating implicit costs

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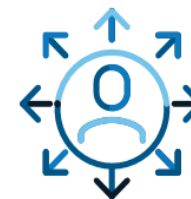
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Multi-Asset



Responsible
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Multi-Manager



Real Estate



Fixed Income



Equity

BMO Global Asset Management capabilities - Funds



Multi-Asset

- 6 Universal MAP Funds
- 3 Sustainable Universal MAP Funds
- Pyrford Global Total Return



Multi-Manager

- 5 MM Navigator Funds
- 5 MM Lifestyle Funds



Real Estate

- UK Property Fund
- Property Growth & Inc
- European Real Estate Securities
- Global Real Estate Securities



Responsible Investment

- Responsible Global Equity
- Responsible UK Income
- Responsible UK Equity
- Responsible Sterling Corp Bond
- Responsible Global EM*

EM = Emerging Markets



Eddie Barstow

Senior Associate,
Solution Sales



07732 083 209



Eddie.Barstow@bmogam.com

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Contact us

BMO Global Asset Management (EMEA) – Head Office

Exchange House
Primrose Street
London EC2A 2NY
Tel: +44 (0) 20 7628 8000

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