FINANCIAL STANDARD GUIDE TO

DIRECT SHARES TRADING

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CONTENTS

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Just as online brokers revolutionised share trading for DIY investors, those with dedicated wholesale solutions are leveling the playing field between managed funds and direct share investors.

INDUSTRY SNAPSHOT

OVER THE PAST 20 YEARS, online share trading has progressively become an integral component of the services provided by financial planners.

The ease and speed with which comprehensive share market information can be accessed and the lower cost base associated with executing trades online has transformed how financial planners do business.

As a result, a handful of online share trading service providers – operating at the wholesale level nationally – are rapidly becoming the preferred direct shares option by financial planners.

Complementing the fee-for-service model that financial planners are moving towards is the growth of online share trading services with solutions specifically catering for the financial planning community.

Just as online brokers revolutionised share trading for DIY investors, those with dedicated wholesale solutions are leveling the playing field between managed funds and direct share investors.

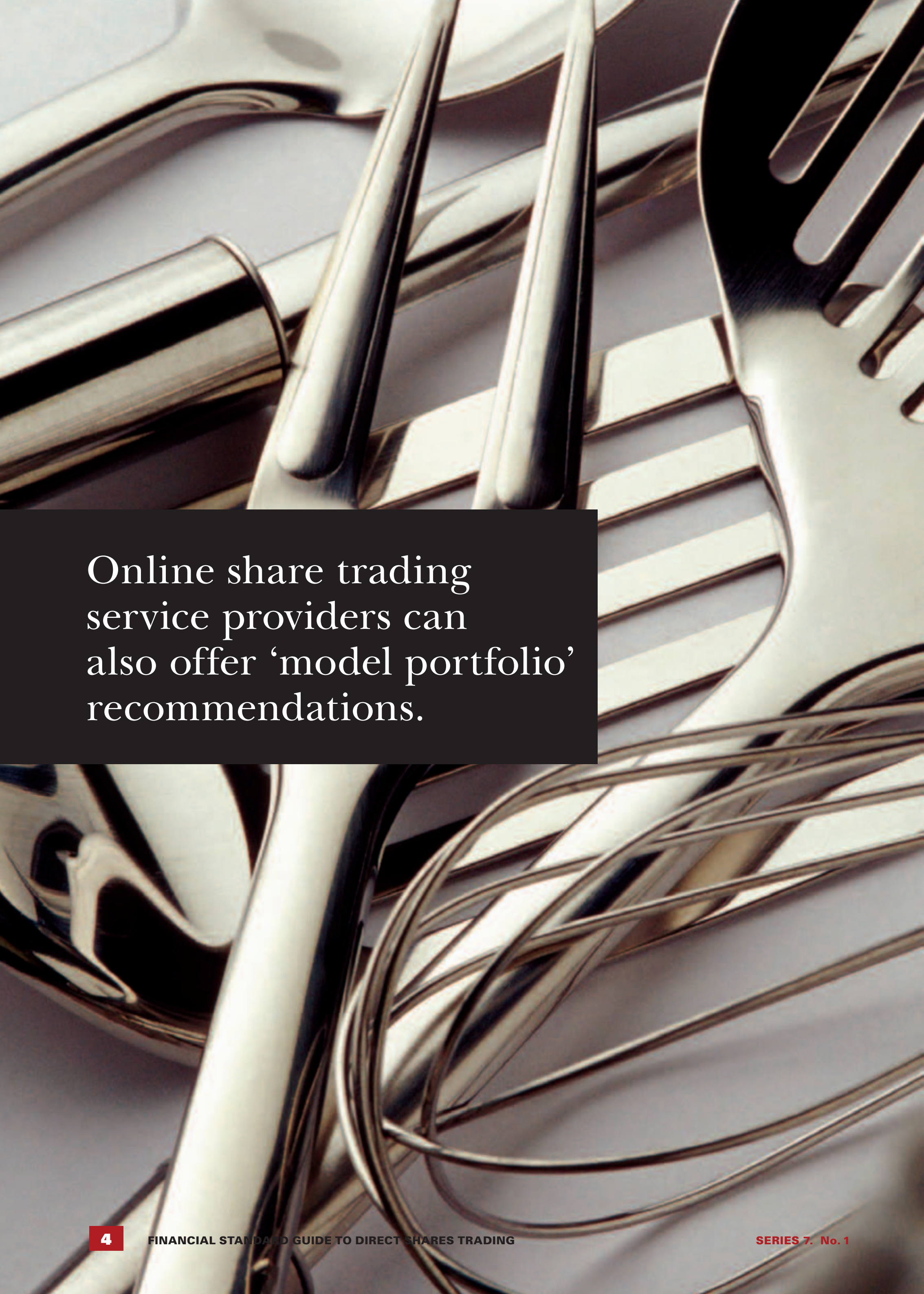
Competing head-on with full-service brokers as providers of direct share advice, fast trade execution, real-time access to market data, stock research and client reporting services – online share trading services are now used by over a third of all financial planners.

According to a 2010 Planner Direct Equities Report by researcher Investment Trends, 38 per cent of financial planners now use online share trading as one of numerous interfaces to access stock research and execute trades. Contributing to this uptake is the integration of online broking data within financial planning software and the rapid growth of self-managed superannuation funds (SMSFs).

Higher levels of transparency, dividend imputation credits and fewer CGT impacts – compared with managed funds – have also aided the popularity of online share trading. While share market trading volumes were depressed during the economic downturn, there are now 650,000 Australians operating online share trading accounts.

Much of this growth is attributed to the explosion in SMSFs, up 23 per cent last year. Excluding branch networks, Investment Trends research found that around two-thirds of financial planners currently provide advice around direct shares. Assuming the SMSF sector continues to grow rapidly, the uptake of online share trading by financial planners is expected to jump another 10 per cent by 2012.

This guide explores the opportunities in online share trading and practical applications for financial planners who are considering adding these wholesale services for their existing and prospective clients.



Online share trading service providers can also offer ‘model portfolio’ recommendations.

ONLINE TOOLS

FINANCIAL PLANNERS ARE IN THE DRIVER'S SEAT of share trade execution thanks to the tools now available through wholesale end-to-end online trading solutions. Over the next few years, the growth of direct shares as an asset class can only guarantee more features and better services.

Despite this, many financial planners are only starting to scratch the surface of the diverse and sophisticated toolsets now at their fingertips. Among them are:

- Market pricing data.
- Company announcements.
- Share market related news services.
- Research and recommendations on ASX-listed stocks.
- Recommendation compliance.
- Real-time streamed market data.
- Quotes on equities and derivatives.
- Enhanced charting abilities with added indicators/drawing tools.
- Extensive market-watch and alerts capabilities.
- Customisable watchlists and custom keys.

These days, online share trading service providers can also offer 'model portfolio' recommendations. Provided to online share trading service providers by third party research houses, model portfolios are selected to complement a client's individual requirements, investment time horizon and appetite for risk.

Once financial planners have registered with an online share trading service provider and sought the necessary client authorisations, ongoing paperwork to execute the trades is minimised through a centralised control system.

Given that keeping track of all their trades through numerous interfaces is at best unwieldy, financial planners are expected to gravitate to this central control provided by online share trading service providers over time.

OPTIMISING THE BENEFITS

GIVEN THAT MANY FINANCIAL PLANNERS are gravitating towards a fee-for-service remuneration model, the more streamlined the administration and execution of share trades, the more efficient and profitable their overall practice becomes. Greater participation and transparency into their share holdings, and net tax position, can give clients with direct shares a better outcome than one exposed to shares through managed funds.

Online share trading service providers complete the missing link in the quest by financial planners to offer a full suite of financial services. Now that the financial planning community is able to make investment decisions independent of asset classes and lifestyle position, the value has refocused on the quality of the underlying advice. By commoditising the administration and execution of share trades, the value of the advice is expected to become increasingly more important.

Given that the Australian economy is in recovery phase, and consensus forecasts expect robust corporate earnings for 2011, shares as an asset class is expected to continue growing. The pending entry of lower-cost rival trading platforms to the ASX, together with new products continually being introduced to the market is expected to be a 'net positive' for financial planners offering advice on direct shares.

In addition to delivering better tax outcomes, and more engaged clients with fewer complaints, online share trading toolsets will continue to evolve along with an increasingly better educated base. Having just come through the worst financial market in 70 years, there's greater pressure to find low-cost investment vehicles. A case in point, the growth in SMSFs, along with other popular platforms will continue to boost the growth in direct shares – all of which will need supporting with quality advice.

The more streamlined the administration and execution of share trades, the more efficient and profitable their overall practice becomes.

INVESTMENT THEMES AND OPPORTUNITY SETS

WHAT'S COME TO PROMINENCE along with the rise of SMSFs is the popularity of investment platforms. According to an Investment Trends 2009 Small Self Managed Super Fund Investor Report, 72 per cent of investors used an investment platform.

Mark Johnston, the researcher's founding principal, expects regulatory changes to add to the financial planner uptake of lower-cost platforms, including those below, for their clients:

Wrap platforms

Wrap everything into a consolidated bundle, making it easier for the financial planner to see the entire portfolio and to handle the accounting. In addition to streamlining corporate actions, such as share splits and rights issues, wraps also offer financial planners investment and risk tools that would otherwise be unaffordable.

Self Managed Super funds (SMSFs)

One of the biggest types of super by value, Australia's 600,000-plus SMSFs manage $332.3 billion in total account balances in the year to June 2009, and accounted for 31 per cent of the $1.07 trillion held in the super system. A key driver of their popularity is the control members have over their investments.

Index funds

Designed to track the performance of a benchmark stock market index like the S&P/ASX 200, index share funds have lower fees than active managed funds, and are better suited to investors who recognise that shares outperform most other asset classes over time.

Exchange Funds Trading (ETFs)

Typically trading within 1 per cent of NTA, ETFs are expected to become increasingly popular with financial planners as a cost-effective way of diversifying a client's portfolio.

Listed Investment Companies (LICs)

Despite being less transparent, LICs are still twice as popular as ETFs in terms of volume traded, and trade at a more significant discount or premium to their NTA.

Australian Real Estate Investment Trusts (A-REITs)

Allow investors to purchase an interest in a diversified and professionally managed portfolio of real estate assets.

Managed Accounts

Individually managed accounts (IMAs), separately managed accounts (SMAs) and unified managed accounts (UMAs) are portfolios of securities that are beneficially owned by the individual investor but managed by professional managers or 'model portfolio' managers. Unlike managed funds, the securities in managed accounts are visible and portable with the investor owning the underlying shares. As well as better managing their tax position, investors don't accrue capital gains associated with unit prices in managed funds.

Hybrids

Higher risk investments paying a predetermined rate of return or dividend until a certain date.

By commoditising the administration and execution of share trades, the value of the advice is expected to become increasingly more important.

CLIENT DEMAND TO DRIVE FUTURE GROWTH

Sponsored statement

Pete Steel, General Manager, Core Equity Services

The end of certainty

It often takes a cathartic event like the global financial crisis to expose the erroneous assumptions which underpin industries. The great bull run enjoyed by global stock markets between March 2003 and November 2007 enabled a culture of advice that cynics may say lacked analytical rigour. The pressure of the market downturn has subsequently left a sour taste in the mouths of many investors. In the aftermath, consumer behaviour and the conduct of industry participants are changing. The GFC has marked an end to certainty for investors. Many have since embarked on a new conservative path where prudence and control look to become the *strategy du jour*. At the same time, regulators, under pressure from consumer groups, seek to plug regulatory holes and redefine the role of the financial planner.

Facilitation – the new mantra for financial planners

With consumers yearning for transparency, financial planners must reconsider their position and the limitations of their own advice models in order to balance the changing needs and tolerances of investors. Tired of being shackled to fund managers, the unpredictability of markets has led many investors to believe that a self-directed approach, rather than a managed approach, will best suit their needs. In this environment, the adviser still has an important role to play. However, it is a role that may revolve around *facilitation*, rather than *advice* per se. The financial planner can still sit in the middle of the client's financial world but they will be expected to design and oversee an entire strategy rather than play the role of investment advisor.

Direct shares – an opportunity for advisers to remain relevant

Australians have long been enamoured by the idea of direct investing. Our love affair with property is testament to this phenomenon, however, the direct investment philosophy is increasingly being applied to how we invest in shares. Financial advisers are under increasing pressure to be able to deliver such solutions for clients.

Direct shares trading solutions provided by wholesale providers are not new, although Australia's first online trading platform for financial planners met with mixed results when launched in 1999. The internet was in its infancy at the time and issues such as speed and reliability were a major concern for business users. Financial planners found it difficult to provide a complete "in house" direct share offering and were very reliant on their relationships with full service brokers for company research and share execution. The lack of easily available market information, attractive commissions and little data consolidation ensured managed funds were the preferred investment option for financial planners.

As the industry developed, the delivery of dedicated online trading services enabled financial planners to compete head-on with full service brokers for the provision of equities advice, execution and reporting services. Improvements to the speed and reliability of internet technology and the integration of online trading data with financial planning software has ensured a rapid take up of direct equities trading across the financial planning industry.

Looking ahead – future looks strong for direct shares

Client demand for direct shares looks set to grow, and as advice models move towards fee for service, direct shares will continue to provide cost effective access to equity markets for investors. For advisers looking to embrace this trend and review their product offering, online equities trading provides a solution to help meet their clients' demands.

The growth in do-it-yourself superannuation funds has also further enhanced the take up of direct share investment recommendations to clients. Benefits such as higher levels of transparency, dividend imputation credits and less CGT impacts compared with traditional managed funds have also created an increase in demand and awareness from investors towards direct equities portfolios.

Over the next few years the growth of this asset class within the financial planning community will ensure tool sets and information flows rapidly develop. Growth areas such as model portfolios, IMAs and dealer group-driven MDA style services will dramatically change the investment landscape in Australia. Online trading platforms may soon be seen as real alternatives to the traditional master fund or wrap platform with integrated margin lending facilities, tax reporting and corporate action management tools.

How can Core Equity Services help advisers capitalise on this opportunity?

We understand advisers are facing unprecedented pressure to clearly articulate their value proposition – clients expect to know what they are receiving for their fees. Core Equity Services is a leading provider of direct shares solutions for advisers. From equities trading solutions to gearing and portfolio administration, our role is to help facilitate our clients' relationships, and support advisers in providing valued financial outcomes.

To date, we've partnered with more than 10,000 advisers and 400 dealer groups, and helped them provide the best very for their clients.

If you would like more information on Core Equity Services and we can support your practice, please phone Steve James on (02) 8292 8721.

TRENDS IN DIRECT SHARES INVESTING

WHILE MOST FINANCIAL PLANNERS USE MORE THAN ONE CHANNEL – on average 1.5 – to execute share trades, it's wholesale online service providers that are experiencing the biggest growth trajectory. Based on Investment Trends research, more than two thirds of all financial planners now advise on direct shares. Interestingly, this group expects their allocation to direct shares to rise from 23 per cent of their funds under advice (FUA) today to 34 per cent by 2013.

Unsurprisingly, inflows into unlisted managed funds dropped from 62 per cent to 50 per cent compared to the year before. According to the research, the planners that poured more than half of their recent client inflows into direct listed investments only invested 7 per cent into managed funds.

Underscoring what's regarded as a massive shift in planner behaviour – towards more direct shares – is a combination of poor returns from some managed funds and lower costs of non-managed fund alternatives. Direct shares spiked to 20 per cent of new inflows invested for clients, with growth also seen in the proportion going into ETFs, REITs and SMAs.

"Direct shares, once the domain of stockbrokers are now a core part of a planner offering," said Mark Johnston, founding principal of researcher Investment Trends.

"Planners currently advising on direct shares expect to increase the proportion of their clients using this advice to grow from 30 per cent to 43 per cent over the next three years."

Acting as a kind of counterpoint to the migration towards direct shares, all major fund managers now offer planners what are now known as 'model portfolios'. While they look exactly the same as their own portfolios, they're not managed within a unit trust structure.

Interestingly, the synergies embedded within this relationship benefits both parties equally. Planners pay them fees for their 'intellectual property' and, in return for lower fees, the fund manager successfully avoids all the administration typically associated with the average fund.

Growth areas such as 'direct share model portfolios', individually managed accounts (IMAs), and dealer group-driven managed discretionary account (MDA) style services – tailored to a client's individual requirements – are expected to dramatically change the investment landscape in Australia.

CHOOSING THE RIGHT SOLUTION

MANY FINANCIAL PLANNERS ARE INCREASINGLY SEPARATING their advice from product placement. This has opened them to identify solutions that are no longer based from pre-determined product-based solutions.

Steve James, head of Adviser Trading Solutions from Core Equity Services and a long-time share investing expert, said investors are more accepting of lower performance if they've had a greater say in the decision-making process.

Investors also questioned the value of simply investing in managed funds following the disappointing performance of many fund managers during the global financial crisis. Post-GFC, Investment Trends research shows financial planners are placing more new client money into direct shares and towards a growing array of low-cost platforms.

The clarion call from many financial planners is that the benefits of online share trading are becoming much easier to demonstrate to end clients. Having unleashed a basket of tools that were once the exclusive domain of full-service brokers, the benefits of online share trading are becoming much more evident.

FEES

EARLY IN JUNE 2010 ASX ANNOUNCED the lowering of its headline equity market trade execution fees by 50 per cent. Later in the same month a range of new order-type trade execution functionality was introduced (including large order matching capabilities) designed to minimise market impact costs for trading participants and end-users in the equity market. The introduction of alternative share trading venues onto Australia's stock market in 2011 is expected to see fees fall even further.

Instead of a flat per-trade pricing, online share trading service providers fees are now moving towards a fee structure based on the bundle of services a financial planner is using. As financial planners move towards a fee-for-service model, the cost of individual share trades is also based on a projected bundle of services financial planners are offering end clients.

The fees incurred by financial planners on share trades vary depending on the method chosen. As a rule of thumb, the rates charged by online share service providers are comparable with wrap brokerage fees – at between 0.10 per cent and 0.11 per cent. This translates to a minimum indicative fee of between $33 and $39 per trade. However, a "transaction cost" also incurred on wraps can add between $10.00 and $20.00-plus to the total cost.

By comparison, full-service retail brokers typically execute trades at between 0.75 per cent and 1.00 per cent-plus if no other arrangements are in place between the parties. Based on these ratios, the difference in fees incurred between an online trade at 0.10 per cent and 1 per cent on a $25,000 trade can be $25 versus $250 respectively.

Client who chose to go direct to "online discount brokers" can expected to pay around between $15 and $20 per trade, depending on whether it's completed over the phone or online. Brokerage on trades in excess of $50,000 can go as high as $30–$50 across the spectrum.

Arrangements governing how brokerage costs are dealt with are typically stated within individual client agreements. While some clients pay brokerage fees direct to the provider used, a financial adviser may undertake to cover a predetermined number of initial trades within their annual fee.

TAX AND COMPLIANCE

THE TAX OFFICE HAS ISSUED A COMPREHENSIVE GUIDELINE associated with a whole range of share trading, not least being the distinction between a share trader and share investor. While the share trader conducts business activities for the purpose of earning income from buying and selling shares, a share investor invests in shares with the intention of earning income from dividends and capital growth but does not carry on business activities. Myriad other tax issues include:

- receiving dividends,
- participating in dividend reinvestment schemes,
- bonus shares,
- inheriting shares,
- giving or receiving shares as gifts,
- selling shares, and
- demergers.

It's important that financial advisers provide full disclosure on tax considerations pursuant to share trades made. Special attention also needs to be given to the varying tax considerations relating to a client's transition into retirement. Similarly, clients need to be reminded of tax consideration when investing in shares for a partner who may be on another marginal tax rate.

During the initial [licensee-developed] data gathering process, the financial adviser needs to ascertain the client's overall appetite for risk. This will indicate whether their portfolio best complements direct equities or some other investment strategy. Regardless of investment performance, financial planners need to provide an audit trail of all correspondence given to the client – including supporting research – along with the underlying advice provided.

CASE STUDIES

Case Study 1: Facilitating the execution

Andrew Height, Financial Planner, Lachlan Partners

AS A MORE RECENT ADDITION to numerous broking arrangements, online share trading services are another way a full-service financial planner like Height delivers wealth creation solutions. While around 60 per cent of Height's clients hold direct shares, he says around 99 per cent prefer him to buy and sell shares on their behalf.

By the time a statement of advice and financial plan is prepared, Height can gauge which channel – full-service broker, a platform structure or direct shares – best complements a client's needs and objectives. "To determine how share trades should be executed, I need to find out: (a) what level of information flow/research investors require; (b) how much they plan to invest in shares; and (c) how personally involved they wish to be in actively managing their portfolio," says Height.

While the value is in the advice, he says the form of service delivery typically determines the ease of trade execution. "As a financial planner I can't perform a transaction at a stock exchange, but I'm approved to offer a broad spectrum of advice – including shares," says Height. "So an online share trading service providers acts as the interface between advice and implementation."

Once an account is opened and the necessary authorisations are signed off, Height is then able to buy/sell shares on his client's behalf – subject to their ongoing approval. Given that Height is more concerned with the after-tax outcome, he says share turnover within any financial year tends to be under 20 per cent.

Height says while some clients choose to use their own full-service broker to execute share trades, added flexibility and lower costs are attracting greater numbers to online solutions. While they don't all provide a full range of services and back-up, like access to research, reporting, data analysis and information flow, he says some online brokers have successfully packaged specific solutions for financial planners.

Given that providing the best possible solution to clients is how he makes money, Height says it's important to understand how the capabilities provided by any online share trading service provider help to not only inform, but cost-effectively implement the advice and risk management. "The most flexible part of any online broking solution is an easy to use electronic platform," says Height. "Financial planners need to understand the intricacies of the online services, and how the benefits flow on to clients."

Case study 2: Embedded in the process

Mike Summers, Financial Planner and Managing Director, My Advice Pty Ltd

NOW THAT DELIVERING SUPERIOR FINANCIAL SERVICES at competitive prices is a commercial reality, Summers says online share trading services are now embedded in the DNA of his firm's business. He says the desktop execution of share trades, plus the accessibility of research, reporting tools, and analysis offered by many online share trading services means financial planners no longer have to withdraw from advising on direct shares.

He says the cost, speed and ease with which share trade transactions can now be executed means that as planners they no longer have to relegate direct share advice to the 'too hard' basket.

"In years past we had to pick up the phone and tell a broker to buy "x" amount of ABC shares with settlement taking up to a week, instead of the 48 hours it now takes online," says Summers.

He says full-service online share trading services fill the void between DIY share traders and high net-worth share investors – who have traditionally preferred to deal through full-service share brokers. According to Summers, many online share trading services now support the execution of a share trade with the types of services previously only available through full-service brokers, like comprehensive research and analysis. "This could mean providing diversification through a small parcel of shares, detailed research towards a stock a client may be leaning towards or the opportunity to participate in an IPO," says Summers.

He says the efficiencies offered via online share trading services add another dimension to his suite of financial services, without additional overheads. As financial planners, Summers says his firm will always be an early adopter of technology that eases service delivery and reduces costs.

"Investors now recognise that the 'full services' of a financial planner who has access to online share trading services, extend well beyond those of 'full-service' brokers – without compromising the cost or quality of the underlying advice," says Summers.

Desktop share trading facilities and research aside, Summers says some online share trading service providers also offer comprehensive portfolio review services for those with major share portfolios. "The efficiencies of online share trading services help us make money," says Summers. "The seamless extension of these online share trading services to our clients also enhances our reputation as a provider of comprehensive financial services – without any downside."

EASY GUIDE

FINANCIAL PLANNERS can stay on top of their client's direct shares portfolio using the platform provided by their direct shares solutions provider.

The following screenshots are for illustration purposes only and are sourced from Core Equity Services.

CLIENT HOLDINGS SUMMARY

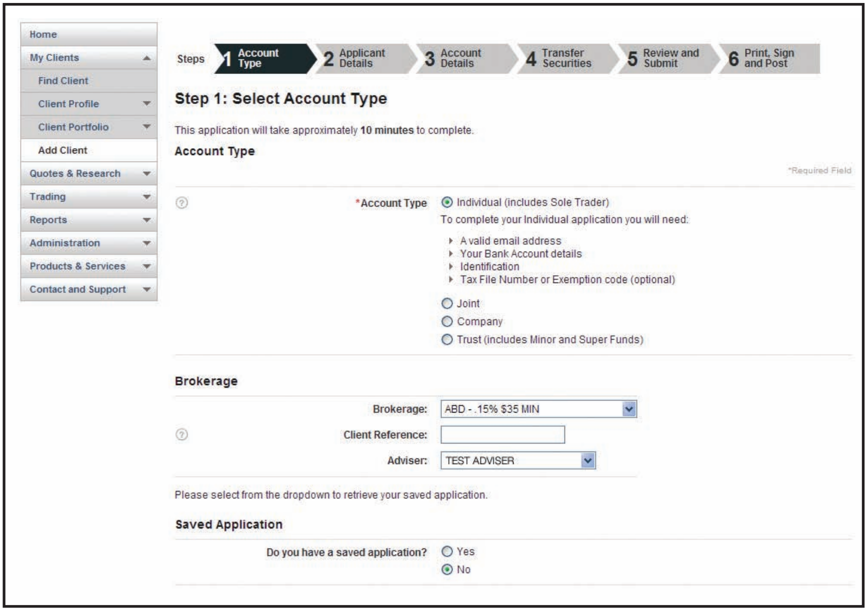
A snapshot of your clients' holdings, showing you key portfolio information at a glance.

Code	Registered Units	Available Units	Reserved Units	Purchase Price ($)	Last Price ($)	Market Value ($)	Profit / Loss Value($)	Profit / Loss %	Change (Today) Price($)	Change (Today) Value($)	Actions
BHP	15	15	0	39.620	41.000	615	21	3.5	0.050	1	Actions
Total						615	21			1	

Code	Units	Purchase Price ($)	Last Price ($)	Market Value ($)	Profit / Loss Value($)	Profit / Loss %	Change (Today) Price($)	Change (Today) Value($)	Actions
BHP	1,000	30.000	41.000	41,000.00	11,000.00	36.67	0.050	50.00	Actions
CBA	1,000	32.000	51.100	51,100.00	19,100.00	59.69	-0.400	-400.00	Actions
TLS	1,000	4.000	2.660	2,660.00	-1,340.00	-33.50	0.020	20.00	Actions
Total				94,760.00	28,760.00	43.6		-330.00	

SET UP YOUR CLIENTS' ACCOUNTS ONLINE

Follow the easy step-by-step process to add a new client account.

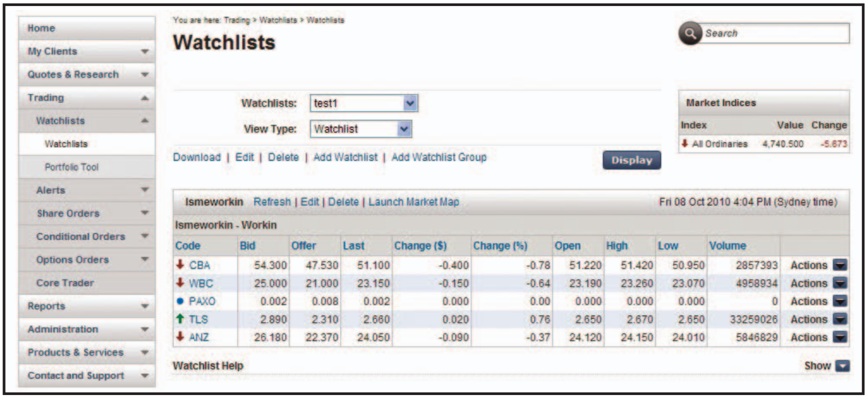


QUOTES

Look up share prices and access detailed share data using interactive charting features for a more in depth analysis.

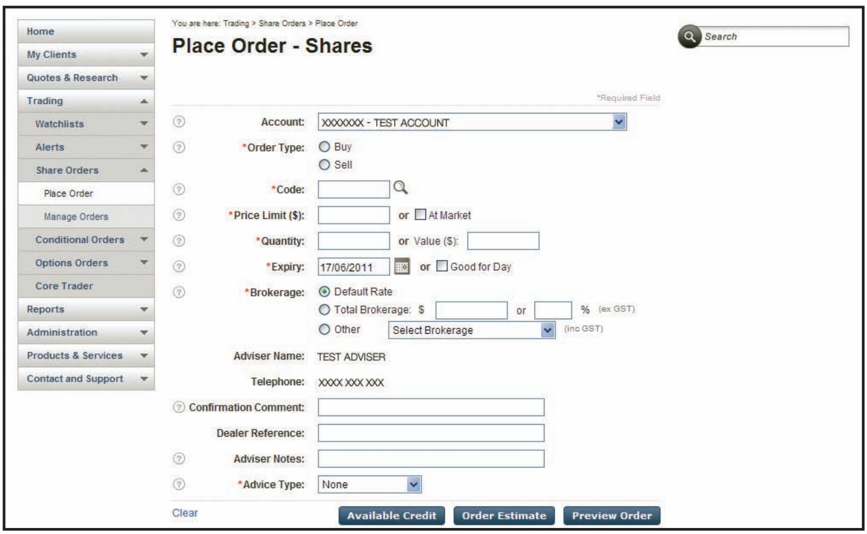
WATCHLISTS

Watchlists allow you to keep track of the securities you are interested in. Track up to 1,000 stocks and create up to 10 watchlist groups.



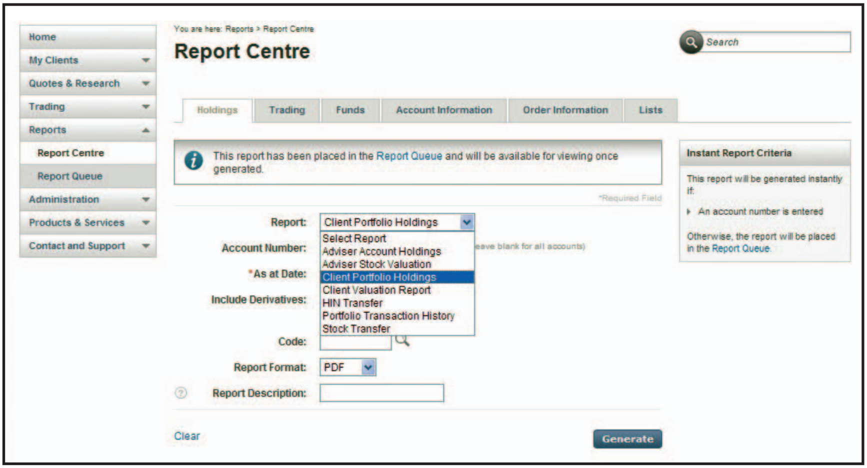
ORDER PAD

Place orders online for fast straight-through processing.



REPORT CENTRE

Use the Report Centre to generate timely and accurate reports on your entire client base, or for individual clients.



GLOSSARY

Beneficial ownership	When an investor has a vested and indefeasible interest in the assets held in their personal portfolio.
Blending	When an investor chooses a number of model portfolios, in the proportions of their choice, to construct their personal portfolio.
Compulsory cash component	The percentage of cash held within the account to facilitate trading and cash component payment of fees.
Corporate actions	An action taken by an entity for the purpose of giving an entitlement to holders of a class of the entity's securities.
Individually managed account (IMA)	A managed account where the professional investment manager manages account (IMA) investment portfolios and implements different investment decisions across the accounts based on the personal circumstances and objectives of each investor.
In specie transfer	When an investor's existing stocks are transferred into their personal portfolio. Intellectual property From an SMA perspective, this is the stock picking strategy of the model provider.
Managed discretionary account	An umbrella term used to refer to any services where the clients hand in account (MDA) their money or other assets to the MDA operator and give that operator the discretion to manage those assets on their behalf.
Managed investment scheme	Also known as managed funds, pooled investments, or collective scheme (MIS) investments. It is a scheme where money is pooled together with that of other investors in exchange for an interest in the scheme.
Minimum trade size	When securities in a personal portfolio are only traded if the trade size meets the specified size. It is the smallest trade that can be done in a personal portfolio.
Model portfolio	An investment strategy selected by the adviser and managed by a model portfolio manager on an ongoing basis.
Model portfolio manager	The manager of the model portfolio (referred to as the model portfolio adviser, model provider or the fund manager).
Netting	When buys and sells are matched and off-set against each other. Can be done at both portfolio and scheme level.
Nominated representative	Generally a financial adviser, or professional adviser, who will provide all instructions to the SMA provider on behalf of the investor.
Non-beneficial ownership	As opposed to beneficial ownership. Usually when the clients invests in shares within a unitised managed fund.
Personal portfolio	An investor's account into which their investments are allocated within an SMA. A personal portfolio is generally constructed using a selection of model portfolios and a compulsory cash component.
Rebalancing	The process where a client's actual holdings are compared to the updated model portfolios and changed accordingly.

GLOSSARY continued

Rebalancing date	Usually each business day before the market opens.
Responsible entity	The licensed entity or body that operates a managed investment scheme or managed account.
Sell-down	When securities are sold at the client's discretion.
Separately managed account	A portfolio made up of securities that are beneficially owned by the individual account (SMA) investor and managed by professional managers or model portfolio managers. Unlike investing in a managed fund, an SMA investor can add, delete or lock shares in an SMA.
Substitution	When an investor substitutes an individual security with another ASX listed security, cash, or pro-rates across the other securities in the personal portfolio.
Unified managed account	Comprehensive portfolios of individual separate accounts and packaged account (UMA) products, such as mutual funds and exchange-traded funds (ETFs), with a complete asset allocation in a single account.

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