

The Beep Brief

A response to the CSA CONSULTATION PAPER 81-408
regarding the discontinuing of Embedded Commissions.

Back Matter

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PROFESSIONALS**

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June 9th 2017

<http://business.financialpost.com/news/fp-street/canadas-market-watchdogs-look-at-fundamentally-flawed-embedded-fees-on-investment-funds>

Canada's market watchdogs assessing impact of ban on 'fundamentally flawed' embedded fund fee model

BARBARA SPECTER | September 27, 2016 6:23 PM ET



Ontario Securities Commission chair Maureen Jensen says Canada's compensation model for mutual funds is fundamentally flawed and that regulators are looking at an outright ban on embedded fund fees as a "possible solution."

“The current compensation model consists of fees set by the fund manager to incent sales,” Jensen said Tuesday in her first major address since taking the helm of the country’s largest market watchdog. “This does not put the investor’s interest first, and that’s a fundamental flaw that needs to be addressed.”

Following the luncheon speech at the Toronto Board of Trade, Jensen told media it is up to the investment industry to come up with a viable alternative to a ban.

She said some suggested alternatives, such as capping the embedded fees, do not go far enough because they don’t eliminate conflicts of interest at the heart of the current system.

“We know this would be a major change for investors and the industry,” she told the business crowd during her speech. “That’s why input from all of our stakeholders is necessary throughout this process.”

The Canadian Securities Administrators, an umbrella organization for provincial commissions, will publish a consultation paper by the end of the year that looks at the potential impacts of an outright ban on embedded fees for investment funds, including mutual funds. It is the culmination of an examination that has been under way for more than three years.

The investment industry has fought strongly against curtailing embedded mutual fund fees, which have been banned in other jurisdictions such as the United Kingdom. Industry groups argue that banning the embedded fees in favour of a set annual fee for advice would squeeze some investors out of the investment game because they either cannot afford, or would chose not to pay the upfront fee.

Industry representatives have also argued that new rules requiring greater disclosure of fund fees will improve outcomes for investors by giving them a better understanding of what and how they pay for advice.

Jensen called these “critically important” changes, but said “disclosure alone is not enough.”

In her speech, she cited research from the National Bureau of Economic Research that she said suggests a combination of embedded fees and unsuitable portfolio construction has caused the investment returns of advised clients to lag passive market benchmarks by two to three per cent a year.

“The impact of these fees on investor returns is significant,” she said. “Investors experiencing this kind of outcome on a consistent basis would never break even and would, in fact, be worse off.”

Jensen, who took the helm at the OSC in February, also used the speech to announce that the regulator will be the first in Canada to launch a hub to work directly with fintech companies. The

official unveiling of LaunchPad is to take place in a few weeks, and the plan is to help the upstart financial technology firms navigate — and even potentially tailor — the regulatory framework.

The upstarts, which use technology and data to compete in traditional financial services business lines from lending to investment advice, don't fit "neatly" into current regulations, Jensen said, acknowledging that some requirements "might not make sense" for the new business models.

"Based on our experience so far, many Fintech companies 'don't know what they don't know' about operating in a regulated industry, and that can threaten their ability to do business," she said. The idea behind LaunchPad is to help "tailor regulation and oversight to their unique business models, as long as investor protections are in place."

Forty fintech firms have sought registration over the past couple of years, Jensen said, adding that these include online advisers, peer-to-peer lenders, and crowdfunding platforms.

She said another recent OSC initiative, a paid whistleblower program with rewards of up to \$5 million for tips that lead to successful cases against those who breach securities laws, has already proven "fruitful." It has generated 30 tips since the launch in July, some of which involve alleged malfeasance on accounting statements and disclosure violations.

There are suggestions of "serious potential offenses" among the tips received, Jensen said, adding that tipsters are coming forward to reveal alleged activity and behaviour that would have been very difficult for the commission to unearth on its own.

"I am encouraged by these early results," she said. "New enforcement tools like this will help us resolve cases more quickly and effectively."

Financial Post

PORTFOLIO STRATEGY

Lower-cost mutual funds? Dream on

ROB CARRICK

The Globe and Mail

Published Friday, Apr. 25, 2014 6:09PM EDT

Exchange-traded fund companies have been slashing their fees lately in a display of macho one-upmanship that you never see in the mutual fund business.

Mutual fund fees are the black hole of Canadian investing. We know from work done by the independent analysis firm Morningstar that our fund fees are among the world's highest. But the fund industry's reluctance to talk about fees makes it hard to tell whether they're falling or not.

So let's dig into the numbers. As a proxy for the fund industry, we'll look at 12 popular mutual funds with combined assets of close to \$100-billion. Three of the funds had lower fees in late 2013 than they did five years ago, while nine were charging more.

The past five years were a period when fund companies had to deal with the introduction of the harmonized sales tax in some provinces. A key competitive consideration for the fund industry: Eat the extra costs of the HST, or pass them along? Other business pressures over the past five years included the rise of the ETF sector, which is much smaller than the mutual fund industry but faster growing, and the lingering shock to investor confidence caused by the market crash of 2008-09.

As shown by the group of 12 widely held funds, the overwhelming preference in the fund business over the past five years was to let fees float higher. Where fees did rise, the total increase was typically 0.1 of a percentage point or less. While such increases would have had a modest effect on investor returns, they're still highly symbolic. They suggest that investors should give up on the idea that mutual fund fees in Canada will ever meaningfully decline on an industry-wide basis.

This sort of decline has long been anticipated, in part because our fees are high on a global basis. Fee competition from the ETF business, a direct competitor to mutual funds, would also suggest lower fund costs ahead. The final argument for lower fees is based on economies of scale – the idea that funds become more efficient to run when their fixed costs are applied against rising assets.

On our list of 12 popular funds, there is one that has become significantly cheaper in the past five years. It's Investors Dividend, which went from a management expense ratio (MER) of 2.68 per cent in 2009 for its Series A version to 2.39 per cent in 2013. Investors Group announced a year ago that it was cutting fees to make its comparatively expensive products more competitive, and here is one tangible result.

Fees also declined for Dynamic Strategic Yield and Beutel Goodman Canadian Equity over the past five years, though not so dramatically. The latter fund's decline was notable because the fee was already near the low end for Canadian equity mutual funds.

The nine funds with rising fees over the past five years show a pattern of multiple small increases. The \$17.5-billion RBC Canadian Dividend Fund – it's the country's largest mutual fund, according to Globeinvestor.com – has had the MER for its Series A version rise from 1.7 per cent in 2009 to 1.79 per cent in 2013.

A spokesman for RBC Global Asset Management said the rising MER is due entirely to the HST. He also noted that the administration costs built into the MER were cut by 0.02 of a percentage point at the beginning of 2014, while the administration fee for RBC Balanced fell 0.04 of a percentage point. "Overall, over 90 per cent of RBC GAM mutual funds have MERs that are below the category average," he wrote in an e-mail.

It's worth noting that every bank-run mutual fund on the list of 12 popular funds is more expensive to own than it was five years ago. This is admittedly a small sample, but the banks do seem intent on squeezing more fee revenue from their mutual funds.

Rising fees may seem inconsequential for a fund like RBC Canadian Dividend, which has regularly outperformed both the average return for its peers in the Canadian dividend and income equity category and the S&P/TSX composite total return index.

BMO Bond is a different story – returns have been consistently below average over the past five years. Scotia Canadian Dividend made 13 per cent annually for the five years to March 31, while its peers averaged 14 per cent and the index averaged 13.7 per cent.

How common is it for investors to pay fees – maybe even rising fees – for indifferent or worse returns? “Out of all the mutual funds I cover, I would say 25 per cent are pretty decent,” said analyst Dave Paterson of D.A. Paterson & Associates. “You’ve got another 50 per cent that are acceptable, but you might as well be in an ETF, and 25 per cent that probably shouldn’t be sold.”

ETFs have tiny MERs because they’re robotic index-trackers for the most part, whereas mutual funds must bear the cost of analysts and portfolio managers who select individual stocks and bonds. Fund fees also include commissions paid by fund companies to the advisers and dealers who sell their products, whereas ETFs typically do not.

A fair-and-square comparison of ETFs and mutual funds would add a percentage point to ETF fees to cover the cost of investment advice and financial planning that is baked into most fund fees. But thanks to the latest round of fee cuts, you can combine ETFs and fee-based advice and still pay much less than you would with mutual funds.

The iShares S&P/TSX Capped Composite Index ETF (XIC) has an estimated MER of 0.05 per cent today, down from 0.27 per cent a year ago. The iShares people cut the cost of this fund in response to a fee reduction made a while back in a competing product, the BMO S&P/TSX Capped Composite Index ETF (ZCN). BMO’s response came this week – a further fee cut in ZCN to match iShares.

The back story here is that ETFs had a disappointing 2013, sales-wise. While global stock markets soared, the flow of money into equity ETFs was offset to some extent by money pouring out of bond ETFs. Add a growing number of competing ETF providers to this picture and you end up with recent fee cuts announced by iShares and BMO.

The mutual fund industry had quite a decent year in 2013 and now sits on roughly \$1-trillion in assets, compared to \$66-billion for ETFs. Do not expect a mutual fund fee war any time soon.

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GIVE CLIENTS A REAL CHOICE

[John J. De Goey](#) / January 4, 2011

Advisors generally do a good job in helping their clients make smart decisions with their money. Most try to help clients obtain a meaningful understanding of capital markets. Most try to make reasonably suitable recommendations. These advisors will diversify between equity and income, value and growth, small cap, large cap and a number of other ways, too.

What I see less of though is a diversification between active and passive products and strategies. This, of course, could be an all or nothing proposition or a mix and match (core and satellite) combination.

Most financial advisors recommend an all active approach all the time. These same advisors insist they have no bias at all and that they go out of their way to help their clients make informed decisions about the products and strategies being pursued.

I beg to differ.

My sense is there are advisors who are deliberately silent on the matter of cost impacts when discussing options with their clients.

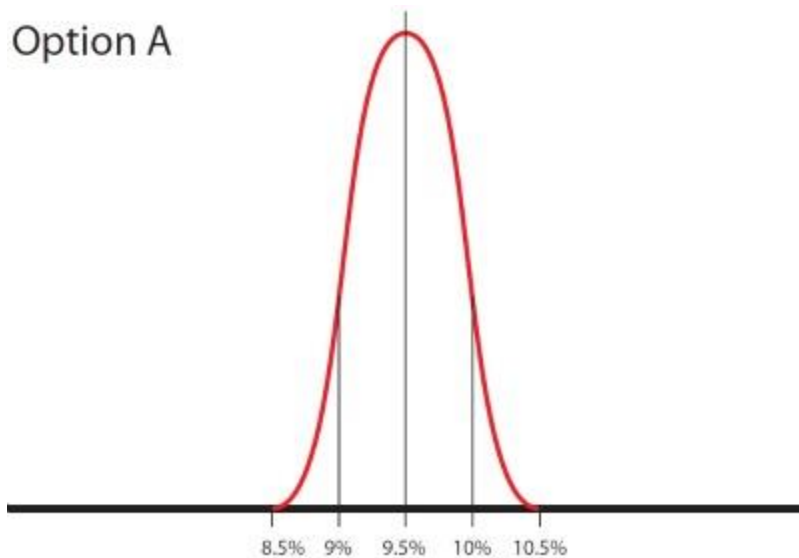
Here's a simple example. Why not show clients both options? Don't direct them one way or another to start. Simply explain that both options are on the table and that over the course of their lifetime, both would likely be reasonable depictions of their overall investment experience.

For anyone who wants a credible bit of background and rationale regarding what follows, please read William F. Sharpe's "The Arithmetic of Active Management". If you can't locate a copy, you can get it [here](#).

Sharpe's paper provides a simple way of combining the notions of risk, return and cost. It shows that both historically and logically, an average investor's expected return is the return of the asset class minus the cost of the product used to get exposure to that asset class- plus or minus a degree of variance.

In my illustrations, Option A features a 9.5% average expected return with a relatively modest variance (tracking error), while Option B features an 8.5% average expected return, but with a fair bit of additional variance (positive or negative "alpha").

Option A

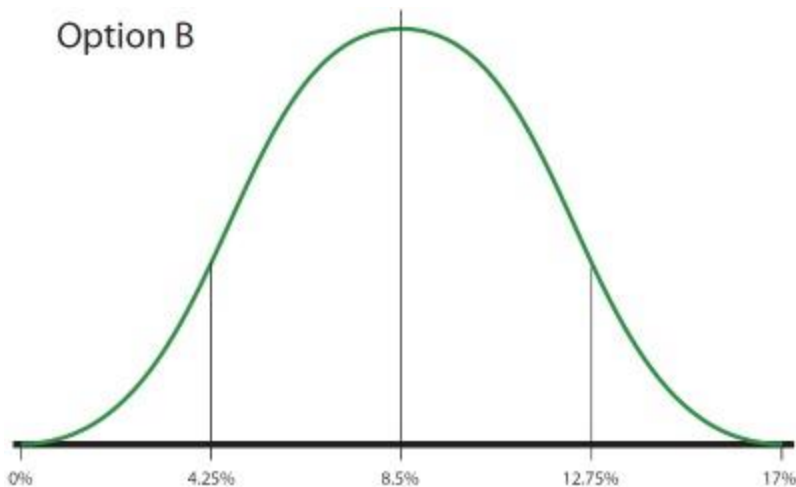


Since the differences are due to product cost and the likely dispersion of returns, we're left with Option A hugging a benchmark minus a lower cost, +/- a tracking error and Option B costing more and having a greater variance of possible return outcomes due to security selection.

One would reasonably expect modest tracking error for the passive option and a much higher variance for the active option. If markets return 10% and the passive option costs 0.5%, while the active one (featuring no advisor compensation) costs 1.5%, then the long-term difference is 1% per annum- forever.

Is it worth a certain 1% cost increase if that choice is most likely to involve a similar reduction in long term returns with a wider dispersion of outcomes? Remember that for every person on the right side of the centre line in either option, there's another on the left side. There are pros and cons to both approaches, but which option is a typical investor more likely to choose if asked? Both options have a constituency.

Option B



Considering the choices available according to Sharpe's paper, investors should clearly understand their two options. Here's a value proposition that you may wish to consider taking to them. Ask "If I could show you how to save tens or even hundreds of thousands of dollars over the course of your lifetime by simply replacing your current investment products with products that have a similar expected pre-cost risk and return profile, but which cost 1% less and have less expected volatility, is that something that would interest you"?

All I know is that every time I ask that question, I get a resounding...Yes.

In fact, the only people I've ever met who don't give such a response are the people who would never asked the question in the first place.

John J. De Goey, CFP, is the vice president of **Burgeonvest Bick Securities Limited (BBSL)** and author of **The Professional Financial Advisor II**. The views expressed are not necessarily shared by BBSL. You can learn more about John at his Web site: www.johndegoey.com.

How much are your mutual funds really costing you?

New fund industry trade group infographic understates long-term effect of fund fees.

By Christopher Davis | 20/07/16

What Scottish poet Andrew Lang said of politicians--that they "use statistics in the same way that a drunk uses lampposts"--could also be said of the Investment Funds Institute of Canada's (IFIC) recent effort to illustrate the value investors receive from paying mutual fund fees.

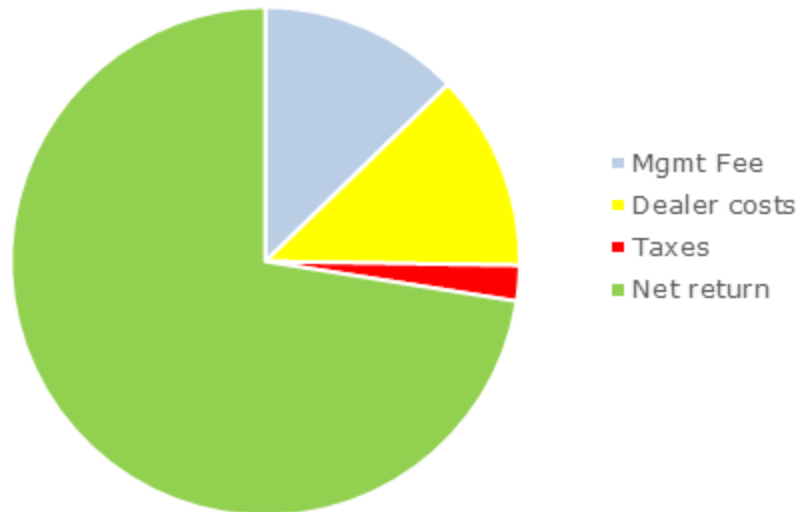
Christopher Davis is Director of Morningstar Research at Morningstar Canada. In this role, he oversees Morningstar's Canada active fund research analyst team and sits on the Canadian Morningstar Analyst Ratings Committee. He is Morningstar Canada's lead analyst for the Fidelity and Sentry fund families. He also represents Morningstar on the Canadian Investment Funds Standards Committee. Prior to assuming his current role in 2012, he was a senior fund analyst in Morningstar's U.S. office. During his tenure, he led Morningstar's coverage of Fidelity Investments and was the editor of the Fidelity Funds Newsletter. He also served as the lead analyst on several other asset managers including the Baron, FPA, Columbia Acorn, Ariel, and T. Rowe Price fund families, as well as for the health-care category. His specialties included behavioral finance, income oriented, and tax-managed fund. He also oversaw Morningstar's target-date fund coverage of the Fidelity and TIAA-CREF series. Davis joined Morningstar in 1999 as a data analyst and became a fund analyst in 2000. Davis holds a bachelor's degree in economics and political science from the University of Illinois Urbana-Champaign

The industry trade group says its recently released [infographic](#) on the topic, which coincides with new regulatory requirements under the Client-Relationship Model – [phase 2 \(CRM2\)](#) mandating dollar-value disclosure of advisory fees, is designed to illustrate the impact of fund management, distribution and tax costs on investor accounts.

Given its source, the message to investors isn't too surprising: You're getting a great deal! If a fund's management-expense ratio (MER) is 2.2%--which an [IFIC-funded study](#) says is the average asset-weighted cost of funds sold through advice-based channels--just 2.2 cents of every dollar invested gets you professional money management and investment advice. All but a tiny slice of the pie grows along with your investment.

IFIC gets the basic arithmetic of fund expenses right, but it doesn't put them into the proper context. What sounds like a trifling sum in comparison to the size of your overall investment appears quite substantial as a proportion of your investment's returns. Let's say your 60% stock/40% bond portfolio closely matches the 8.4% pre-expense return¹ this asset mix has averaged over the past 30 years. An 8% return before fees turns into 5.8% after subtracting the 2.2% MER. What IFIC calls a great value will have eaten more than 25% of your investment returns for the year, as the chart below demonstrates.

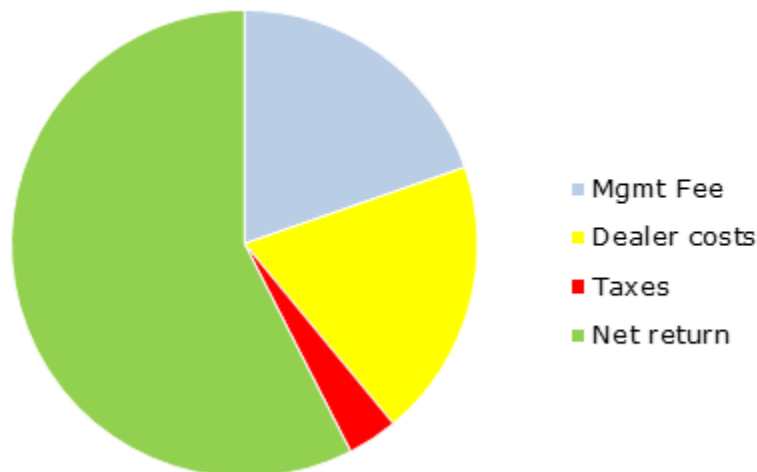
Fees eat more than 25% of an 8% market return



Source: Morningstar. Chart assumes 8% gross annual return and 2.2% in annual expenses.

Market returns mean fund expenses chew up an even larger piece of the pie. This is a reality investors may confront in coming years. While it was plausible to expect 8% gains from a 60/40 portfolio over the prior three decades, investors should expect more subdued long-term returns going forward. With the FTSE TMX Canada Universe Bond Index--the bellwether for the investment-grade bond market--yielding a skimpy 1.8%, it's all but impossible to match the 9% annualized gain it notched over the 30-year period. It's not beyond the realm of possibility a 60/40 portfolio returns 5% instead of 8%. Instead of swallowing 25% of pre-expense returns, the MER would gobble nearly 45%.

Fees eat up nearly 45% of a 5% market return



Source: Morningstar. Chart assumes 5% gross annual return and 2.2% in annual expenses.

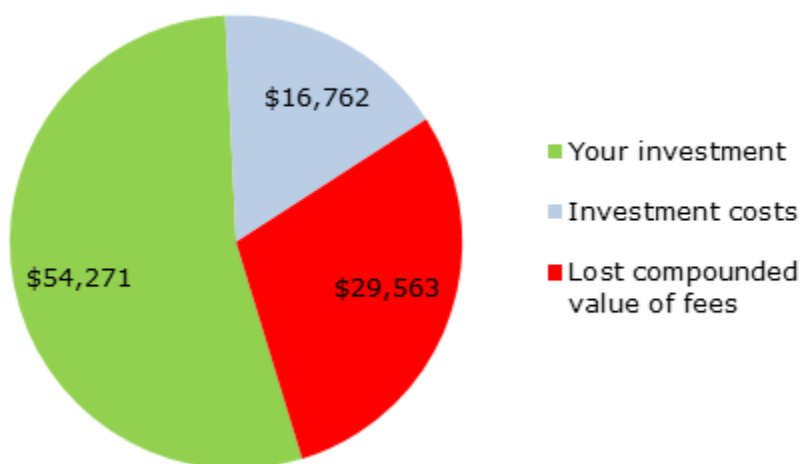
Thanks to miniscule yields, bond investors will feel the expense pinch the most. The median MER for commission-based core domestic bond funds clocks in at 1.59%, consuming nearly all of the investment grade market's 1.8% yield. Yield typically makes up the better part of bond returns, but that's especially the case these days. The bond market has benefited mightily from the boost it's gotten from three decades of declining interest rates--bond prices and rates move in opposite directions--but with yields at already-low levels, there's not much room for them to fall further. (And if they rise, you're likely to earn negative returns, adding insult to the injury of a yield-swallowing MER.)

The ugly math of fund costs: Where compounding works against you

The harm done by fund fees worsens over time for the same reason your investments grow. If you've shelled out 2.2 cents on the dollar in fees, the 97.8 cents put to work grows exponentially thanks to the magic of compounding. But so does the value of the 2.2 cents paid in fees.

As an example, let's get back to the 60/40 portfolio averaging 8% annual returns before fees with a 2.2% MER. Over a 30-year period, a \$10,000 investment will grow to about \$54,300 after fees. Over that stretch, the investor will rack up almost \$16,800 in investment expenses. However, the opportunity cost is a lot higher. Without fees, \$10,000 would rise to about \$100,600 over 30 years. The difference between the before- and after-fee balance--more than \$46,000--is almost three times what the investor paid in fees. The cost to the investor isn't just \$16,700 but also the more than \$29,500 in foregone gains. While the MER will have consumed about a quarter of the investment returns on average in a single year, the combined explicit (investment fees) and implicit (compounded value of investment fees) costs will have devoured 45% over a three-decade span.

Over long haul, fees eat nearly half your investment



Source: Data generated using Savii Financial Concepts MER Calculator.

Beware of termites

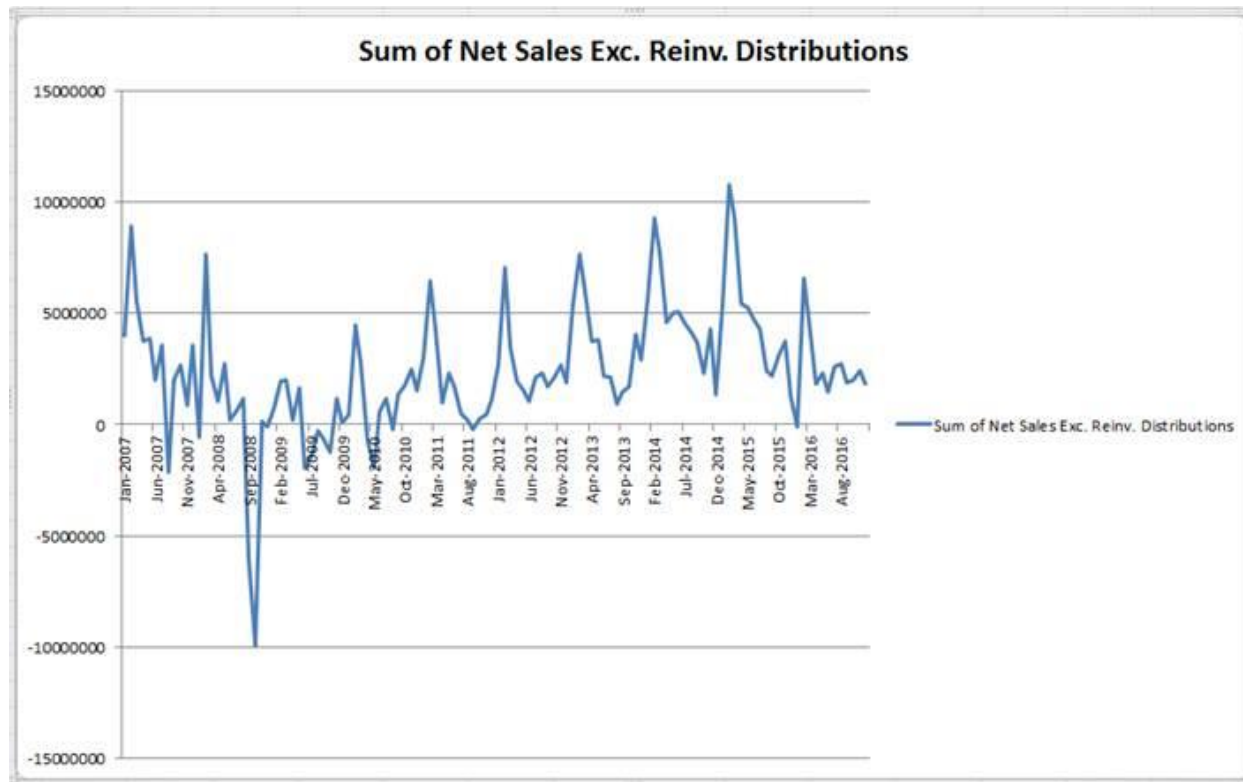
Of course, there's no world where you can invest without fees. Investment managers don't work for free, though low-cost ETFs now offer something not far from it. Paying for financial advice, whether as part of or separate from the MER, chips away at returns on one end, but a capable advisor can more than make up for it on the other by minimizing investment and tax costs, managing asset allocation, and ensuring clients save enough and stick to their financial plan when the going gets rough.

The question, though, isn't whether investment providers should be paid but how much. Because the price you pay comes directly out of your investment returns, less is always better. Even seemingly small costs add up over time. As John Oliver, the host of HBO's *Last Week Tonight*, more colourfully noted, fees are like termites: They may be small and barely noticeable, but they'll eat your future.

Note

¹ Our pre-expense return calculation uses 30-year annualized returns of the S&P/TSX Composite Index and the FTSE TMX Universe Index as of June 30, 2016.

Graph from Spreadsheet of Mutual Fund Net Sales (source IFIC below)



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VALUE FOR YOUR MUTUAL FUND FEES

Your fees pay for services provided by:

- **Your fund manager** – the company that manages the mutual funds that you buy.
- **Your dealer** – the firm where your financial advisor is registered. Some dealers charge an additional fee to you directly.

...and for **taxes** to federal and provincial governments.



These three types of costs are reflected in the fund's Management Expense Ratio (MER).

- Your Money – Invested to Grow
- Fund Manager Fees
- Dealer Fees
- Taxes

FUND MANAGER SERVICES



Sets the **strategy** and **goals** for a fund



Keeps **records** for the fund and for all clients, including tax reporting

Chooses and monitors **experts who buy and sell** investments to match the fund's goals



Provides or arranges for **legal, accounting, audit and custodial services**, and ensures the fund meets regulatory requirements



DEALER SERVICES

Your dealer firm provides these services to you directly or through your advisor, and works to ensure your advisor meets government rules and regulations:



Understands and reviews **your financial needs** and **how much risk** you are willing and able to handle

Keeps detailed records about your account



Delivers **account statements** and other information to you



Guides you to build and maintain your financial plan



Provides you with **information and access** to your account online



Buys/sells units of a fund for you, based on your needs and your ability to handle risk



Is a member of **investor protection funds** and **regulatory organizations**

TAXES

GST and HST are charged on fees and services



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Fee-based compensation could take a huge toll on MGAs

by Alain Thériault Feb. 28, 2017 07:00 a.m.

The newly minted obligation to disclose mutual fund fees will probably spread to segregated funds. If the regulators also ban embedded commissions and MGAs are forced to implement fee-based compensation only, it may cost them \$200 million, a recent study finds.

The consultation by the **Canadian Securities Administrators** (CSA) on the possibility of eliminating embedded commissions in mutual funds is troubling MGAs. They worry that this ban will spread to segregated funds, just as disclosure has.

Disclosure of segregated fund commissions would affect MGAs' economic model because of their structure. This finding was stated in an *Insurance Advisory Service* report on MGAs published in August 2016, produced by **Strategic Insight**.

An excerpt of this report obtained by *The Insurance and Investment Journal* states that the segregated fund compensation model will continue to be largely skewed towards deferred sales charges (DSC). This compensation structure accounted for 40% of gross seg fund sales in 2015, compared to 20% for mutual funds during the same period. The smaller proportion of DSC for mutual funds is due to the fact that CRM2 disclosure requirements already apply to them.

"Based on MGA gross sales and the estimated DSC share in 2015, DSC point-of-sale commissions alone had an annual economic impact on MGAs and their advisors of approximately \$200 million," the report confirms. Strategic Insight thinks that DSC will have a greater impact on MGAs than on mutual fund dealers.

Hub Financial President **Terri Botosan** is optimistic despite these regulatory issues. "It's a very exciting time for the MGAs: we must participate in discussion with the regulators, and make sure that every party considering these decisions understands what that might mean for the customers," she says.

We know that disclosure is imminent for segregated funds, **James McMahon**, president of **Financial Horizons Group** – Quebec. "Regulatory changes are accelerating in the industry, and we have to spin on a dime, which is getting more and more expensive. We have a back-office system for mutual funds and segregated funds, with a staff of over 50 people. If the advisors all go to fee-based compensation tomorrow morning, it would take me four to five years to absorb the shock," he says.

The **Canadian Association of Independent Life Brokerage Agencies** (CAILBA) and the insurance industry overall have clearly expressed their support for embedded commissions in segregated funds to the **Canadian Council of Insurance Regulators** (CCIR), says **Michael Williams** a **BridgeForce Financial Group** (BFG) partner who is also president of CAILBA. "Agents are not afraid of disclosing and stating at the point of sale with the client that they have a choice as to how they pay for advice. I hope the regulators heard the message. Even if mutual funds embedded commissions are banned, we believe we can still support embedded commissions on seg funds with success," he adds.

Six of one...

James McMahon thinks that by banning commissions, regulators will create a bigger problem than the one they wanted to solve. "Take a couple who saves \$25 or \$50 per month and over the years manages to accumulate

substantial assets. Who will take care of them, who will help them? The regulators haven't answered that question yet!"

Michel Kirouac, vice-president and general manager of **Groupe Cloutier**, does not understand why the CSA is leaning toward one model rather than another. He views them as equivalent. "I don't really see a difference between charging the customer fees and selling funds with embedded commissions. In the industry, 90% of funds foresee compensation for the advisor of about 1%," he explains.

Compensation still hovers around this mark, Kirouac adds. A fund with embedded commissions whose management expense ratio (MER) is 3% will pay the advisor a trailing commission of 1%. The rest will go to the manufacturer. If this fund exists in an F series, the MER will be 2% and the advisor can adjust his or her trailing commission. "For example, we see an average trailing commission of 0.6% to 1% in F series funds," Kirouac says.

In the fee-based model, customers pay the manufacturer fees of 2%, and the advisor negotiates the fees directly with the customer. "This is the model that the regulators are heading toward. If the fee-based model is imposed, this may affect the value of investment fund blocks of business," Kirouac points out.

Michel Kirouac is not a fervent believer in the single fee-based model. "100% transparency is a fine principle, but what will the banks put on their statements? This reform will confuse people for nothing, in addition to affecting advisors who manage large asset volumes. We are not against disclosure, and it's already required by law. But eliminating trailing commissions would be quite a shock, and we would have to learn to live with it," Kirouac adds.

Groupe Cloutier is poised to submit a brief as part of the CSA consultation on the possibility of banning embedded commissions in mutual funds.

More mutual funds jumping on the ETF bandwagon

by [Leo Almazora](#) 20 Apr 2017

With ETFs gaining traction among investors worldwide, mutual fund managers would have every reason to dislike their low-cost competition. But there's evidence that, for some, it's a love-hate relationship.

Citing data from independent investment research firm Morningstar, Marketwatch reports that more mutual fund managers are including ETFs in their portfolio.

In 2016, 1,222 mutual funds had an ETF among their holdings, accounting for a median value of 4.5% of the mutual fund's total assets under management.

Compare that to 2006, when there were only 595 ETF-holding mutual funds, with a median of 1.2% of the fund's assets placed in an ETF.

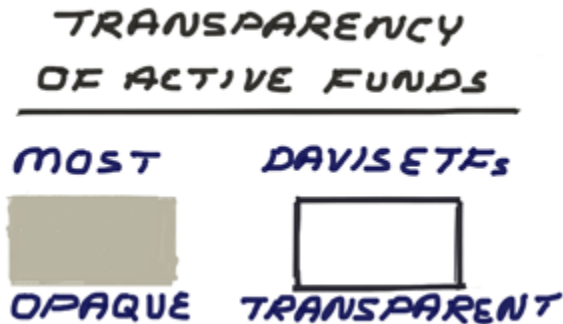
Such mutual funds are still the minority, however: a 2016 fact book released by the Investment Company Institute, an association of US funds, reported that there were more than 9,000 US mutual funds in 2015, holding US\$15.7 in assets.

The top ETFs for mutual funds were equity-based, with the most popular being the SPDR S&P 500 ETF Trust — the largest ETF on the market with US\$232 billion in assets. Six of the most widely held were bond ETFs, among which were two “junk bond” funds.

Morningstar didn't list which mutual funds used which ETFs, but it's possible that mutual fund managers use fixed-income ETFs to easily obtain broad exposure to the bond market, especially less liquid areas like emerging-market debt.

A Simple Solution to Offering an Active ETF

Thursday, January 12, 2017



Three new exchange-traded funds began trading today: Davis Select U.S. Equity (DUSA), Davis Select Financial (DFNL) and Davis Select Worldwide (DWLD). Normally such an event is not particularly noteworthy from our viewpoint. The launches of these funds are, however. They are actively managed equity ETFs based on strategies used for Davis Advisors' mutual funds, separately managed accounts and institutional funds. More importantly, they will follow the disclosure rules long used by index ETFs.

A bit of context is needed to understand why the launch of these funds is raising eyebrows. Actively managed ETFs remain relatively few in number. Most mutual fund companies have refrained from offering actively managed exchange-traded funds—particularly ETF versions of their equity-focused strategies. One particular hurdle has oft been attributed as the reason: transparency. Index (passive) ETFs disclose their holdings daily. Most mutual funds do not.

Attempts to provide a hybrid approach, meaning ETFs with reduced transparency, have generally not been successful. One platform that did pass the Securities and Exchange Commission's muster is Eaton Vance's NextShares. NextShares' exchange-traded managed funds provide limited transparency. Vanguard has its own platform and has filed to create ETF share classes for some of its actively managed funds. Last year, the SEC approved petitions from Bats Global Markets and the New York Stock Exchange for a streamlined process for listing actively managed ETFs. This was viewed as a positive for the industry, but it's not clear that the approval resolved the transparency hurdle.

Mutual fund provider Davis Advisors has settled on a simple solution for dealing with the issue of transparency. In registration statements filed earlier this month, the company wrote: "On each day that the Trust is open for business... the names and amounts of Deposit Securities to be included in the current Fund Deposit for each Fund will be published." Restating this in layman's terms, the ETFs' holdings will be disclosed daily. No lag. No complicated structure. Davis' actively managed ETFs will follow the same rules for disclosing their portfolios as index ETFs have done since the first exchange-traded fund (SPDR S&P 500 (SPY)) was launched in 1993.

Full, daily disclosure among actively managed ETFs is not a new concept. PIMCO provides it, as does Doubleline. The difference is that these companies offer bond ETFs. Since an issuer can have many bond issues outstanding and because the trading volume in each specific bond varies, there is less concern about active traders trying to jump ahead of a bond fund manager making portfolio changes than there is for a stock fund manager making portfolio changes. There are some actively managed equity ETFs offering daily disclosure [e.g., AdvisorShares Wilshire Buyback ETF (NYSE Arca: TTFS)], but they are relatively few in number and small in size. The four largest actively managed bond ETFs alone accounted for more than \$2 out of every \$5 invested in the 176 actively managed ETFs in existence as of December 31, 2016, based on data from Morningstar.

Davis Advisors is better positioned than other actively managed mutual fund providers to provide daily transparency because its mutual funds have below-average turnover ratios for their respective categories. The firm intends to follow a similar approach with its ETFs. Barron's quoted chairman Chris Davis as saying "it would be very strange if [the ETFs] ended up with a different kind of portfolio" than Davis Advisors' mutual funds. As such, it will be interesting to see if Davis Advisors turns out to be a trailblazer or more of an exception. The headlines and trends I've seen so far suggest that Davis will be an exception—unless these new ETFs turn out to be quite successful.

We've excluded the Davis funds from our mutual fund guide (which will be updated next month) because of the loads and expenses associated with the share classes most available to individual investors. Morningstar shows the Davis New York Venture (NYVTX), Davis International (DILAX) and Davis Financial (RPFGB) mutual funds as outperforming their category benchmarks. This potentially bodes well for the ETFs, but—as is the case with any brand new financial product—it would be prudent to monitor how they perform before making a decision on whether or not to invest in them.

DAVID O'LEARY

Why we'd celebrate a ban on embedded commissions for advisers

DAVID O'LEARY

Special to The Globe and Mail

Published Wednesday, Jul. 20, 2016 5:00AM EDT

David O'Leary, CFA, MBA is managing partner at Eden Valley Partners, a wealth management practice in Toronto

The Canadian Securities Administrators recently [took another step closer](#) to banning embedded sales commissions to financial advisers. My colleagues and I celebrated this news, since we believe a ban on commissions would be a huge win for both investors and our industry. Surprisingly, many industry stakeholders still argue against a ban. Here's why they're wrong.

Embedded sales commissions (also known as trailer fees) have two contentious problems: They create a conflict between the interests of adviser and clients, and they obfuscate the fees investors pay.

Embedded commissions present a conflict of interest because the adviser is being paid by the very provider of the investments they are recommending to clients. It would be like your doctor getting paid by pharmaceutical companies for prescribing their drugs to you. Even worse is the fact that different investments pay different commission amounts to advisers. So as an investor, you don't know whether your investments are the very best ones out there, or just the ones that rewarded your adviser most handsomely.

The second problem with commissions is that they are embedded within a larger fee (known as the MER, or management expense ratio) that bundles together all sorts of fees to various parties. This makes the amount a client pays the adviser far less transparent. In my experience, most clients don't realize their adviser receives any part of the MER – if they're even aware they are paying an MER.

Those who object to a ban on commissions are almost exclusively people who stand to profit from them. And they offer a variety of disingenuous arguments to defend them.

One common argument is that banning commissions would hurt investors since it would reduce the amount of choice they have in how they pay for financial advice. Portfolio manager John De Goey has been [quoted](#) with an excellent response to this: "Today, most restaurants offer a choice between tap water and carbonated water. Would adding a third option – toilet water – make for better outcomes?"

Another common argument claims that Britain banned commissions to disastrous effect. Claims are made that banning commissions created an advice gap, where smaller investors can't find advisers willing to serve them. This is blatant disinformation. No one knows precisely what impact the banning of commissions has had there. There are two reasons for this. First, we don't have enough data yet. The British ban came into effect just more than three years ago. And second, banning commissions was just one part of a sweeping set of changes known as the Retail Distribution Review.

Britain's Financial Conduct Authority has attempted to measure the impact of these changes and published a number of reports. Everyone admits their conclusions are tenuous, though, given how little data we have. Moreover, these changes were made against the backdrop of an evolving technological and sociological landscape, so that it may never be possible to isolate the effect of banning commissions from all the confounding variables.

More important, we have good reasons not to fear a dramatic advice gap in Canada. We have a healthy and robust banking system that gives the vast majority of us access to advice at a reasonable cost. And we have been a beneficiary of the trend toward robo-advisers.

Instead of fighting a commissions ban, let's promote financial literacy. That starts with clear information about what investors are paying for advice, and a system of adviser compensation that allows investors to trust they are receiving objective advice.

If we're successful, the industry won't have to hide the true cost of financial advice, because Canadians will see its full value and willingly pay a reasonable fee for it.

Understanding financial statements: TERs

BY **Dean DiSpalatro** February 27, 2015

With all the talk in the media about mutual fund fees, you may have seen references to TERs. What are those?

Trading Expense Ratio (TER) is a metric that figures into the price of mutual fund investing. The TER's calculated by taking the sum of all the fund's transaction costs and dividing it by the average value of fund assets for the annual reporting period.

So, if a fund has a TER of 0.27%, it means 0.27% of the fund's average yearly assets went to trading expenses.

Those expenses include brokerage commissions the fund manager incurs when buying and selling securities, notes Terry Rountes, CFO of Funds at Mackenzie Investments in Toronto.

They also include custodian transaction fees, which are charged each time a portfolio manager buys or sell a security. It's similar to paying bank fees for certain transactions, such as ABM withdrawals.

Investing in global markets is much more expensive, notes Dennis Tew, head of sales compliance and business operations at Franklin Templeton Investments in Toronto, and that will be reflected in higher TERs.

Emerging and frontier market funds tend to have the highest expenses. These markets aren't as efficient and lack the liquidity of developed market exchanges, so it costs more for managers to get trades done.

Tew adds some companies have better access to volume pricing on trades, which trims trading costs — like buying food in bulk.

Comparing TERs of bond and equity funds doesn't work because of the different ways these securities are traded. Commissions are embedded in a bond's spread, so unlike equity trading commissions, they don't factor into the TER calculation.

Funds that hold both stocks and bonds should have similar allocations for it to make sense to compare TERs. For instance, a growth fund with 80% equity and 20% fixed income will have a considerably higher TER than a balanced fund with a 50% equity, 50% fixed income mix, simply by virtue of the asset allocation. (If there's cash in the fund, it's likely going to be used for buying. And, as far as fees are concerned, cash falls in the fixed-income bucket.)

"But let's say you compared two balanced funds that are more closely aligned in terms of asset mix," says Rountes. "Any differences would be dictated by the manager's investment style."

A manager with a buy-and-hold strategy “doesn’t go in and out of the market a great deal. So, the expectation is he or she can incur fewer transaction costs and fewer commissions, and therefore the TER will be lower,” adds Rountes

The TER, along with Portfolio Turnover Rate (PTR), can help you judge whether a manager’s marketing fits the facts.

Say you want buy-and-hold managers who hand-pick stocks through bottom-up analysis. Consistently high PTRs and TERs could be a red flag, notes Tew.

“If [he’s] getting into more rapid turnover every year or two years, and [is] being held out as a buy-and-hold, bottom-up stock picker, the question would be, ‘Why are you finding better opportunities so quickly after making these picks?’ ”

He notes it’s possible the manager’s making consistently exceptional choices that quickly hit her growth targets, triggering sales. When that’s the case, gains will be reflected in her fund’s performance. But if a high-turnover fund isn’t doing so well, there may be a disconnect between the manager’s buy-and-hold billing and how she actually runs the fund.

MERs & TERs

https://www.fidelity.ca/cs/Satellite/doc/FF_UAD_A_en.pdf

http://dox3erp.distributtech.ca/ModulesERP/Uploads/48/PDF/pps_BT4_en.pdf

http://fundfacts.bmo.com/advisorEnglish/BMO_Dividend_Fund-EN-Series_A.pdf

<http://www.theglobeandmail.com/globe-investor/funds-and-etfs/funds/time-to-out-mutual-fund-industrys-closet-indexers-with-active-share/article27484440/>

MUTUAL FUNDS

Revealing the closet indexers among Canada's mutual funds

[IAN MCGUGAN](#)

The Globe and Mail

Published Wednesday, Nov. 25, 2015 6:11PM EST

Last updated Thursday, Nov. 26, 2015 4:49PM EST

<http://www.theglobeandmail.com/globe-investor/funds-and-etfs/funds/osc-to-examine-actively-managed-funds/article29004948/>

Regulators launch probe into the 'closet indexers' of the mutual fund industry

[CLARE O'HARA](#) - WEALTH MANAGEMENT REPORTER

The Globe and Mail

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<http://www.theglobeandmail.com/globe-investor/funds-and-etfs/funds/canadians-slow-to-shift-to-low-cost-index-investing/article34011085/>

Canadians have been surprisingly slow to adopt low-cost index investing

[TIM SHUFELT](#) - INVESTMENT REPORTER

The Globe and Mail

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"Even BMO, the country's second-largest ETF provider, wraps its moderately priced ETFs in high-priced mutual funds before selling them at bank branches," Mr. Davis said. ← Christopher Davis, director of research at Morningstar Canada

The shift to F Class does not mean lower fees

July 11, 2014 - 0 comments

Financial advisors throughout Canada are terrified. The Client Relationship Model (CRM2) is coming quickly, and it means that advisors will be obliged to disclose their fees and charges to clients. The non-disclosure of fees has been a quiet issue for years in the Canadian financial services industry. Most investors don't even realize that when they buy a mutual fund, the cost of ongoing financial advice is built into the management expense ratio (MER). It's bad enough that Canada has the highest average MER in the world at well over 2%, many Canadians are also paying for advice that they aren't receiving.

Disclosure is terrifying to advisors because when clients start to see the dollar amount that they are paying for advice each year, they will want justification. With the popularity of low cost ETFs, and the development of algorithm-based advice in the US, there is downward fee pressure coming from all angles.

Financial advisors are not fools. There has been a big industry push over the last few years for commission based advisors to prepare for the impending disclosure requirements. Part of this preparation has been a shift toward F class mutual funds. F class funds separate the advisory fee from the management expense ratio; when an advisor uses an F class fund, the client pays them directly. This eliminates the conflicts of interest present when advisors are paid commission by a product, and it also forces the advisor and client to agree on a fee that is fair relative to the level of service being provided.

I can't predict how commission based advisors will transition into the fee based world, but I would imagine that the standard 1% advisory fee will continue to be prevalent. With this in mind, I decided to look at Morningstar's database of F class mutual funds domiciled in Canada. I found that the average MER across all F class funds (excluding money market funds) is 1.29%. This means that even if an advisor decides to discount the advisory fee to .75%, the client is still paying, on average, over 2% in fees. There are some mutual fund families that do offer low costs; DFA funds come in with the lowest MERs, followed closely by TD's series of F class index funds.

Around 75% of financial advisors in Canada are only licensed to sell mutual funds, making it that much more difficult for investors to find unbiased advice at a reasonable price. IIROC's CRM2 disclosure requirements are moving advisors away from commissions to a fee based model, eliminating an inherent conflict of interest. It is a step in the right direction for financial advice, but unless investors demand a low-cost market-based approach from their advisors, it won't stop Canadians from pouring money into expensive mutual funds.

Robo-advisor CEO: Here's why I told clients they couldn't trade in sell-off

Alex Rosenberg | [@AcesRose](#)

Wednesday, 29 Jun 2016 | 5:59 PM ET CNBC.com

Betterment CEO on trading halt Wednesday, 29 Jun 2016 | 5:42 PM ET | 07:08

Automated investment advisor Betterment suspended client trading amid Friday's market turmoil, in what the company's founder and CEO now describes as a good decision that should have been better communicated to clients.

"The only thing I would do differently is I would put a notification in the app and say, 'By the way, we delayed trading right now,'" Betterment's Jon Stein said Wednesday on CNBC's "[Fast Money](#)."

Betterment is one of the most prominent robo-advisors, which are known for their low costs and high degree of automation; The company reports managing \$4.8 billion for 170,000 customers.

On Friday, as stocks tanked in reaction to the U.K. vote to leave the European Union, Betterment suspended all trading from the market open until about noon EDT, [apparently](#) without informing clients. While this is within the scope of its client agreements, other well-known robo-advisors declined to halt trading, and Betterment's move has raised eyebrows on Wall Street.

Stein, however, said that Betterment's sole goal was to act in the best interest of clients.

"In a time of extreme uncertainty, we wanted to be very careful about how we handled customer orders," Stein said. "Even if you have the best technology, you don't want to go out sailing into a hurricane."

Stein made the case that Friday morning was not the best time to execute trades, and that since "Betterment's customers are long-term investors," making money off of the market's next move did not loom large on clients' minds.

Interestingly, Friday's market mayhem did not seem to steer individuals away from the robo-advisor's services.

Not only did customers not leave Betterment, but "more people signed up on Friday than on a typical Friday," Stein said Wednesday.

Search for this string “MFDA-licensed advisors have firm grip on Canada’s mass market” at <http://www.investmentexecutive.com>

MFDA-licensed advisors have firm grip on Canada’s mass market

New client research project from the SRO aims to explore what client segment would be most affected by the potential elimination of embedded commissions

By Beatrice Paez | April 25, 2017 17:00

Companies cited in this article

Financial advisors licensed with the Mutual Fund Dealers Association of Canada (MFDA) represent close to nine million households in Canada, or about 56% of all households, according to the results of a new research project from the self-regulatory organization (SRO).

Specifically, of the households that deal with MFDA representatives:

1. about 80% fall within the mass-market space, defined as those with less than \$100,000 in assets,
2. while 15% are in the mid-market range (\$100,000-\$500,000), and
3. 8% are affluent investors (more than \$500,000).

These were some of the key findings from the MFDA's client research project, which was announced early in 2016 and designed to produce a wide-ranging profile of mutual fund dealers' client base. The report's "timely" arrival comes at a moment when the mutual fund industry is bracing for a potential ban on embedded fees — the impact of which has yet to come fully into view, says Mark Gordon, president and CEO of the MFDA, who presented the preliminary findings of client research project at the Federation of Mutual Dealers in Canada's annual conference in Toronto.

The MFDA is aiming to explore the data collected in this project, which are based on the responses of all of its registrants, probing for trends that might offer guidance on which client segment, for example, stands to be most affected by the potential elimination of embedded commissions.

Read: [The end of embedded commissions? How we got here](#)

"We cannot predict the ultimate impact of the ban because there are too many variables. However, with these data, we can now, with some degree of confidence, identify those stakeholder groups that have the greatest chance of being impacted," Gordon says. "We can also, to some extent, identify the potential scope of that impact on stakeholders."

As part of the project, the MFDA mandated that registrants fill out clients' information, including age, address, account type, product code, the market value of their investments, for example.

The MFDA can also use these data, Gordon says, to map areas in which there may be a concentration of higher-risk products and to produce an aggregate picture of different demographics.

The SRO plans to publish its report on this project sometime in the spring.

Photo copyright: racorn/123/RF

A portfolio manager's view on the ban on embedded fees

by [Joe Rosengarten](#) 22 Mar 2017



After the President and CEO of [Advocis](#), Greg Pollock, gave his views on the CSA's plans to ban embedded commissions within mutual fund products last week, WP received a barrage of emails and calls from advisors and portfolio managers eager to speak out on this contentious, polarizing issue. In this special guest article, Portfolio Manager with [Industrial Alliance Securities Inc.](#), John De Goey, outlines his response to [Advocis](#)' view point.

"In essence, [Advocis](#) believes that the proposed discontinuation of trailing commissions would be detrimental to both advisors and their clients. The organization also claims to be in favour of choice and transparency. I'd like to respond to these positions with my own comments – and by asking [Advocis](#) to answer a few questions...

Making compensation transparent does not do anything to change pricing. Four quarters does not cost more than a dollar; not liking having to pay separately does nothing to change the quantum of payment. Why does [Advocis](#) continue to suggest that transparent advice is somehow less accessible to investors of all account sizes?

The experience of the Retail Distribution Review (RDR) in the UK shows that once embedded compensation was no longer an option, advisors moved quickly to recommending lower cost products to clients. This is a real world experience that showed all investors paid less after the switch. This was clearly a win for consumers. Why doesn't [Advocis](#) mention it?

Investors pay for the sum of both products and advice. Why does [Advocis](#) only talk about the cost of advice and not the total?

[Advocis](#) says the number of advisors would drop if embedded compensation was no longer an option. I favour high standards/good advice and am opposed to low standards/questionable advice. The consensus is that it was overwhelmingly the less able advisors that left the business in the U.K. because they couldn't meet new (higher) proficiency requirements. Does [Advocis](#) want such advisors to continue in business? Is [Advocis](#) suggesting that every single advisor has unambiguous utility?

The Brondesbury and Cumming Reports showed that embedded compensation causes advisor bias. This bias, in turn, is extremely harmful to investor outcomes. Meanwhile, [Advocis](#) says almost nothing about evidence regarding advisor bias. Is [Advocis](#) unconcerned about the harm it may cause? If not, then what, exactly, is the [Advocis](#) position about the demonstrable harm caused by the bias that is part and parcel with embedded compensation?

Richard Thaler has done important work to show that people can be made better off by reducing their choices. By being "pro choice" [Advocis](#) implies that it merely favours maximizing retail client options. However, if the additional 'choice'

on offer is shown to be sub-optimal, wouldn't they agree that removing the worst option can actually improve the universe of possible outcomes?

Many people have long thought financial advice was free. Similarly, many people fear that CRM II statements (which often go unread) still allow some clients to delude themselves into thinking advice is free. As strong proponents of transparency, wouldn't [Advocis](#) agree that a separate, itemized bill is more transparent and therefore more desirable than a yearend statement that can easily be misplaced, misinterpreted or missed altogether?

Finally, it should be acknowledged that [Advocis](#) does not speak for all advisors. For instance, I have long advocated for transparent, professional financial advice. Will [Advocis](#) be clear in future articles and comments that there are a number of advisors out there who are opposed to their stated views?

I would prefer that [Advocis](#)'s responses be rooted in demonstrable causal facts. For instance, [Advocis](#) has often suggested that the drop in the advisor population in the UK was due to the elimination of embedded compensation, while it is widely believed that the primary culprit is higher proficiency standards. Correlation is not causation... and a little truth and clarity in lobbying would be nice."

John De Goey is a Portfolio Manager with [Industrial Alliance](#) Securities (IAS). The views expressed are not necessarily shared by IAS.

Advisor: Why I support the ban on embedded fees

by [Joe Rosengarten](#) 19 May 2017

When the CSA launched a consultation paper outlining a possible ban on embedded commissions and trailer fees back in January, a [fiery industry debate](#) commenced and it shows no signs of fizzling out. In anticipation of receiving a deluge of responses, the CSA set a longer than usual consultation period of 150 days; a period that comes to an end in early June.

The proposed ban has been met with [strong opposition from various industry insiders](#) and bodies, many of whom are currently preparing submissions to send to the CSA. The Investment Funds Institute of Canada, for example, called on the CSA to “reconsider whether there is evidence of a market failure sufficient to justify prohibiting embedded commissions.”

“If regulators have concerns about specific sales misconduct, existing rules give them the enforcement tools they need to address the concerns they have identified,” Paul C. Bourque Q.C., IFIC president and CEO, said. “As a result, we are asking the CSA to reconsider whether a prohibition on embedded commissions is the only option.”

[Many in the industry sit on the other side of the debate](#), including Jennifer Black, a Private Wealth Manager and Portfolio Manager at DFS Private Wealth. Black currently runs a fee-based practice and likes the idea of banning embedded fees.

“I like the first step regulators took with starting to disclose fees a little more clearly to clients, but there is still an element that is not fully disclosed,” says Black. “Hopefully the next step is banning embedded fees.”

Black believes that, under the current rules, many investors are unaware of the true costs they incur and how they are calculated. “If there are embedded fees which are not paid as commission to the dealership, the actual embedded cost is not being disclosed,” Black says. “That makes it difficult for investors to know what their true costs are.”

Black sees a discrepancy in the industry between advisors who build holistic strategies and plans for the long-term and those who simply focus on selling products and accumulating assets. “Those advisors who are just sales people and don’t add value from a servicing perspective might retain those assets for three or four years, but, going forward, they are going to find it very difficult to hold onto clients in this industry,” she says. “In a world with no embedded fees their compensation will go down if they’re not adding the value that will warrant their clients to go fee-based. You need to provide service for that.”



Gordon Pape: I've crunched the numbers. It's true. ETFs are usually better

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GORDON PAPE

The Globe and Mail

Published Friday, May 19, 2017 9:56AM EDT

If you can't beat them, join them.

That's the approach being taken by a growing number of traditional mutual fund companies as they expand into the ETF (exchange-traded funds) business.

Mackenzie Financial, AGF, Dynamic, RBC, and TD have all launched new ETFs in the past couple of years. In April, Manulife and Desjardins entered the field. Fidelity has started an ETF line in the U.S. and it's probably only a matter of time until Fidelity Canada does the same. During March and April, 24 new ETFs were launched in this country.

Mutual funds still dominate in terms of assets under management (AUM) by a wide margin. As of the end of April, the ETF industry reported AUM of \$126.3-billion. That was up \$3.3-billion from the previous month. The traditional mutual funds business is more than 10 times as big, with assets of \$1.3-trillion as of the end of March. You might think the mutual fund companies would just dismiss ETFs as a bothersome fly.

But ETFs are growing at a faster rate and no wealth management company can ignore that for long. At the end of 2006, Canadians had only invested \$15.2-billion in ETFs. A decade later, that figure was \$113.6-billion. That's an annualized growth rate of more than 22 per cent.

Investors are opting for ETFs for three reasons. First, they are relatively easy to understand. Second, they are cheap – some funds charge management fees of less than one-tenth of a per cent. Third, they are liquid. You can buy or sell at any time either on-line or by calling your broker.

But how do they fare in investment terms? We keep reading stories about how index funds continually outperform actively managed funds. Is that really the case? I did an analysis of three of the most popular ETFs and this is what I found.

Canadian equity funds: The most widely held ETF that tracks the full TSX Composite is the iShares S&P/TSX Capped Composite Index ETF ([XIC](#)) with assets of more than \$3 billion. It has been around since 2001, so we have a decent track record with which to work. As of April 30, this ETF was showing a 10-year average annual compound rate of return of 4.34 per cent. That is much better than the 3.18-per-cent average for the Canadian Equity category, as reported by GlobeFund, which comprises both mutual funds and ETFs. There are a few actively managed mutual funds available to the general public that have beaten XIC over that period. They include Mawer Canadian Equity (up 7.97 per cent over the decade), Beutel Goodman Canadian Equity Fund (6.15 per cent), BonaVista Canadian Equity (5.88 per cent), and Fidelity Disciplined Equity (4.71 per cent). However, most actively managed funds fell well short of matching XIC's returns.

(Note that I did not include F-series funds or those with unusually high minimum investment requirements in this analysis.)

U.S. equity funds: The iShares Core S&P 500 Index C\$-Hedged ETF ([XSP](#)) is the leader here in terms of assets at \$4.1-billion. However, the falling loonie has compromised its returns, which averaged only 9.81 per cent over the past

three years. There is a smaller unhedged version of this fund that trades under the symbol XUS. It shows a three-year average annual gain of 18.37 per cent.

That's almost the same as the BMO S&P 500 Index ETF ([ZSP](#)), which is the largest unhedged U.S. equity ETF. It has a three-year average annual compound rate of return of 18.35 per cent.

To compare these to actively managed funds on an apples-to-apples basis, we need to take currency variations into account. The return on both the unhedged ETFs is impressive and there are only a few U.S. dollar-denominated mutual funds with the same general mandate that beat them. They include the TD U.S. Blue Chip Equity Fund (up 19.33 per cent over three years), the Beutel Goodman American Equity Fund (up 18.9 per cent), the CIBC American Equity Fund (up 18.72 per cent), and the Mackenzie U.S. Dividend Fund (18.55 per cent).

Global equity funds: The BMO MSCI EAFE Index ETF ([ZEA](#)) is the leader here in assets under management. It tracks the performance of large and mid-cap stocks in countries around the globe except the U.S. and Canada. It recently passed its third anniversary and showed an average annual compound rate of return of 8.39 per cent over the three years to April 30. That is comfortably ahead of the group average for the International Equity category of 7.09 per cent but there were several actively managed mutual funds that bettered it by a wide margin.

One of the most impressive was the Trimark International Companies Fund, which posted a three-year average annual compound rate of return of 14.51 per cent. This was despite having a much higher management expense ratio of 2.98 per cent compared to only 0.22 per cent for ZEA. Sometimes you *do* get what you pay for.

The bottom line: Based on this small sample, ETFs are doing the job for investors. Unless you are very skilled (and lucky) at picking actively managed mutual funds, you will probably do as well or better by investing in a comparable ETF. If you want to know why this segment of the wealth management industry is growing so fast, there's your answer.

Gordon Pape is Editor and Publisher of the Internet Wealth Builder and Income Investor newsletters. For more information and details on how to subscribe, go to www.buildingwealth.ca. Follow Gordon Pape on Twitter at twitter.com/GPUUpdates and on Facebook at www.facebook.com/GordonPapeMoney

How are MERs Calculated and Stated?

The MER is expressed as a percentage of the fund's total assets. For example, if you invested \$5,000 in a series A Canadian balanced fund with a 2.28% MER¹, you would pay \$114 in fees for management, administration and taxes for a given year.

This chart illustrates how the cost of a mutual fund is calculated, and how it is put to work.



* The 2% management fee represents 81% of the total 2.28% MER. 50% of Mackenzie management fees are paid out to dealers in some form of compensation: trailers, commissions, co-op marketing.

¹ Represents the MER of a typical Canadian balanced fund.

² The applicable tax rates are calculated by taking a weighted average of the tax rates applicable to the province of residence of the investors of the Fund. An assumed tax rate of 10.6%, reflecting the current blend of Mackenzie Investments investors in HST and non-HST provinces, was used for the purposes of calculating the MER. The actual tax rate may differ.

Mutual funds

The breadth and depth of the Investors Group mutual fund line ensures that clients have the right mix of fixed income, balanced, and Canadian, U.S. and international equity mutual funds to help them achieve their financial goals.

Commissions, fees and expenses may be associated with mutual fund investments. Read the prospectus before investing. Mutual funds are not guaranteed, values change frequently and past performance may not be repeated.

- IG AGF Canadian Balanced Fund
- IG AGF Global Equity Fund
- IG AGF U.S. Growth Fund
- IG Beutel Goodman Canadian Balanced Fund
- IG Beutel Goodman Canadian Equity Fund
- IG Beutel Goodman Canadian Small Cap Fund
- IG FI Canadian Allocation Fund
- IG FI Canadian Equity Fund
- IG FI U.S. Large Cap Equity Fund
- IG Fiera Canadian Small Cap Fund
- IG Franklin Bissett Canadian Equity Fund
- IG Mackenzie Canadian Equity Growth Fund
- IG Mackenzie Cundill Global Value Fund
- IG Mackenzie Dividend Growth Fund
- IG Mackenzie Floating Rate Income Fund
- IG Mackenzie Income Fund
- IG Mackenzie Ivy European Fund
- IG Mackenzie Strategic Income Fund

Why we need regulations to protect seniors from unscrupulous financial advisers



JASON HEATH | July 8, 2016 1:32 PM ET

The Ontario Securities Commission has announced the formation of the Seniors Expert Advisory Committee, with the deadline for applications set for July 29. The committee could be instrumental in preventing the overt financial abuse of Ontario's elderly. But, even more importantly, it can alert children and grandchildren to the more covert abuse that the financial industry is quietly getting away with every day.

"The Seniors Expert Advisory Committee will give the OSC access to a multidisciplinary team of experts on issues related to older investors, providing us with valuable input," says Maureen Jensen, chairwoman and CEO of the Ontario Securities Commission.

The key issue for the committee, as I see it, relates to the lack of a fiduciary standard for Canadian financial advisers. This is a real risk at a time when our aging population is wealthier than ever and becoming increasingly vulnerable due to the natural changes in cognitive function as we age.

Consider this: your aging parents and grandparents' financial advisers have no obligation to provide them with advice that is in their best interest. So, unlike their doctor, pharmacist or accountant, there is nothing to require their banker, mutual fund salesperson or insurance agent to put them first. To me, this is like having a fox guard a hen house.

Here are some things that children and grandchildren should look out for:

1. Bankers who direct savings to proprietary, in-house products, despite the potential of better, non-bank alternatives.
2. Investment advisers who use mutual funds with embedded fees of two to three per cent, which nearly guarantee retirement savings will generate little to no return.

3. Insurance agents offering insurance solutions for all financial needs, when non-insurance solutions may be better or when no insurance may be needed in the first place.

The OSC initiative comes in the wake of last year's establishment of The Expert Committee to Consider Financial Advisory and Financial Planning Policy Alternatives by the Ontario government. The province has also signed on to the proposed expansion of the Canada Pension Plan. It seems clear that retirement and seniors are important for the province, but unfortunately, there is push-back from the industry.

According to the Investment Funds Institute of Canada, "Financial advisers already are subject to specific rules and regulations that clearly address the main issues that arise in the relationship between a financial adviser and his or her client. The introduction of a statutory fiduciary duty would not help to clarify the scope of an adviser's duties from situation to situation."

Quite to the contrary, I think a fiduciary duty does clarify the adviser's duty in all situations — put your client first, no matter what. This is particularly important because most people have no idea what sort of financial practices to seek out or avoid in the first place.

It's one of the reasons that the U.S. Department of Labor introduced new rules in April forcing American financial advisers managing retirement and pension accounts to act in their clients' best interests — the so-called fiduciary standard that the Canadian industry is trying so hard to avoid. White House estimates peg the cost of adviser conflicts of interest at US\$17 billion a year, primarily due to investors being placed in products with excessively high fees.

As near as I can tell, the only negative impact on seniors and retirement security from a fiduciary standard are on the retirement savings of the unscrupulous financial advisers (hopefully, a minority of advisers out there) who are raking in those bloated fees.

The OSC committee will include members from a variety of practice areas, ranging from lawyers and academics to doctors and the financial industry. It will be interesting to see which financial industry participants end up on the panel, given that everyone in the industry has varying degrees of conflicted interests. The pessimist in me can't help but think that some people in the financial industry benefit from passive, uninformed seniors and their busy, trusting children.

As an Ontarian with aging parents, I do hope the Seniors Expert Advisory Committee considers the benefit of a government-imposed fiduciary standard to ensure that all seniors — my parents included — are protected. It seems clear the financial advice industry won't self-regulate and do it themselves.

Financial Post

Jason Heath is a fee-only Certified Financial Planner (CFP) and income tax professional for Objective Financial Partners Inc. in Toronto.

Link → <https://www.theglobeandmail.com/globe-investor/funds-and-etfs/funds/do-it-yourself-investing-fund-fees-draw-fire/article35067755/>



No advice but still a price: Fund fees for DIY investors draw fire

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CLARE O'HARA - WEALTH MANAGEMENT REPORTER

The Globe and Mail

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The majority of mutual funds sold through online brokerages are charging clients millions of dollars in fees for advice they are not receiving, an issue regulators are being pressured to reform.

About 83 per cent of mutual funds sold through discount brokerages in Canada include trailing commissions that are typically charged by financial advisers for the advice they provide. Of the total \$30-billion in assets held in mutual fund products in discount brokerages, more than \$25-billion remain in fund series that bundle an advice fee within the product, according to a paper released in January by the Canadian Securities Administrators.

These funds are commonly known as Series A mutual funds and account for 68 per cent of the total amount of funds sold in Canada, according to the Investment Funds Institute of Canada (IFIC). These funds can charge a management expense ratio between 1.5 per cent to 2.5 per cent. By comparison, Series D funds – those tailored for do-it-yourself investors that strip out advice fees – it can be less than 1 per cent.

Do-it-yourself investors usually do not work with advisers to purchase investment products. As a result, these investors conduct independent research, make their own investment decisions and receive lower cost pricing when building an investment portfolio.

"Since discount brokers cannot and do not provide investment advice, clients are being robbed of returns," says Ken Kivenko, an investor advocate. "The investor abuse is staggering. Collecting money for advice while not providing it doesn't seem to bother [the regulators]."

Mr. Kivenko says there have been repeated efforts by industry groups to get the regulators to sanction discount brokers, but so far they have been ignored.

Earlier this month, IFIC proposed regulators adopt a rule that would ensure mutual funds that carry an embedded adviser fee are only sold in channels where advice is offered.

"Most companies already provide other series of funds with no or nominal trailer fees that investors can purchase if they are do-it-yourself investors or want to pay for advice separately," IFIC says in a statement. "The industry's proposal would advance the goal of ensuring that low-trailer or no-trailer funds are available to these types of investors in a more uniform and transparent way."

The regulators include all provincial securities commissions and the Investment Industry Regulatory Organization of Canada (IIROC) – which oversee investment firms including those in the discount brokerage channel.

"We think with IFIC joining in, IIROC may finally be forced to act," Mr. Kivenko says. "Seniors' nest eggs have been overcharged by these outrageous fees – fees for no service and fees that have been charged for many years."

IIROC recently issued findings on a review it completed on compensation-related conflicts of interest, and while it did not specifically look at the discount brokerage channel independently, the regulator said it will take IFIC's comments into consideration.

There are more than a dozen discount brokerages in Canada, including those run by all the major banks.

When contacted by The Globe and Mail, the majority of these discount platforms confirmed Series A mutual funds were available for purchase by DIY investors. Both HSBC InvestDirect and Desjardins online brokerage platform Disnat do not offer Series A funds for purchase. (Laurentian Bank Discount Brokerage and Credential Direct did not return calls for comment.)

Among those offering the funds, several platforms said they were aware of the discrepancies in fees being paid and either have measures in place, or are working on establishing measures, to make clients aware of additional options for purchase.

RBC Direct Investing will only sell a Series A mutual fund if a DIY version is not available. If a client's search for a Series A fund, they will only see an option to sell. About 50 per cent of all its mutual-fund assets under administration is held under their Series D offerings.

While TD offers DIY investors funds with embedded fees, it also offers its online clients low-cost index funds – known as the e-series – with MERs that can be as low as 0.33 per cent.

Questrade Financial has set up a reimbursement program to pay back all trailer fees directly to clients when they purchase a commission-based product (although there is an administration fee deducted to do so).

Qtrade's platform does not have a reimbursement program, but has pro-actively contacted clients to educate them more on the fund series. In February, Qtrade e-mailed all investors stating: "One way to avoid trailer fees is to hold D-series funds, which are a lower-cost option offered by some mutual-fund managers. Many Series D funds are already available on our website."

Virtual Brokers, a division of BBS Securities Inc., offers Series A funds, but they have minimal assets as the platform has seen a significant shift to exchange-traded funds, says Bardya Ziaian, CEO of BBS Securities Inc.

But many industry groups are asking regulators why the funds are allowed to be offered on these platforms in the first place.

FAIR Canada – an investor advocacy group – has long argued that discount brokerages should not be permitted to offer Series A mutual funds since they are not permitted to provide recommendations or advice, says Marian Passmore, director of policy and chief operating officer of FAIR Canada.

FAIR Canada has asked regulators to consider a requirement for discount brokers or fund companies to offer a class of funds that have no trailing commissions. In addition, the recommendation would also see all firms that offer a particular mutual fund be required to offer the "F" class version of the fund, which does not have a trailing commission.

<https://www.youtube.com/watch?v=oU1Xe-hF8LE>

Note: I tinkered with the title caption below, I snipped it from the beginning and inserted it over the caption at a later point in the video.



<https://www.theglobeandmail.com/globe-investor/investment-ideas/strategy-lab/index-investing/dont-bet-against-time-with-actively-managed-mutual-funds/article35081122/>



Don't bet against time with actively managed mutual funds

ANDREW HALLAM

Special to The Globe and Mail

Published Monday, May 22, 2017 6:16PM EDT

Andrew Hallam is the index investor for [Strategy Lab](#). Globe Unlimited subscribers can view his [model portfolio here](#) and read more in the series [online here](#).

Rocky Balboa probably said it best. In his 2015 movie, *Creed*, Sylvester Stallone's character identified every boxer's nemesis. Time.

"Time takes everybody out. Time's undefeated."

It's much the same with actively managed mutual funds. You might think you've found a winner. It might beat the index over a three, five or 10 year period. But the index is much like time. Eventually, it wins.

The [SPIVA Canada Scorecard](#) says the S&P/TSX composite index beat 91.11 per cent of actively managed Canadian equity funds over the 10 years ended Dec. 31, 2016. The S&P 500 beat 98.28 per cent of U.S. equity funds sold in Canada. The Global stock market index beat 96.4 per cent of actively managed global stock market funds. Sometimes we're tempted to search for winning funds. But that's a quest in vain. Take the Thomson Reuters Lipper Fund Awards. Each year, they award top-performing funds. Time, however, has the final laugh.

For example, in 2013 the [RBC O'Shaughnessy All-Canadian Equity Fund](#) was Lipper's top Canadian equity fund. It had the industry's best three-year track record. After it won the award, plenty of new investors piled into its corner. But the following year, TD's [Canadian stock market e-Series index](#) beat it by almost seven percentage points. RBC O'Shaughnessy All-Canadian Equity Fund earned 3.56 per cent. TD's Canadian Index e-Series index earned 10.23 per cent.

In 2014, the Lipper Fund Awards gave top honours to the new three-year Canadian equity champ. It was the [Phillips Hager & North Vintage D fund](#). New investors jumped on board, putting their money on a winner. But the following year, that fund lost 9.6 per cent. TD's Canadian e-Series Index dropped just 8.53 per cent.

In 2015, [Mawer's Canadian Equity Fund Series-A](#) took Lipper's top three-year honours. One year later, it gained 15.77 per cent. TD's Canadian e-Series Index gained 20.63 per cent.

The Canadian Lipper Fund Awards began in 2007. That year, they awarded Dynamic Mutual Funds the top equity fund performer. Dynamic won the award based on their overall performance. But time has hit them hard since then.

Dynamic's Canadian equity funds with 10-year track records averaged 1.23 per cent for the 10-year period ended April 30, 2017. Inflation in Canada averaged 1.61 per cent. That means your grocery bills rose higher than Dynamic's Canadian equity funds.

In the United States, there's at least one firm that boasts they can beat the index. It's called American Funds. The company's website shows that five of its actively managed funds trounced the S&P 500 between 1976 and 2016. It says, "So the next time you hear 'You can't beat the index,' consider American Funds' long-term track record."

Unfortunately, they're boasting from the canvas as they remember better days. After fees, [Vanguard's Total Stock Market Index \(VTSAX\)](#) knocked them out over the past one-, three-, five-, 10- and 15-year periods. Investing with index funds is like betting on time itself. Time is undefeated.

DYNAMIC CANADIAN EQUITY FUNDS	10-YEAR ANN. RETURN	TD CANADIAN INDEX E-SERIES	10-YEAR ANN. RETURN
Dynamic Power Canadian Growth Class	1.60%	TD Canadian Index-eSeries	4.26%
Dynamic Power Canadian Growth Fund	0.70%		
Dynamic Power Small Cap Fund	1.40%		
Dynamic Canadian Equity Category average	1.23%	TD Canadian Index e-Series average	4.26%

DYNAMIC U.S. EQUITY FUNDS		TD U.S. INDEX E-SERIES	
Dynamic Power American Growth Class	9.60%	TD e-Series U.S. Index	8.73%
Dynamic Power American Growth Fund	9.50%	TD Dow Jones Industrial Average Index-e	9.13%
Dynamic American Fund	7.00%	TD Nasdaq Index-e	11.12%
Dynamic U.S. Equity average	8.70%	TD U.S. Index e-Series average	9.66%

DYNAMIC EUROPEAN EQUITY FUNDS		TD EUROPEAN INDEX E-SERIES	
Dynamic European Value Fund	1.17%	TD European Index e-Series	2.42%
Dynamic European Equity average	1.17%	TD European Index e-Series average	2.42%

*Ten-year returns ending April 30, 2017

JOHN SOPINSKI/THE GLOBE AND MAIL, SOURCES: DYNAMIC.CA; TDCANADATRUST.COM

DSC ALTERNATIVE HAS LIMITED MERITS

[Melissa Shin](#) / May 12, 2017



“Worried about DSC fees? Find out how to make 5%+ at the grid and not have to lock the client in!”

Intrigued? So was a Toronto advisor, who received this message from his managing general agent.

The answer was a life insurance-style chargeback schedule for segregated funds. If the client exited the fund within a fixed period, the advisor would have to repay the commission earned at time of sale—instead of the client being dinged with deferred sales charges.

On the face of it, that’s an improvement. The advisor gets compensated for the upfront work required to place the funds and, in theory, the threat of a chargeback keeps the advisor providing service for at least the next few years.

Win-win, right? Not so fast.

Advisors we talked to lauded the structure for freeing the client from undue exit restrictions. But some pointed out the advisor penalty could create another conflict.

“While the arrangement gets the investor off the hook for DSC charges, the benefit may be superficial, since this arrangement creates a powerful incentive for the advisor to keep the investor in the fund, even if it has ceased being optimal or suitable,” says investor advocate Neil Gross, president of Component Strategies Consulting.

Great advisors don’t intend to let compensation influence what they sell. Studies have shown, however, that loss aversion can be up to twice as powerful as the desire to gain. Lest you think yourself immune, researchers have found loss aversion to affect undergraduate students, pro golfers, foreign policymakers and capuchin monkeys. At the very least, the chargeback structure would be ill-suited to advisors who can’t stand to lose money.

As CSA says in Consultation Paper 33-404 (which doesn’t apply to seg funds or insurance licensees): “When deciding how to respond to a conflict of interest involving clients, only avoidance or controls (but not disclosure alone in most cases) are responses that [...] can be fully effective.”

One company offering the product concedes it isn’t for everyone. A rep told me an advisor “would need to choose” which clients would be suited. “The main objective was to allow the client [to not have] redemption fees if he left. The advisor is taking the risk.”

“There is evidence that embedded commissions paid by investment fund managers to dealers/representatives on sales made under the DSC option can [...] incent unsuitable recommendations.”

—CSA Consultation Paper 81-408

That's fair. But most common retail structures allow clients to redeem funds without undue charges. They just tend to pay out less up front—and there's the rub.

Every structure is vulnerable to conflicts—advisors paid by the hour can drag out a meeting; flat-fee advisors can rush through planning. But it's embedded commissions that have drawn the ire of regulators, and for good reason. A chargeback schedule is an improvement to DSC, but a marginal one, as advisors may be loath to recommend an exit, even if it's the right thing to do. And, since seg funds don't fall under CRM2, clients may never know about that perverse incentive.

Advisors must be paid fairly for their work. But minimizing one conflict while creating another isn't a solution.

[Melissa Shin](#) is Editor of Advisor Group. Email her at melissa.shin@tc.tc.

CLIENT COSTS WILL FALL UNDER COMMISSIONS BAN: LETTER TO EDITOR

Staff / May 24, 2017

Our current regulatory environment continues to generate reader commentary. Here, we publish a letter to the editor arguing that the cost of advice will not rise if embedded fees are banned.

Where is the evidence that unbundling will put advice out of reach? Where is the evidence that the cost (of advice or otherwise) will rise? Why haven't all advisors been frustrated by what IFIC is only now (in 2017!) noting as a problem ([\[advice trailers\] paid to DIY service providers](#))?

[I acknowledge that under an embedded commission ban,] the cost of advice is unlikely to change materially. Similarly, product costs (especially re: mutual funds) will likely drop, but only modestly.

The big change regarding client cost is the substitution effect. [\[As we saw in the U.K.,\]](#) advisors will likely move from recommending high-cost products (often used previously due to embedded compensation) to recommending low-cost products (once embedded compensation is no longer available). The absolute savings will be passed on to investors. In short, the U.K. experience is a smoking gun [showing] that advisors are motivated more by compensation than by product merit when making recommendations to clients. When the compensation filter is removed, they actually do the right thing.

Here's an example. Let's say clients are currently paying 2.35% via a mutual fund MER (including a 1% trailing commission that goes the advisor). In an unbundled world, the cost advice might actually go up (say to 1.1%, on average). However, instead of using F-class funds that cost 1.35%, the advisor might recommend an ETF that costs 0.25%. That's a 0.1% increase in the cost of advice – and a 1.1% decrease in the cost of investment products. The absolute total cost to clients (since clients pay for both the investment product “parts” and the financial advice “labour”) is about 1% cheaper. A client with a modest \$100,000 portfolio would actually pay \$1,000 less every year as a result.

It is simply disingenuous to talk exclusively about the cost of advice – as if the cost of investment products was not even a consideration.

Sincerely,

John J. De Goey, CIM, CFP, Fellow of FPSC
Portfolio manager, Industrial Alliance Securities Inc., Toronto

Canadians prefer financial advisors to robo-advisors

Only 7% of Canadians said they're likely to trust a robo-advisor's recommendations, new global HSBC study finds

By Beatrice Paez | May 24, 2017 16:15

As financial services institutions worldwide throw their weight behind emerging technologies, Canadians appear to be more lukewarm about embracing them than residents of other nations, according to a new report from London, U.K.-based HSBC Holdings PLC.

The survey, which polled more than 12,000 individuals from 11 countries, suggests a divide in attitudes between Asia and the Western nations toward technology, including the adoption of robo-advisors.

Among Canadians, there's still a strong preference for taking guidance from a human financial advisor over advice generated through an algorithm powered by artificial intelligence.

In particular, of the 1,001 Canadians represented in the survey, a mere 7% said they're likely to trust recommendations delivered by a robo-advisor. That's in contrast to 44% in China and 38% in India.

Moreover, the survey suggests that only 18% of Canadians surveyed feel that robo-advisors are able to offer more accurate advice than their human counterparts.

Canadians' ambivalence about the benefits of technological innovation reflects a lack of trust in new technology, the report notes.

In fact, the poll suggests that Canadians are among the most content with their bank's existing technology services — and they may not be so enthusiastic over the use of fingerprint technology to identify themselves or chatbots.

Appetite for chatbots, which can dish out information traditionally delivered by a customer service representative, for example, may not be as widespread in Canada. The report suggests that only 16% turn to chatbots for customer service help.

In general, many Canadians express doubts about technology's ability to improve the world, with only 56% saying innovation can yield positive change compared with 89% in China and 85% in India.

"While those in Canada may be more resistant to change than their eastern counterparts, the research also points to the huge potential of educating people on upcoming and existing technologies as Canadians are among the most likely to respond positively to education around biometrics — such as touch and voice ID," says Larry Tomei, executive vice president and head of retail banking and wealth management with Vancouver-based HSBC Bank Canada, in a statement.

Slow uptake of new technology among Canadians could affect support for innovation, hindering financial services' efforts in Canada to develop solutions for the domestic market.

To make clients more receptive to the adoption of new technologies, the report suggests the need for greater education, perhaps even a touch of human intervention, with traditional advisors using the new tools to complement the work they do.

News from globeandmail.com

Looking for fee relief? Do the math before dumping mutual funds for ETFs

Wednesday, April 28, 2010

DAN HALLETT

A recent Globe and Mail article suggested that investors can improve their returns by replacing mutual funds with exchange-traded funds. This argument hinges on minimizing fees with ETFs, thereby adding fee savings (over more expensive mutual funds) to bottom line returns.

But if you think that dumping your mutual funds for ETFs is the path to riches and higher returns, think again.

The average mutual fund investor pays about 2 per cent annually in management fees, operating expenses and taxes. The average investor in TSX-traded ETFs pays closer to 0.4 per cent a year. The average potential cost savings, then, are about 1.6 per cent per annum. But this is only available to do-it-yourself (DIY) investors. Otherwise, investors who need professional advice have to pay for it either through higher product fees or fees paid to an adviser in addition to ETF expenses.

The 2 per cent average mutual fund fee generally includes compensation for advisers, whereas ETF fees do not include the cost of obtaining advice. So-called fee-based or fee-only advisers charge a fee equal to 1 per cent to 1.4 per cent of your portfolio value. Add that to ETF fees and taxes and you've got total annual fees of 1.5 per cent to 1.9 per cent annually. Wave goodbye to that fee advantage.

For those who need advice, there is great value in the design of a custom asset mix. In addition, selecting a handful of ETFs from among the 1000-plus trading in North America is challenging for most. But if you expect to fully benefit from low ETF fees, you'll have to jump into the driver's seat of your portfolio and become a DIY investor.

A problem for some DIY investors is that there is a significant barrier to realizing the full cost benefits of ETFs. In the hands of DIY investors, the ETF fee advantage usually vanishes thanks to poor portfolio construction and frequent trading.

Of all of the "indexed" or ETF portfolios that I have reviewed over the past 16 years, only two were focused on obtaining the broadest diversification possible at the lowest possible cost. This boring strategy is key to successful indexing. But investors can't seem to stop buying all of the market's slices and dices that ETF sponsors have packaged for investors. This not only violates the basic tenets of successful index investing, but it also sets the stage for more return-detracting behaviour.

I estimate that investors in stock mutual funds tracked by the Investment Funds Institute of Canada tend to hold their funds for an average of 6 to 7 years. (Note that this average is dollar-weighted, not based on an average of each investor's holding period.) ETF investors, on the other hand, only hold for a fraction of the time of their mutual fund investor peers. And there is strong evidence suggesting that the more frequently individuals trade, the less money they make.

Brad Barber, Yi-Tsung Lee, Yu-Jane Liu and Terrance Odean studied all the trades made on the Taiwan Stock Exchange from 1995 through 1999 for a 2008 paper entitled "Just How Much Do Individual Investors Lose by Trading?" They found that individuals lost a total of almost 4 per cent annually to trading fees and poor timing (while institutions profited). Similar research on U.S. investors pegs the "trading losses" at about 2 per cent per year. This is consistent with past Barber and Odean stock trading studies.

In a 2000 paper, they found that the higher an investor's trading frequency, the lower the investor's net returns.

My own research over the past decade strongly suggests that more volatile investments lure more investors into making ill-timed trades. But there is hope. Investors can benefit by paying attention to total fees, regardless of the type of

investment. Investors that can develop an awareness of the real impact of brokerage costs and ill-timed trades can change their performance-detracting behaviour. Less aware investors, however, may want to think twice about jumping head first into the ETF world.

Dan Hallett is director of asset management for Oakville, Ont.-based HighView Asset Management Inc.

Investors demanding lower-cost funds

by [Leo Almazora](#) 25 May 2017

Results from a recent study by a global research firm indicate continued investor demand for low-cost mutual funds and ETFs, which are typically passive funds and institutional share classes.

In a survey of open-end mutual funds and exchange-traded funds, Morningstar found they had an asset-weighted average expense ratio of 0.57% in 2016, down from 0.61% in 2015 and 0.65% the year before that. This was due to increased investor demand for lower-cost funds, mainly passive funds and institutional share classes that charge less in fees.

The asset-weighted average expense ratio was used in the study rather than a simple average. According to the firm, an asset-weighted average could better reflect average costs borne by investors, since a simple average could be skewed by a few high-cost funds with low asset levels. “In 2016, the simple average expense ratio for all funds was 1.14%, but funds with an expense ratio above that level held less than 10% of fund assets at the end of 2016,” the study’s authors said. “So it is very misleading when a fund company touts ‘below-average fees.’”

The firm also found that on average, the largest 2,000 funds in 2013— which accounted for 85% of mutual-fund and ETF assets at the time — did not change their expense ratios over the three-year period. This means the decline in average fund fees that investors paid was due largely to switches to lower funds.

The figures indicate that passive funds hold wide appeal. In 2016, they cost investors an average of 0.17% — 58 basis points less than active funds. From the fund providers’ perspective, passive funds are also cheaper: their asset-weighted costs decline more rapidly than those for active funds. This two-pronged advantage has led to passive funds’ having larger inflows than their active counterparts for the past six calendar years.

Investors’ general appetite for lower fees has affected preferences within the active segment. Past interest in pricier funds has waned in recent years; expensive active funds saw US\$91 billion in outflows in 2014, and US\$369 billion in outflows in 2016. The rush out of expensive funds accounted for all the outflows from active funds over the past two years.

On the passive side, the preference for low fees is also evident. The funds with fees in the cheapest 20% tended to gather almost all passive-fund inflows. The trend was found to hold across US equities, international equities, and fixed income — the three largest asset class groups. Vanguard and BlackRock/iShares, both firms with a broad offering of low-fee passive funds, were the only two firms to really benefit from the rapid growth in passive funds.

Investors Group moving clients to experienced advisors Regional managers are overseeing the reassignment of clients to veteran advisors following the dismissal of approximately 400 primarily younger advisors

By Geoff Kirbyson | May 26, 2017 07:30

Client accounts are moving around at Winnipeg-based Investors Group Inc. perhaps like never before after the dealer firm reduced its roster of financial advisors over the past few months.

The firm recently parted ways with approximately 400 primarily younger advisors as CEO Jeff Carney continues to put his stamp on the company, slightly more than a year into his tenure. At the end of the first quarter, the company had 4,754 advisors, down from 5,321 a year ago. Almost half of those who remain (2,262) are considered veterans with four or more years of experience.

In turn, regional managers at Investors Group are overseeing the reassignment of clients to veteran advisors who remain with the firm, says Ron Arnst, assistant vice president of brand management and media relations. "Typically, the regional manager matches clients with appropriate [advisors] considering any clients requests, such as age range and gender," he says.

Investors Group clients are free to switch advisors within the company at any time, a process regional directors also facilitate.

However, clients who have opted to follow their departing advisor to another firm were subject to the typical redemption and withdrawal process, Arnst says, noting that the deferred sales charge (DSC) schedule also applies.

"DSC funds carried a slightly lower [management expense ratio], but also had an additional fee schedule that applied if or when the client redeemed the investment prior to the seven-year schedule period," he says.

Investors Group is far from alone in taking such steps, says Dan Richards, CEO of Clientinsights in Toronto. Specifically, larger financial services firms have been taking a harder look at their smaller producers during the past several, often making the payout gird more punitive.

"In some cases, I'm sure [larger firms] hoped the advisors would get the message and find somewhere else to work," Richards says. "If firms aren't seeing the prospects of running a significant book of business, increasingly they're saying [to those advisors], 'It's not going to work out'."

Along with the increased focus on veteran advisors, Investors Group is also increasing its focus on high net-worth clients. However, the firm isn't looking to shed smaller accounts.

"Investors Group is committed to working in the best interests of all clients," Arnst says, "regardless of asset size."

IGM downsizing, focusing on HNW clients

The financial giant has let 400 advisors and 80 administrative staff go in recent months

By Geoff Kirbyson | May 05, 2017 17:30

Jeff Carney, CEO of Winnipeg-based IGM Financial Inc. believes sometimes you have to get smaller before you can get bigger.

The firm's biggest operating company, Investors Group Inc., has let go more than 400 advisors and administrative staff positions.

Thanks to higher standards for advisors, 400 primarily younger consultants were let go in recent months.

"I've raised the standard," Carney says. "We didn't think they were going to make it under the new skills we're looking for in the future."

At the end of the first quarter, the number of veteran consultants — defined as those with four or more years of experience — was 2,262, slightly less than half of the cohort of 4,754. There were 5,321 consultants a year ago. Carney, who took over as CEO of IGM a year ago, says he doesn't rule out further job losses in the future, but says no immediate layoffs are imminent.

The firm also laid off 80 administrative staff. "We combined some different [regional] districts together and created an opportunity to reduce costs and put that money back to work in other things that we're trying to do," Carney says. "It's a reallocation of resources."

Thirty of those affected people were in Winnipeg with the remaining 50 spread out across the country.

"I'm still in my early days. I'm looking at everything. I don't want to sit here and say we'll never have [more layoffs]," he says. "Right now, I'm focused on growing our company and accelerating the growth. In some areas we might be hiring, and in some areas we might be reducing, depending on what we're doing with our business model as we evolve."

"Where we can find efficiencies," he adds, "we [have to act] because it's a competitive landscape and we've got to reinvest in pricing, products and people who can bring new skills to us."

Carney addressed the media following IGM's annual general meeting in Winnipeg Friday morning. A couple of hours earlier, the company announced net earnings available to common shareholders for the three months ended March 31 of \$177.1 million (74¢ per share) up from \$167.0 million (69¢) in the corresponding period a year earlier.

Part of the increased focus on veteran consultants is a heightened focus on high net-worth clients.

"We're moving more up-market," Carney says. "We were probably working too hard for the smaller clients and now we're working for the right ones. We don't want to walk away from our smaller clients but they don't need that level of sophistication at that stage of their lives vs somebody who has accumulated significant wealth and needs to know that their retirement is going to fund the rest of their lives."

TD LOWERS TRAILERS, BUT DOESN'T SEEM TO PASS SAVINGS TO CLIENTS: CONSEILLER EXCLUSIVE

Conseiller Staff / May 25, 2017



[A Conseiller.ca exclusive report](#) finds that TD has lowered trailers on certain funds, but did not subsequently lower the fees charged to clients.

Several advisors provided Conseiller.ca with documents showing that on April 1, TD Asset Management cut trailing commissions on the following funds:

- TD Ultra Short Term Bond Fund;
- TD Balanced Income Fund;
- TD Balanced Growth Fund;
- TD Diversified Monthly Income Fund.

With the TD Balanced Income Fund, for instance, the trailers fell 25 basis points, but the management fee, so far, remains the same.

When asked for comment regarding the trailer reduction, TD declined.

Advisors told Conseiller.ca they felt the move was, while compliant, unethical. One spoke of boycotting TD funds.

CSA, OSC grilled on embedded commissions

by [Leo Almazora](#) 30 May 2017

In a recent submission to the CSA's consultation paper on discontinuing embedded commissions, a senior investor expressed frustration over regulators' failure to answer questions he asked about the model.

"I contacted the CSA with five questions related to the disposition of embedded commissions under certain changing 'advisor' to investor relations," said an 83-year-old investor Peter Whitehouse in a seven-page letter emailed to the association. "I received a response that I should click on a provided link to the OSC and rummage through 74 Rules, Instruments & Policies papers that should be related to my quest."

Prior to contacting the CSA, Whitehouse reached out to the OSC to ask the same questions. The OSC did not answer them, but did say that embedded commissions are sent from the mutual fund company to the investment dealer, who then distributes the commissions among its advisors based on a pre-arranged agreement.

The questions Whitehouse asked the regulators were:

- What happens to the continuation of the embedded commission payouts when an investor terminates their relationship with their financial advisor? Who gets the future embedded commission payouts?
- What happens to the continuation of the embedded commission payouts when a financial advisor employed by Investment Dealer "A" resigns from an investor's account?
- What happens to the continuation of the embedded commissions payouts when the investor's financial advisor employed by investment dealer "A" sells the investor's account (selling the book) to another financial advisor employed with the same investment dealer "A"?
- What happens to the continuation of the embedded commissions payouts when the investment dealer resigns from the investor's account?
- What happens to the continuation of the embedded commission payouts when an investor terminates their relationship with a financial advisor employed by investment dealer "A" and the investor transfers their account to investment dealer "B"?

In his letter, he asserted advisors – dealing representatives – should not be given sales commissions by the fund companies they recommend, calling it a "pure conflict of interest" that exposes investors, particularly seniors, to various abuses.

He also spoke out against advisors who sell investors mutual funds on a deferred sales charge (DSC) basis without disclosing that they'd immediately receive a 5.5%-6% sales commission. According to Whitehouse, there's no requirement for advisors to inform investors of the high sales commission rate prior to the transaction, or of the detrimental impact related to DSC-based fund purchases.

He further urged the CSA to disallow bank-owned dealers' practice of sending complainants to an "internal ombudsman." Since there is no regulatory disciplinary oversight of such bodies, he contended, it exposes wronged investors to low-ball restitution recommendations and rejection of valid claims based on false and misleading reasons.

"If a dealer rejects a claim, they should be directed to OBSI and never to the unregulated entity of the bank 'internal Ombudsman,' as so many bank brochures do," said Whitehouse

Real estate referral fees: The good, the bad and the ugly

The common business arrangement could be improved with transparency

BY TERESA BOARDMAN

TODAY 3:00 A.M.

Key Takeaways

- Helping a homeseller find the perfect agent adds value to the transaction.
- Consumers have a right to know if their agent is paying a referral fee and whether a referral constitutes a recommendation.

I just love it when a check comes in the mail a few weeks or months after I referred a friend, family member or client to a Realtor in another market. I try my very best to find the perfect match. Sometimes I even turn leads away (insert gasp here) with instructions on how to find an agent and what to look for.

There are times when I accept clients from other agents and pay them a referral fee. Usually it works well, and I don't mind paying the fee for a client who is ready to buy or sell now.

That's the good. However, referral fees are also territory for abuse, and the practice can leave consumers in the dark about who's paying who.

More leads than home sales

Agents and other industry players "capture" leads so that they can sell them. The internet has made it easier than ever to do so. (Indeed, there are far more leads than there are home sales.)

We get emails and phone calls about leads who are looking for an agent in our market. Apparently, these leads wait patiently for their captor to sell them to an agent. Maybe that's what happened to all the homesellers this year.

Referring agents can become the middlemen that come between middlemen without adding value. The captor adds no value to the transaction; the client remains in the dark, unaware of the exchange.

One improvement: Transparency

Consumers often confuse referrals with recommendations. They may not vet the agent but assume that the referral is a vote of confidence.

The weakest kind of referral, of course, is the lead capture. The person who captured the lead knows nothing about potential clients and whether they're qualified to buy or ready to sell. If the agent who accepts the lead is able to convert him or her into a client, and that client buys or sells real estate and the transaction closes, the referrer expects a fee.

Some of the agents who refer business to me found me on the internet. They don't know me or anything about me. They don't know if I will do a good job. Most of the time they do not know the lead either. They acquired contact information, and they want to get paid for it.

Consumers who click on the wrong link or call the wrong agent may end up paying that agent indirectly as their contact information is given to another agent. I wonder about the people who get captured and sold because they cannot find a Realtor — not finding a real estate agent would take some effort.

The system could be improved by requiring the person making the referral to disclose the fee (and who knows who and how they know each other) to all parties.

In Minnesota, we must disclose who is paying us a commission and how much, but we do not have to disclose how much (or who) we are paying for the business.

The law says that I can only pay licensed brokers for a referral. The first thing I do when a referral comes in is check to see if the person making the referral is licensed and if they are active.

Calls about a ‘business opportunity’

People I don’t know will occasionally call with a “business opportunity.” They want share the name of a person looking to buy or sell a house, and for me to pay for it.

Most agents have heard relocation horror stories from clients. Let’s say Big Box Brokerage (BBB) has a relocation department. BBB refers persons who are relocating to BBB agents. Often, the agents with the least amount of experience will agree because they do not yet have enough business and they need the experience and the money.

BBB takes 40 percent of the new agent’s commission and charges a 35 percent referral fee. The buyers or sellers end up with an inexperienced agent who is working for almost nothing. The consumer ends up with an inexperienced agent tasked with navigating a cross-country relocation.

What consumers have a right to know

We need to do more to educate consumers. They need to understand that if they get referred to an agent, they should interview that agent like they would any other and ask the same questions. They need to understand that in their real estate search, they may get captured and sold, or end up being referred by one agent to another for a fee without ever knowing.

I don’t think leaving contact information on a real estate agent website is wise. I have a hard time understanding why people do it and why they enjoy drip email campaigns and having agents keep in touch with them.

I won’t leave my contact information on any website, and I block advertising campaigns or opt out of them. I am just not lead material.

Helping a homeseller find the perfect agent adds value to the transaction. It is wonderful when a friend or a past client thanks us for introducing them to that amazing agent.

Referring business to others (even if we don’t know them) just because we can add value to our bank accounts could be part of the reason why people don’t trust real estate agents.

Teresa Boardman is a Realtor and broker/owner of [Boardman Realty](#) in St. Paul. She is also the founder of [StPaulRealEstateBlog.com](#).

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RBC INSURANCE REDUCES MERS ON SEG FUNDS

Staff / June 5, 2017

RBC Insurance has reduced management fees by 20 basis points on seven of its balanced segregated funds. The changes are effective June 5, 2017, and are available to all new and existing clients with no restrictions.

	RBC GIF Invest series		RBC GIF series 1		RBC GIF series 2	
	MER before fee reduction (%)	MER after fee reduction (%)	MER before fee reduction (%)	MER after fee reduction (%)	MER before fee reduction (%)	MER after fee reduction (%)
RBC Balanced GIF	2.48	2.25	2.79	2.57	2.97	2.74
RBC Conservative Growth & Income GIF	2.20	1.99	2.46	2.24	2.61	2.38
RBC Balanced Growth & Income GIF	2.41	2.20	2.60	2.39	2.80	2.59
RBC PH&N Monthly Income GIF	2.37	2.15	2.76	2.54	2.88	2.66
RBC Global Balanced GIF	2.48	2.25	2.72	2.51	2.84	2.62
RBC Select Conservative GIF	2.26	2.04	2.64	2.42	2.83	2.61
RBC Select Balanced GIF	2.41	2.19	2.70	2.48	2.89	2.67

Note: The 2016 MERs before fee reduction are the actual MERs for the year ended December 31, 2016. The 2016 MERs after fee reduction recalculate the 2016 MERs as if the new management fee percentages had been in effect

throughout 2016. The MERs for 2017 are expected to be between the 2016 MERs before fee reduction and 2016 MERs after fee reduction, since the reduced management fee percentages will take effect partway into 2017.