[Translation]

Competency, Honesty and Integrity

If we were to replace compliance with Competency, Honesty and Integrity, this would go a long way towards truly protecting the taxpayer.

To do so, we should, first, abolish any sales contests and bonuses associated with attaining a certain sales volume, as well as thoroughly review the compensation of all financial planners and advisors who work in financial institutions.

If offering one product in favour of another enhances month-end and year-end bonuses, how can we be sure that the advisor always has the client's best interest at heart?

In taxing one financial product but not the other, should we also be questioning the integrity of the financial system itself?

What would happen if taxpayers were to pay fees on mutual funds only?

And, is it possible that the compensation of financial security advisors may involve more ethical and transparency problems than that of mutual fund dealer representatives? Over the past few months, we have seen financial security advisors using various schemes to enhance their sales volume.

Have we already experienced a similar problem with mutual funds? So, why is everyone making such a fuss about the compensation of mutual fund representatives and, by extension, fees charged on mutual funds?

Should we review the compensation principle of mutual fund representatives simply because other countries have done so, and because dishonest individuals claim that investors would benefit from additional savings of approximately 2% per year with exchange-traded funds (ETFs) over the long term!

In fact, I believe that any information claiming such benefits from ETFs amounts to false, deceptive and misleading information. What's worse: a potential conflict of interest or misleading people knowingly?

Such false impression that savings could be made from ETFs gave rise to the whole saga of the compensation of mutual fund representatives. However, by doing so, we are overlooking two significantly greater issues.

First, could the majority of taxpayers who invest less than $5,000 per year ultimately be required to pay more for the services of a financial specialist? Second, why do we continue to offer taxpayers the possibility of investing in group retirement plans, registered pension plans (RPPs) and the Québec pension plan (QPP), even though such

investments operate almost exactly in the same manner as mutual funds? The only difference is that the representative's compensation is accounted for as opposed to the salaries and employee benefits of all those who work for the other retirement plans.

What about Sabia's compensation and that of the other officers and employees of these plans? Shouldn't there be a requirement for the actual impact of salaries and benefits to be indicated on their plans' annual returns so that taxpayers can better assess their advisor's worth? And, what if we were to discover that taxpayers could obtain a better return, net of fees, by investing with their mutual fund representative rather than in these plans?

This issue was covered in the August 15, 2012 edition of *Finances et Investissement* in an article titled "*François Legault fait bondir l'industrie* (François Legault shakes up the industry)." On one hand, the *Fédération des travailleurs et travailleuses du Québec* (FTQ) stated in a press release that the QPP charged management fees of 0.8%, while on the other, Joanne De Laurentiis, President and CEO of the Investment Funds Institute of Canada (IFIC), indicated that the distribution fee had been omitted.

"And yet, public pension plans have distribution fees of 105 to 110 basis points. But, there's no mention of this." If it were solely a question of management fees, excluding distribution and administration fees, "I could talk about mutual funds with management fees of 80 basis points," explained Joanne De Laurentiis.

Would it not be wiser to provide help and guidance to taxpayers to ensure the best possible retirement rather than question ourselves about compensation principles?

Regardless of the statistics—be it the average compensation per worker, the number of taxpayers with an income below $50,000, the average or median RRSP or the average amount of investment income—it is easy to determine that the vast majority of taxpayers (close to 80% of the population) are not able to invest more than $5,000 per year. Whether it's a question of a fee-based compensation or a commission, is there any real difference for the average individual? Even with a 5% commission, is $250 per year too much to pay for the services of a specialist?

I would remind you that structures are already in place for the richest investors to pay lower management fees, without having to change anything in the existing regulations.

Do conflicts of interest exist only in the case of mutual fund representatives? What about the compensation of real estate agents and financial security advisors? How is it that a commission averaging $10,000 received by a real estate agent upon the sale of a property be considered reasonable, and $250 received by a mutual fund representative be considered unreasonable? Yet, aren't the work and the competencies required just about equivalent in both cases!

It's one thing to talk about transparency in financial services, but why isn't there better information available about compensation offered to financial security advisors? Could it

be that for equivalent competencies they receive more compensation than mutual fund dealer representatives?

Talking of transparency, how will financial institutions compensate for the loss of commission paid to them through their investment companies? Even if financial institutions have always claimed that their advisors were not paid any commission, they were, however, fully compensated according to the same structure used for independent advisors, in the form of management fees deducted directly from the sale of investment funds and redistributed according to the sales objectives. To ensure fair competition, everyone should adopt the principle of an hourly compensation rate!

However, to get rid of commissions will only negatively affect the accessibility of mutual funds for low-income and middle-class individuals. In fact, all progress made by mutual funds to democratize investment would be wiped out.

Who would want to pay fees to invest in mutual funds, while other types of investments, such as GICs, principal-protected notes and labour-sponsored funds, benefit from an unfair advantage?

Right now, financial planners and advisors are already primarily focusing on the richest investors. Do you really believe that such changes in compensation would offer more service to the less well-off clientele? Surely, the result would be the exact opposite?

An article dated August 16, 2012, written by Ronald McKenzie of Advisor.ca, titled "*Les comptes à honoraires sont plus payants*" (Fee-based accounts are more profitable) says it all. The average income generated is $2,900 compared to $870 for a transactional account.

In all seriousness, who would want to manage clients who invest less than $5,000 per year, or even those who simply want to benefit from the Canada Learning Bond upon opening a registered education savings plan (RESP)? Once the 1% management fee is eliminated, even financial institutions will need to turn towards fees to help pay for their numerous financial planners and advisors. And what of the less well-off clientele? Will they still be able to open an RESP and contribute to their RRSP? Is that why they are now talking about voluntary retirement savings plans (VRSPs) to counter this problem? Only those who believe in Québec's perfect progressive tax structure might view it as an advantage. In fact, much like the imposition of fees, a VRSP would be the worst option for the majority of taxpayers.

With hourly fees of $60, $100 or more, how many people could actually spend time talking about investment, debt, financial and taxation matters with a mutual fund dealer representative? It's all well and good to talk about the importance of financial literacy and education, but who would be there to guide the 78% of taxpayers who earn less than $50,000 per year?

To say that all this would supposedly resolve all conflicts of interest! Let’s be clear, who in the world of finance or in the government has never had to face some kind of conflict of interest? As Desjardins Group’s former president and chief executive officer, Alban d’Amours, clearly said: any person who is compensated for helping another person make more money is in a conflict of interest.

The initial issue of compliance was also viewed as the panacea of all fraud problems. However, several years down the line, would it be true to say that such compliance could have prevented fraudulent activities in the Norbourg, Carole Morinville or Earl Jones cases? On the contrary, compliance has created more problems than it has resolved. Instead of concentrating efforts to improve the advisory aspect, all the focus has remained on a single topic.

While Yves Chartrand and Claude Laferrière have been working on marginal effective tax rates (METRs) since 1999, and while various documents from both governments reveal that they understand the consequences, how can we explain that nothing has been done by either the government or the financial industry to advise people that it is completely false to believe their tax rate will be lower at the time of retirement? Is it because the governments themselves are in a serious conflict of interest in this matter?

Are financial institutions actually acting with integrity and honesty when they produce ‘personalized’ statements, which, in fact, are merely a reproduction of previously published returns? Yet, they are acting in full compliance with the requirements!

Financial planners and advisors who propose maximizing RRSPs, while ignoring the fact that the METR will probably be higher at the time of retirement, may be in compliance with current procedures, but are they actually protecting the financial wealth of their clients in light of the voracious tax system? Moreover, VRSPs and the QPP are up against the same problem. How can we claim that it would be beneficial to invest in such plans when the probability of having a higher level of METR at the time of retirement is very real?

In proposing pooled registered pension plans (PRPPs) and VRSPs, which have the supposed benefits of RRSPs, along with low management fees, and in failing to mention the impact of RRSP withdrawals on 20 or so socio-fiscal measures at the time of retirement, are these wonderful governments truly defending and protecting taxpayers?

And now on to the second issue—believing compensation can resolve all conflicts of interest is just as ridiculous. In my opinion, the simplest way would be to eliminate the 5% deferred sales charges (DSCs). As for penalties associated with breaching a mortgage contract, people are always under the impression that this information had not been previously mentioned to them.

How can we blame advisors for choosing this option? While this method immediately recognizes that the direct and indirect costs of service delivery are higher the first year, it has also proven to be the most advantageous, monetarily, for advisors over time.

And yet, if the amount invested is less than $5,000, this means that all commission methods are, in any case, incapable of paying the advisor's work at its fair value. On average, how many hours need to be spent on discussing investments, tax implications and the various elements of compliance, as well as on completing all the paper work?

I am under the impression that fee changes will more likely incite investors to turn towards ETFs, believing that they will make huge savings. But, as in all other walks of life, it does not mean that just because a product or service costs less to start with that the client will necessarily come out on top!

Nothing can better protect the taxpayer than Competency, Honesty and Integrity. I am not pointing the finger specifically at mutual fund dealer representatives but at the financial industry as a whole. We must learn to re-examine methods, understand the need for certain paradigm shifts in financial services and make the client's profitability a priority. We also need to ensure that more people in the financial industry understand today's tax system and not that of the 1950s.

As Mr. Chartrand clearly explains: "There are so many ramifications and implications on the real burden that tax tables are meaningless …" While the Laferrière-Chartrand curves have been known since 1999, I still question why the financial industry continues to ignore this reality when the marginal tax rate has an impact on all financial decisions. Are we deliberately still allowing the entire industry (financial and fiscal) to use software applications based on the progressive tax principle? Are we willingly steering investors towards more volatile products even though ETFs do not offer any real savings over the long term?

What we need is a 180 turnaround, a real paradigm shift, with regard to the quality of information provided, as opposed to focusing on compensation. Let's stop brandishing around old myths once and for all and get with the current financial and fiscal reality.

So we say, away with maximizing RRSPs, with the progressive tax concept, with the misused rate equivalency, with the famous 150% debt rhetoric, with the supposed benefits of ETFs, PRPPs, VRSPs and the QPP, and of course, away with the false relationship between compliance and taxpayer protection…

Let's get back to what really matters: the taxpayers. Let's stop misleading them to believe that they can do everything themselves… and more cheaply.

Votre clé pour des Finances d'OR. [Your key to the best finance information.]

Jean-François Robert, M.B.A.

Course lecturer (taxation, finance and personal investments)

[Translation]

Column no. 2: Both sides of the coin

Be it food or financial products, advertising seeks to promote the positive aspect only. But, we all know there is nearly always “another side to the coin.”

Just as our greatest strength can also be our greatest weakness, we have to learn to look at both sides of the coin before choosing a product or service.

Financially speaking, it would be difficult to remain oblivious to registered retirement savings plans (RRSPs), tax-free savings accounts (TFSAs) and exchange-traded funds (ETFs) since rarely a day goes by that these products are not mentioned. Without going into excessive detail, I will attempt to give you an idea of the other side of the coin.

In terms of the main financial products, what are the greatest advantages or benefits of RRSPs, TFSAs and ETFs?

I am pretty sure that you would say tax savings for RRSPs, flexibility for TFSAs and low management fees for ETFs. But, what if I were to tell you that these are also their greatest weaknesses?

Let’s begin with RRSPs—a product primarily introduced for retirement savings. Unfortunately, since the fiscal/tax advantages are its main attraction, we all too often see people who want to make withdrawals before the age of retirement to offset a drop in income or to repay debts.

It’s important to understand that making contributions to an RRSP reduces the amount of taxable income, which results in tax savings. However, as soon as a withdrawal is made from an RRSP, the amount of taxable income increases. Of course, you are under the impression that the deduction made by your financial institution is your only loss, but, unfortunately, this is not the case. Each time your income increases, 14 socio-fiscal measures, such as child tax benefits, child assistance and other funding, can transform your RRSP withdrawal into a real nightmare. I have previously seen a case where an RRSP withdrawal of $10,000 represented an actual withdrawal of $1,800. Yes, it’s true—a loss of 82% once tax and socio-fiscal measures were applied!

Never assume if you have minor children that it may be advantageous to withdraw your RRSPs, even if your income has been reduced, unless the amount of your FAMILY INCOME AND RRSP WITHDRAWAL IS LESS THAN $26,000! If you have difficulty resisting the temptation to dip into your RRSP, take a look at last week’s column to better understand the consequences of what’s at stake.

And, how could the flexibility of a TFSA possibly be considered a disadvantage? Because it’s so easy to make withdrawals from a TFSA, instead of seeing through fixed-term goals—such as saving for a trip, a vehicle, or retirement—you end up using it to help pay for an unexpected expense. However, one of the main advantages of a TFSA is the possibility of earning tax-free savings. So, the longer you leave your savings in a TFSA, the more advantageous it will be.

Though it is often claimed that a TFSA is the ideal tool for an emergency fund or a short-term goal, a TFSA is in fact worth considering as a retirement planning tool.

Finally, let’s look at the low management fees of ETFs. Why could this be a disadvantage? First, we have to ask ourselves the right questions. Do we always gain when we buy cheaper products, such as shoes, clothes, knick-knacks or other items? Do we really get our money’s worth when we buy at Dollarama or any other discount store?

Regardless of the type of service—accountant, mechanic, electrician, speech therapist, osteopath—a final decision should never be based solely on cost. It is easy to forget that the immediate cost has very little bearing on the quality of service, care or the final result. What you probably don’t realize is that over the long haul, it is simply not true to suggest that you would have made more money with ETFs!

I could repeat the same exercise with yet more financial products, such as group RRSPs, fixed-rate mortgages, $7 daycare establishments, to name but a few, but I’m sure you have understood the main thrust. Don’t rely on advertising and media to make a wise choice. Yes, all financial products have their advantages, but you need to know when these should be acquired and under what circumstances.

Jean-François Robert, M.B.A
Mutual fund dealer representative
Tax preparer
Course lecturer (taxation, finance and investments)
www.financesdor.com
jean-francois.robert@usherbrooke.ca