SIPA
SMALL INVESTOR PROTECTION ASSOCIATION

A Voice for Small Investors

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CANADIAN SECURITIES ADMINISTRATORS
DISCUSSION PAPER AND REQUEST FOR COMMENT 81-407
MUTUAL FUND FEES
December 13, 2012

Dear Sirs;

We are pleased to submit our comments on CSA Consultation Paper 81-407, Mutual Fund Fees.

The Small Investor Protection Association (SIPA) was founded in 1998 and is registered in Ontario as a national non-profit organization. At that time there were no organizations interested solely in the welfare of investors.

SIPA is pleased to offer our comments on this important issue based in part upon 14 years of interviewing investors who have suffered loss (in some cases extreme loss) due to the failures of the industry and regulators to afford adequate investor protection. Since its founding SIPA has interviewed hundreds of small investors. Most of these investors have brutally frank comments about mutual fund fees and commission structures .

If trailer commissions are to be used to offset the cost of ”services", just what are those services ? The minimum standard, NAAF/KYC suitability process, in itself, is insufficient to properly construct, plan and manage an individual’s portfolio to meet their financial liabilities over time. It is only really sufficient to support product sales on a set of simple parameters, even though the implied service, the one the investor has been led to believe they are often paying for, is not one regulators are willing and able to regulate or enforce. It is the distribution system that must change before the advice business can be considered professional. While the end goal is to raise the bar on advisors , we must first raise the floor.

It would seem natural that an industry that deals with Canadians' life savings, and has the power to cause investors to lose all of their savings, should have a responsibility to come clean on fees. For some inexplicable reason the cost of a product is not considered in the suitability analysis even though fund fees are the major determinant of fund performance and portfolio outcomes In any event, we strongly recommend that fund fees be given more prominence in FUND Facts by listing them before performance . This is entirely consistent with research in behavioural finance. It's also consistent with the NASAA Investor Bill of Rights http://www.nasaa.org/2715/investor-bill-of-rights/: Investors have a right to Receive complete information about commissions, sales charges, maintenance or service charges, transaction or redemption fees, and penalties. Of course, with Fund facts being delivered after the sale, in effect there is no disclosure of these fund fee levels. We recommend that Fund Facts be delivered before or at the time of sale.

It is misleading when the regulators allow the use of the term "Advisor" for representatives that are selling product and are not qualified or registered to provide advice. There is a registration category of "Adviser" for those qualified to give advice, but most investors are not aware of the significance of vowels in the regulatory system. The use of misleading titles is a big issue as it allows salespersons to masquerade as trusted advisers and thus suppress the importance of mutual fund fees and overstate the value of fund fees. Trailer commissions lead to skewed advice because “advisers” are in a deep conflict-of-interest. This misrepresentation especially impacts seniors, retirees and pensioners. According to OBSI 2012 complaint data, 53 % of the people who complain to OBSI are 60 years of age or older (48% in 2012). The major cause of complaints is unsuitable investments and its relative leveraging. A frequent theme of these complaints is that the faith the senior placed in somebody was either unwarranted or somehow violated.

According to the OSC IAP and IEF Report " Strengthening Investor Protection in Ontario - Speaking to Ontarians" http://www.osc.gov.on.ca/documents/en/Investors/iap_20130318_strengthening-investor-protection.pdf significant investor vulnerability prevails – an investor-adviser power imbalance exists for most, but is particularly **problematic for those who lack confidence in their financial literacy:** Ontarian investors lack confidence about their financial literacy – only 11% describe themselves as ‘very confident’. This places advisers in a powerful position. A majority of investors (58%) rely on their financial adviser as their main source of investment information. Thus, a conflict-of-interest could easily lead to investors paying higher fees than if no conflict-of-interest existed. This is why we advocate a statutory fiduciary duty for those dispensing investment or financial advice as well as appropriate proficiency standards. An immediate consequence of this is the prohibition of transaction -tied commissions.

The use of a senior-specific certification or designation by any person in connection with the offer, sale, or purchase of mutual funds, or the provision of advice as to the value of or the advisability of investing in, purchasing, or selling securities, either directly or indirectly or through publications or writings, or by issuing or promulgating analyses or reports relating to securities, that indicates or implies that the user has special certification or training in advising or servicing senior citizens or retirees, in such a way as to mislead any person should be ruled as a dishonest and unethical practice. We urge the CSA to adopt **NASAA MODEL RULE ON THE USE OF SENIOR-SPECIFIC CERTIFICATIONS AND PROFESSIONAL DESIGNATIONS** http://www.nasaa.org/wpcontent/uploads/2011/07/3-Senior_Model_Rule_Adopted.pdf without undue delay or provide rationale why not.

The mutual fund is the investment of choice for Canadians. Over 12 million Canadians own them with a total assets exceeding $800 billion and pay $4.6 billion in trailer commissions. While excessive fund fees can reduce Canadians savings by up to 50% over a lifetime as outlined in recent studies, other widespread practices in the investment industry can also result in Canadians losing all of their savings as well as their homes leaving them destitute and without hope. Excessive leveraging and unsuitable fund choices/asset allocation, driven by sales commissions/grids, are the primary reasons for extreme loss.

While actively-managed mutual fund fees have fallen slightly over time , the Investor Economics report on Fund Costs of Ownership *Mutual Fund MERs and Cost to Customer in Canada: Measurement, Trends and Changing Perspectives*, provides some interesting insights. One indicator is the explosive growth of mutual fund wraps . Fund wraps have captured nearly 80 cents of each dollar flowing into the mutual funds industry between 2007 and 2011.The increased importance of fund wraps which carry a MER premium relative to stand-alone funds (reflecting a higher equity weighting and supposedly expanded value proposition) counteracted the decline in industry asset-weighted MERs. In effect, tasks such as fund selection, portfolio design and rebalancing formerly done by the Rep were delegated to the wrap manager at a higher price. Wraps generally contain house/proprietary funds and so make no attempt to provide best-in-class economical funds. We therefore see no incremental benefit of wraps for the small investor and in fact question whether they are compliant with KYC /suitability rules in many cases. The benefit to the sales Rep of course is more free time to explore fee generating opportunities. We recommend that the CSA investigate and find out exactly what is occurring with Wrap accounts.

We note that low cost products such as F-series funds are not hot sellers. F-series are designed by fund companies for use in fee-based programs and as such do not offer ongoing trailer compensation. The F-series pricing formula represents the “unbundled” version of the traditional A-series, which features embedded advisor compensation. F-series funds are not made available to DIY investors. According to Investor Economics , F-series represent approximately 3% of industry assets, a miniscule amount. The reason of course is the role of trailer commissions (adviser conflict-of-interest) in ensuring that client Best interests are not addressed. We recommend that F series funds be made available to retail investors.

The MER includes a trailer commission for advice; we believe online brokers should not be permitted to sell funds with embedded trailers since these brokerages do not provide investment advice. The CSA should require that F-series or equivalent funds are provided to discount brokers who would then charge a nominal commission for sale/redemption.

The CSA's point on fund cross-subsidization is a valid one. We agree that this subsidization should be eliminated. Accordingly, we recommend that the specific distribution costs incurred by each series or class of mutual fund securities be allocated only to unitholders in that specific series or class rather than be borne equally by all unitholders in the mutual fund.

The referenced Investor Economics research paper refers to an average hold period of 4.5 years. Since mutual funds are long-term (> 10 years) investments we find this strange. From our limited database we conclude that the reason for this is partly due to DSC fund churning whereby Reps can collect a 5% fee up front by buying a new DSC sold fund. In most cases the victims are seniors. Besides costing investors an early redemption fee, such trades could trigger capital gains tax obligations. There may be other reasons as well such as trading within wraps (which also trigger capital gains obligations) but we feel the CSA should research this anomaly to better understand the underlying mechanics of the short average hold period.

It's one thing to carp about high Canadian fund fees but paying high fees for active management and not getting it moves the abuse to the next level. A new study **The Mutual Fund Industry Worldwide: Explicit and Closet Indexing, Fees, and Performance** at http://www.inquire-europe.org/seminars/2012/papers%20Budapest/summary%20Ferreira.pdf finds some aren't being managed as actively as their fees suggest. Dr. Martijn Cremers, professor of finance at the University of Notre Dame, recently examined the 20 largest Canadian funds (excluding ETFs), representing three main categories – Canadian equity, Canadian-focused equity, and Canadian dividend. These categories contain billions of dollars in assets. What he found was nothing short of a revelation: only 2 funds were truly active, while 12 were in what he calls the "closet index" category. The rest were dubbed "moderately active". We recommend that the CSA investigate whether mutual funds companies are in fact delivering active management for the high fees levied or whether the fees are in fact an example of misrepresentation/breach of contract.

Investors pay higher fees for actively-managed mutual funds in the hope of their fund portfolio outperforming passive benchmarks. It therefore follows that regulators should as a corollary require that account dealers provide investors with account statements that reveal personalized performance results. Indeed, the very fact that fees are paid for advice should demand that performance be measured. We therefore recommend that personalized performance reporting (and fee disclosure) be mandated by regulation. Such reporting will assist investors in their decision making , situation analysis and assessment of adviser value-add.

It is apparent that guidelines and best practices with self-regulation are not sufficient in the absence of fiduciary duty to protect investors when they are mislead by misrepresentation and failure of the regulatory system to correct these malpractices.

It is not enough to say that current regulations provide sufficient protection for investors when suitability is considered key but is not well defined. In the words of one compliance officer of a major bank owned brokerage "All of the products on our shelves are suitable."

As an example of this failure of a suitability standard to protect seniors, one senior made a complaint when their account invested totally in equities lost about 70% of its value. A senior officer of the bank owned brokerage wrote a letter to the senior explaining how each of the 27 positions held were "suitable" investments.

The inadequacy of NAAF/KYCs to define an investor's needs and the practice of the industry to leverage investors to maximize assets under management leads to many investors losing all of their savings. It is therefore critical that the CSA compel fund firms to articulate precisely what services are included in trailer commissions (until they are prohibited). Our recommendation is to prohibit embedded trailer commissions altogether and let investors contract for advice separately. Mutual fund fee levels are important but fee structure is even more important.

As an aside, we have found that “advice” on tax matters has actually harmed small investors. The undifferentiated pitching of RRSP's leads to problems when mandatory RRIF withdrawals are required. Ultimately, the withdrawal is treated as taxable income at the time it is taken out, which can have a devastating effect on a senior’s GIS benefit. It is not only subject to tax, it can also reduce GIS at a rate of 50 cents on the dollar. That’s like getting a 20 % refund when making a contribution but being subject to a 70 % tax on withdrawal. After 30-40 years of investing in mutual funds it turns out that all was for naught. It is sales commissions which cause such massive mis-selling.

Investor education, POS disclosure, and other approaches are no replacement for honest, professional advice. Real reform of the mutual fund fee structure is required so that “advice” can be in the investor's Best interests. The mysterious mutual fund maze no longer fits with a connected world that values transparency and fairness.

It is not acceptable to allow continual derailment of initiatives that are meant to improve the investment environment for investors. Given Canadian demographics , we believe the time is NOW for decisive regulatory action on fund fees/structures.

Permission is granted for public posting.

If there any questions do not hesitate to contact SIPA.

We look forward to SIPA's participation in Roundtable discussions on this subject.

Yours truly,

Stan I. Buell
President

REFERENCES

The references and research listed below were used in developing our recommendations

The $25 billion annual mutual fund rip-off
http://cupe.ca/pensions/The_25_billion_annua
A comprehensive study by Canadian pension fund expert Keith Ambachtsheer has found that defined benefit pension plans in Canada achieved annual average returns at least 3.8% higher than mutual funds with comparable investments. Defined Benefit pension funds outperformed the market by 1.23% per year, while mutual funds had average returns that were 2.6% below the market during the 1996 to 2004 period. Returns for most mutual investors were even less than this, as a result of sales fees and consistently poor selection of mutual funds by misinformed investors: buying high and selling low. This means that those with savings in mutual funds lost a total of about $25 billion a year from the higher management fees and lower returns compared to workplace pension funds. Higher management fees are responsible for about $15 billion of this.

Morningstar Research report :Global Fund Investor Experience 2011
http://corporate.morningstar.com/us/documents/ResearchPapers/GlobalFundInvestorExperience2011.pdf "...The story is less happy with Regulation and Taxation. Canada has steep investment taxes that are applied to fund management fees. Although Canada offers fund investors a tax break for capital gains and dividend income, their overall tax bill remains high. Additionally, taxes are levied on the service of fund management. This increases fund expenses. With regulation, Canada restricts competition by not permitting foreign-domiciled funds to register for sale in Canada. Nor does it offer fund investors the protection of a board of directors. **Canada fails for Fees and Expenses. Among the 22 countries in this survey, Canada has the highest annual expense ratios for equity funds, the third highest for bond funds, and tied for the highest for money-market funds. These costs cannot be explained by pointing to unique features of the Canadian fund market. Canada's method for computing fund expenses is the global standard, and its distribution model of financial advisors selling and servicing no-load funds is widely shared (although not by its southern neighbor, the United States)."**

The Pension Fund Advantage: Are Canadians Overpaying Their Mutual Funds? By Rob Bauer Maastricht University and Luc Kicken ,October 1, 2008
Rotman International Journal of Pension Management, Vol. 1, No. 1, Fall 2008
Abstract: The institutional structure through which individuals accumulate retirement savings is an important issue. Ideally, it is expert and low-cost. This article compares the cost-effectiveness of the pension fund structure with the mutual fund structure. The authors hypothesize that the pension fund structure provides investment management services at lower cost because most mutual funds are conflicted between providing good financial results for their clients and good financial results for their shareholders. Specifically, they compare the investment performance of a sample of domestic fixed income portfolios of Canadian pension funds with those of a sample of Canadian fixed income mutual funds. **They find an average**

performance differential of 1.8 percent per annum in favor of pension funds. This performance gap is approximately equal to the average cost differential between the two approaches. They conclude that high mutual fund fees significantly reduce the net returns of mutual fund investors. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1290645

Morningstar research :*How Expense Ratios and Star Ratings Predict Success* If there's anything in the whole world of mutual funds that you can take to the bank, it's that expense ratios help you make a better [purchase] decision. In every single time period and data point tested, low-cost funds beat high-cost funds. To see the results, click here. http://factualfin.com/blog/blog2.php/how-expense-ratios-and-star-ratings-pred In other words, The message here is Fees Count!

Conflict -of- interest part of DNA In "Conflicts of Interest and Competition in the Mutual Fund Industry," Ajay Khorana (Georgia Institute of Technology) and Henri Servaes (London Business School) examine how conflicts-of - interest in the U.S. mutual-fund industry affect competition and investor behaviour (their database covered the period 1979-1998). Overall, their paper "highlights a number of conflicts between fund families and investors," say the authors. For example, they found "no evidence that investors derive any benefit" from annual fees for marketing and distribution (12b-1 fees in the U.S). Furthermore, "fund families generally want to maximize assets under management … and the resulting management fees," an objective at odds with investors' "desire for high risk-adjusted performance at low cost." (U.S. 12b-1 fees are similar to Canada's trailer commissions)

CSA 2012 Investor Index The *Investor Index* also shows that the overall investment knowledge of Canadians is low, with 40 % of Canadians failing a general investment knowledge test. According to the findings, 57 % of Canadians say they are confident when it comes to making investment decisions. Yet most Canadians have unrealistic expectations of market returns. When asked what they think the annual rate of return on the average investment portfolio is today, only 12 % of Canadians gave a realistic estimate, while 29 % provided an unrealistic estimate and 59 % explicitly chose not to hazard a guess. Nearly half of Canadians (49 %) say they have a financial advisor, up from 46 % in 2009 and 42 % in 2006. However, 60 % of those with a financial advisor have not ever completed any form of background check on their advisor. Thirty-one per cent of Canadians say they have a formal written financial plan, up from 25 % in 2009. Although more Canadians have a financial plan, they are reviewing it less frequently (78 % say they reviewed their plan in the past 12 months, down from 83 % in 2009). http://www.securities-administrators.ca/investortools.aspx?id=1011

Risks to Customers from Financial Incentives
http://www.fsa.gov.uk/static/pubs/guidance/gc12-11.pdf [UK FSA] This is an excellent UK regulator document demonstrating how incentives distort advice. After extensive research the FSA found that:

• Most firms did not properly identify how their incentive schemes might encourage staff to mis-sell. This suggests they had not sufficiently thought about the risks to their customers or had turned a blind eye to them.

• Many firms did not understand their own incentive schemes because they were so complex, making it harder to control them.

• Firms did not have enough information about their incentive schemes to understand and manage the risks.

• Most firms relied too much on routine monitoring, rather than risk-based monitoring, such as performing more checks on staff with high sales volumes.

• Some firms had sales managers with a clear conflict- of- interest that was not properly managed.

• Many firms had links to sales quality1 built into their incentive schemes that were ineffective.

• Some firms had not done enough to control the risk of potential mis-selling in face-to-face situations.

Such results have caused the FSA to essentially ban commissions.

Principle 6 of the G20 High Level Principles on Financial Consumer Protection states that "[f]inancial services providers and authorised agents should have as an objective, to work in the **best interest of their customers** and be responsible for upholding financial consumer protection… the **remuneration structure** for staff of both financial services providers and authorised agents **should be designed to encourage responsible business conduct, fair treatment of consumers and to avoid conflicts- of- interest**. [emphasis added]
http://www.oecd.org/regreform/sectors/48892010.pdf

A **2012 OSC IEF study** concluded " ..Two-thirds of investors know little about their advisor when they enter into a relationship with that advisor. Only one-third gets to an advisor through a referral. The most common way to get an advisor is to have one assigned by a bank or financial institution. Investors trust this assigned advisor, because they trust their financial institution to do what is best for them…"]

According to the latest **CFA Institute Global Market Sentiment Survey (2013)** , financial firms have themselves to blame for the lack of public trust in the industry. The survey found that over half of the respondents outside of Canada (56%) believed that the lack of an ethical culture within financial firms was the biggest factor contributing to the current distrust of the financial industry. In Canada that number was slightly higher at 58%.According to the survey participants, one way to regain the public's trust is through the improved enforcement of existing laws and regulations. Globally, 24% of CFA members agreed with this approach. Of the CFA members surveyed in Canada, 27% felt this was one of the best ways to improve investor trust and market integrity. Source:

http://www.cfainstitute.org/about/research/surveys/Pages/global_market_sentiment_survey_2013.aspx

IFIC's 7th Annual Landscape Survey (issued Oct. 3, 2012) asked mutual fund owners to rank mutual funds, GICs, stocks, bonds and ETFs according to how much confidence they have in each product to help them achieve their financial goals. Mutual funds achieved an 80% confidence level compared with 68% for GICs, 59% for bonds, 56% for stocks, and 31% for ETFs. Fund investors also continue to express a strong preference for receiving information about potential fund purchases from their advisor (81%) and for using the advice channel to make their fund purchases (85%). This suggests that regulators should ensure a framework that advice given is in the Best interests of investors.

Mutual fund client statements keep investors in the dark The results from DALBAR's 2012 *Trends and Best Practices in Mutual Fund Statements* demonstrate that the quality of Mutual Fund statements has not shown any improvement since the last study conducted in 2010. Relative to other industries, mutual fund statements do not provide value-added account details that give investors a well-rounded and complete view of their investments. http://www.dalbar.ca/Portals/dalbarca/cache/News//2012%20Press%20Release%20-%20MF%20TBP%20Newswire%20Canada.pdf Better client statements would allow investors the opportunity to track progress and assess the value of advice.

Investor behaviour and beliefs: Advisor relationships and investor decision-making study OSC Investor Education Fund http://www.getsmarteraboutmoney.ca/en/research/Our-research/Documents/2012%20IEF%20Adviser%20relationships%20and%20investor%20decision-making%20study%20FINAL.pdf "..In summary, advisors are the key influence in investor decision-making. Investors rely upon their advisor for planning and asset mix advice, as well as advice on what specific investments to buy. Other sources of information are secondary to the advisor's opinion. Investors trust their advisor to provide advice that benefits the client first. This trust is underpinned by a belief that their advisor has a legal responsibility to 'put the client's best interest first'. With this as a foundation of investor belief, investors find little reason to be concerned about fees, and perhaps as a result, fewer than half of advisors disclose what they are paid..". Another troublesome finding is that disclosure of trailing commissions declines as the age of the investor increases. Some 40% of 20-39 year olds agree that trailing commissions were disclosed versus 24% for age 40-59 and just 18% for those age 60+. This suggests to us that a seniors vulnerability issue has developed.

What Do Consumers' Fund Flows Maximize? Evidence from Their Brokers' Incentives by SUSAN E. K. CHRISTOFFERSEN, RICHARD EVANS, and DAVID K. MUSTO. **ABSTRACT** We ask whether mutual funds' flows reflect the incentives of the brokers intermediating them. The incentives we address are those revealed in statutory filings: the brokers' shares of sales loads and other revenue, and their affiliation with the fund family. We find significant effects of these payments to brokers on funds' inflows, particularly when the brokers are not affiliated. http://onlinelibrary.wiley.com/store/10.1111/j.1540-6261.2012.01798.x/asset/j.1540-

6261.2012.01798.x.pdf?v=1&t=hckxeghx&s=3bcea6c51c751e62a4f9b8a974adf03762dd1e61 February 2013.

90% SALES 10% ADVICE :A SNAPSHOT OF THE FINANCIAL PLANNING INDUSTRY

http://www.industrysupernetwork.com/wp-content/uploads/2011/10/A-snapshot-of-the-financialplanning-industry-110930-1010version.pdf **"**The facts set forth in the report support the position long held by ISN that ongoing commissions and asset-based fees for advice enable planners and dealer groups to earn 'passive' income at the expense of consumers and should be banned, along with all other forms of conflicted remuneration. If ongoing asset-based fees are permitted to continue, credible reform requires that these fees be subject to a regular 'opt-in' mechanism. The ASIC [Australian Securities Commission] report has pulled back the curtain to reveal the extent to which the structure of the financial planning industry impedes planners from being able to act in the best interests of their client. The Future of Financial Advice reforms are essential to restructure this industry to serve the interests of clients, who are relying on advisers to help them save for retirement, build wealth, and otherwise manage their financial lives. However, the financial planning industry has stridently opposed the key aspects of reform legislation that would clean up their industry. The ASIC report makes this opposition easy to understand: this is an industry built around conflicted remuneration and passive income charged to millions of unwary clients (often from their compulsory super) who receive no ongoing services. "

Lessons from proprietary mutual fund returns - Yahoo! Finance Canada
http://ca.finance.yahoo.com/news/lessons-proprietary-mutual-fund-returns-195227448.html

Why Does the Law of One Price Fail? An Experiment on Index Mutual Funds
http://www.ncbi.nlm.nih.gov/pmc/articles/PMC2872995 ABSTRACT : We conduct an experiment to evaluate why individuals invest in high-fee index funds. In our experiments, subjects allocate $10,000 across four S&P 500 index funds and are rewarded for their portfolio's subsequent return. Subjects overwhelmingly fail to minimize fees. We can reject the hypothesis that subjects buy high-fee index funds because of bundled non-portfolio services. Search costs for fees matter, but even when we eliminate these costs, fees are not minimized. Instead, subjects place high weight on annualized returns since inception. Fees paid decrease with financial literacy. Interestingly, subjects who choose high-fee funds sense they are making a mistake.[The composition of their subject pool , college staff/MBA students made it more likely that they would find support for rational theories; given the dismal results it is thus no surprise that ordinary Canadians have trouble figuring out fund fees]

DISCLOSURE IS NECESSARY BUT INSUFFICIENT The mutual fund industry argues that investor education, not regulation, is the way to salvation. This is a diversion. Indeed , a paper by Professor Lauren Willis *Against Financial Literacy Education* argues against too much emphasis on education. The professor believes the day of the informed investor is implausible, given the velocity of change in the financial marketplace, the gulf between current consumer skills and those needed to understand today's complex non-standardized financial products, the

persistence of biases in financial decision making, and the disparity between educators and financial services firms in resources with which to reach consumers. The search for effective financial literacy education should be replaced, the author states, by a search for policies more conducive to good consumer financial outcomes.
http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1105384

Adviser Risk

https://docs.google.com/viewer?a=v&pid=forums&srcid=MDQyNjM4MzIyMTkzMjczODgyNDABMTQxNTYxNzExMTMwMjcyMzE2NzEBV2lUMEYtb1ZrejBKATQBAXYy Trailer commissions are embedded in the management fee rather than shown separately. Many retail investors mistakenly believe there is no cost to buying or owning a mutual fund. They don't grasp the significance of distribution costs on Rep recommendations. Dealer Representatives aren't required to disclose all forms of their compensation, such as trailer commissions, that they earn from clients' fund investments. If mutual fund costs aren't mentioned to clients, they don't become a factor in a client's decision-making. This creates a risk for unsuspecting clients.[Costs deter only one of six investors from buying, according to an Investor Education Fund survey which is a major financial competency problem in itself.]

Do advisors really help reduce the buy high, sell low trap or do they contribute to it?
In their study, "Assessing the Costs and Benefits of Brokers in the Mutual Fund Industry," Daniel Bergstresser (Harvard Business School), John Chalmers (University of Oregon), and Peter Tufano (Harvard Business School) analyze a database of U.S. mutual funds from 1996 to 2004. Their objective was to compare the performance of investors who bought funds through broker-dealers to investors who purchased funds directly. They found that investors with broker-sold mutual funds experienced "lower risk-adjusted returns, even before subtracting distribution costs." They also found that investors purchasing broker-sold funds were directed into funds with "substantially higher fees" and failed to show superior asset allocation. And as for helping investors avoid behavioral biases, "regrettably, the advisers generally demonstrated all the same biases that the rest of us have." Even without this study, one only had to look at how advisors overemphasized technology funds in the late 1990s and how many advisors are overemphasizing energy, gold, and foreign funds today.

Financial Advisor or financial salesperson?
http://retirehappyblog.ca/financial-advisor-or-salesperson/ "One of the big challenges of the financial industry is that most compensation and profits are driven by the sale of financial products like mutual funds and RRSPs. Unfortunately for Canadians, most financial advisors do not get paid to do financial or retirement plans. In fact most financial advisors are not paid for advice. All of their plans and advice are perceived as "FREE"." The Article lists some of the scare tactics used to get clients to invest more.

2010 Advisor Survey Report: Fee vs. Commission Model
http://www.tofeeornottofee.com/2010%20Advisor%20Survey%20Report.pdf The 2010 Advisor

Survey report contains original data collected by *To Fee or Not to Fee* (F2F). The purpose is to provide readers with an overview and comparison of the fee vs. commission financial planner/advisor practice models, which are often improperly contrasted and measured by others. It is also designed to provide benchmarking for the fee model. This is F2F's third time collecting data on the Canadian financial advisor, but first effort at collecting data from commission-based advisors. The important question on minimum asset size is on page 46.

What renders financial advisors less treacherous? – On commissions and reciprocity
https://papers.econ.mpg.de/esi/discussionpapers/2010-036.pdf "An advisor is supposed to recommend a financial product in the best interest of her client. However, the best product for the client may not always be the product yielding the highest commission (paid by product providers) to the advisor. Do advisors nevertheless provide truthful advice? If not, will a voluntary or obligatory payment by a client induce more truthful advice? According to the results, only the voluntary payment reduces the conflict- of-interest posed by advisors.

Do financial advisors improve financial performance? According to Do financial advisors improve portfolio performance?, a study of German investors at Vox by university professors Andreas Hackethal, Michalis Haliassos and Tullio Jappelli. says they don't. The reason is the old bugaboo - costs and fees. Advisors add value but ... "*Even if advisors add value to the account, they collect more in fees and commissions than they contribute.*" Apparently the authors found that richer, older people tend to use advisors more which accounts for a preliminary gross conclusion that "*Investors who delegate portfolio management to a financial advisor achieve on average greater returns, lower risk, lower probabilities of losses and of substantial losses, and greater diversification through investments in mutual funds.*" They note that the financial industry would love to grab that statement for publicity. However, the net truth is completely opposite: "*Once we control for different characteristics of investors using financial advisors, we discover that* ***advisors actually tend to lower returns, raise portfolio risk, increase the probabilities of losses****, and increase trading frequency and portfolio turnover relative to what account owners of given characteristics tend to achieve on their own.*"

Financial Abuse - (this insightful exposition was written several years ago before the IDA morphed into IIROC). Author Andrew Teasdale is an expert on suitability, KYC and portfolio construction)
http://moneymanagedproperly.com/new_folder/rights%20and%20abuse/financial%20abuse.htm **"**

"...Trailer fees: Trailer fees are annual fees paid by a mutual fund company to an investment advisor for recommending the mutual fund. The investor does not need to be told about this even though the money is paid from the investor's own funds. Likewise the advisor has no obligation to do anything for the client to earn these fees. Trailer fees and other referral type fees are an abuse of the client -advisor relationship and, unless these fees are disclosed and used to offset valid and identifiable services performed by the advisor, they increase costs and are detrimental to an individual's financial position. Embedded sales commissions have seriously affected the ability of mutual funds to meet the objectives and needs of clients. Indeed, the benefits of one of the most efficient investment vehicles ever invented have been submerged under the self interests and costs of an industry that has lost sight of its reason for being...." **[** The fact that trailer commissions as a percentage of "adviser" income has risen since 1996 was not known to retail investors .The lack of disclosure added to investor risks and may explain the rapid rise of mutual fund wrap accounts]

Warren Mackenzie Comment letter In this letter Weigh House take a critical view of permitting financial advisers to incorporate http://www.finance.alberta.ca/publications/other/2011-0215-warren-mackenzie.pdf . "**A better option would be to impose a fiduciary relationship which would require that financial advisors put the interest of their (often poorly informed) clients ahead of their own. Starting in 2012 these changes are being implemented in Great Britain and Australia and there is no reason why Alberta could not take leadership and be the first province in Canada to stand up for investors. "**

Mutual Fund Investors: Sharp Enough?
Who are mutual fund investors? The answer is critical to regulatory policy. The mutual fund industry portrays fund investors as diligent, fairly sophisticated, and guided by professional financial advisors. The SEC paints a more cautious portrait of fund investors, though touts improved disclosure by the fund industry as a sufficient antidote. However, an extensive academic literature finds that fund investors are unaware of the basics of their funds, pay insufficient attention to fund costs, and chase past performance despite little evidence that high past fund returns predict future returns. These findings suggest that policymakers should rethink current regulatory policy. Disclosure may not be enough.
http://ideas.repec.org/a/ris/jofitr/0948.html

Out of Sight , Out of Mind: The Effects of Expenses on Mutual Fund Flows
http://faculty.haas.berkeley.edu/odean/papers%20current%20versions/Out%20of%20Signt.pdf
The more opaque the fees , the easier it is to bamboozle retail clients. The paper by Brad Barber, Terrance Odean and Lu Zheng concluded that :"..*We report evidence that mutual fund marketing does work. On average, any negative effect of expense fees on fund flows is more than offset when that money is spent on marketing; non-marketing expenses, however, reduce fund flows. Though [front load] load fees are also spent on marketing, the positive effect of marketing on flows does not appear to be sufficient to offset investors growing awareness of and aversion to loads…" While operating expenses (including embedded trailers) constitute a steady drain on a fund's performance, the effect of that drain is masked by the considerable volatility in the returns on mutual funds…"*

Mutual fund Loads , fees , DSC
http://ssl5.van.ca.securedata.net/canadianmoneysaver.ca/article_retrieve.aspx?article_id=2375
Ken Kivenko

A cross-border perspective on MERs | Morningstar
http://cawidgets.morningstar.ca/ArticleTemplate/ArticleGL.aspx?id=381595 Discusses the US/Canada fund fee differential.

2012 Investment Executive Brokerage Report Card
This chart provides an overview of key advisor statistics

2012 BROKERAGE REPORT CARD

The average investment advisor

	OVERALL		TOP 20%		REMAINING 80%	
	2012	2011	2012	2011	2012	2011
Average						
Size of book ($mil.)	84.9	81.6	169.3	149.1	63.6	64.0
Number of client households	211	212	137	121	230	236
AUM/client household ($)	534,814	522,237	1,343,103	1,339,947	331,451	308,847
% of client account with assets of*						
Less than $100,000	12.9	10.2	4.7	3.6	15.0	11.9
$100,000 to $250,000	17.9	16.4	8.1	8.4	20.3	18.4
$250,000 to $500,000	23.3	24.7	15.9	17.1	25.1	26.6
$500,000 to $1 million	23.0	25.0	27.8	28.0	21.8	24.3
$1 million to $2 million	13.6	14.2	23.1	24.0	11.2	11.7
More than $2 million	9.4	9.4	20.4	18.9	6.6	7.0
Average % of revenue by source*						
Fee for service	1.6	1.6	1.3	0.7	1.7	1.7
Fee/asset-based	49.1	50.1	54.1	54.5	48.1	49.1
Transaction-based	46.8	43.3	40.2	37.0	48.2	44.9
Deal-based	1.8	3.1	2.7	4.0	1.7	2.9
Branch manager override	0.7	1.9	1.7	3.8	0.4	1.4

*NUMBERS MAY NOT ALWAYS TOTAL 100% BECAUSE OF ROUNDING
SOURCE: INVESTMENT EXECUTIVE RESEARCH
INVESTMENT EXECUTIVE CHART

Source of Chart: Investment Executive 2012 Brokerage Report Card

Note that nearly half of investment advisor revenue is derived from transactions and only 1.6 % from fee-based accounts. Just 12.9 % of households have assets totaling less than $100,000 – the average is $535 K. The vast majority (80%) of advisors have 230 client households which means that on average they can expend at most one working day (7.5 hours typically) per client household per year. At say $150.00/hr. the average retail client household should expect to incur annual advice fees of no more than $1125 , give or take. A client household with $535

K in actively-managed mutual fund assets would be charged about $3204 p.a. assuming a 60 bps trailing fee for a balanced portfolio of funds.

The Changing State of Retirement in Canada – Fidelity (Oct. , 2007) http://m.twmg.net/state_of_retirement_cda.pdf A survey of more than 2200 households shows that Canadians are on track to replace only 50% of their pre-retirement income. To maintain a comfortable lifestyle they may need as much as 80% of pre-retirement income. That's one reason that investing fees and robust advice are so important. They can mean the difference between a happy retirement and a very stressful one.

BAD advice on RRSP's leads to investor problems C D Howe Institute-Richard Shillington, "Poverty traps: Means testing and modest income seniors", Backgrounder No.65, April, 2003 (a damning indictment of the current retirement savings system in Canada because of GIS clawbacks & minimum annual withdrawals in RRIF's and their negative impact on lower income people's RRSP's) http://www.cdhowe.org/pdf/backgrounder_65.pdf "*Millions of Canadians accept the homogenous advice of governments and the financial community and put billions into RRSPs. However, for many lower-income Canadians RRSPs are a terrible investment. They are victims of a fraud, however unintentional. Only when more Canadians are aware of the perverse treatment of lower-income citizens' savings will Ottawa be forced to develop measures that reward, rather than punish, their savings efforts.*"

The effect of governance mechanism and structure on fees and performance of Mutual Funds in Canada (2012)
http://dr.library.brocku.ca/bitstream/handle/10464/3998/Brock_Singh_Deepak_2012.pdf?sequence=2

ABSTRACT: Taking advantage of the unique Canadian setting, this study empirically analyzes the impact of presence of the board of directors, as an internal governance mechanism, on fees and performance of mutual funds. Further, the impact of the board structure on fees and performance of corporate class funds is analyzed. We find that corporate class funds, which have a separate board of directors for the fund, charge higher fees; however, they also provide superior performance than trust funds. Furthermore, we find that for corporate class funds, smaller board, with higher percentage of independent directors, and with the fund CEO acting as the chairman of the board is likely to charge lower fees. Also, more independent boards are strongly associated with superior fee-adjusted performance.

Fees intended for active management aren't getting it : It's one thing to carp about high Canadian fund fees but paying high fees for active management and not getting it moves the abuse to the next level. "Actively managed mutual funds are facing a more serious hurdle than the growing popularity of ETFs. A new study finds some aren't being managed as actively as their fees suggest. Dr. Martijn Cremers, professor of finance at the University of Notre Dame, recently examined the 20 largest Canadian funds (excluding ETFs), representing three main categories – Canadian equity, Canadian-focused equity, and Canadian dividend. What he found was nothing short of a revelation: only 2 funds were truly active, while 12 were in what he calls the "closet index" category. The rest were dubbed moderately active". http://www.advisor.ca/investments/market-insights/viks-pick-most-active-funds-arent-really-active-90942 Read the full report **The Mutual Fund Industry Worldwide: Explicit and Closet Indexing, Fees, and Performance** at http://www.inquire-europe.org/seminars/2012/papers%20Budapest/summary%20Ferreira.pdf

Call for expanding CPP is bang on *" ....In a speech at a pension-reform conference in Fredericton, [CIBC CEO Gerry] McCaughey cited new research from CIBC's economics department, which suggests that almost six million Canadians could see their living standards drop by more than 20% in retirement if current savings trends continue and that more than half of today's young workers can expect to see a significant decline in their standard of living when it comes time for them to hang it up.*

More surprising, McCaughey admitted that sacred cows, such as RRSPs and tax-free savings accounts, probably won't enable people to make up the shortfall. Many people don't earn enough to exploit these vehicles fully; and even those who do simply aren't saving enough. What's really needed to fill the gap, he says, is an increase in contributions to the Canada Pension Plan (CPP).Although McCaughey pitched this concept as providing a new choice to Canadians, the true value of such an approach would be to limit choice. Only a public plan can compel higher savings rates by automatically enrolling people to make higher contributions and allowing their natural inertia to keep them invested. By limiting choice, a public plan can prevent people from chasing returns and making silly asset-allocation decisions as a result. Such a plan also ensures economies of scale, which means low-cost money management and no expensive distribution network to fund. This runs counter to what the financial services industry preaches, but McCaughey is correct in saying it." http://www.investmentexecutive.com/-/call-for-expanding-cpp-is-bang-on?redirect=%2Fsearch

Full McCaughey speech "Reigniting a Culture of Savings" National Summit on Pension Reform *Gerry McCaughey, President and CEO, CIBC* February 19, 2013 http://stream1.newswire.ca/media/2013/02/20/20130220_C6850_DOC_EN_23853.pdf Full CIBC Research report at http://research.cibcwm.com/economic_public/download/if_2013-0220.pdf Seems to say that new approaches to retirement savings are required-Bay Street may not offer a good solution for many. Among other things, fees stand out as a critical factor for retirement savings.

Alzheimers, Seniors and Fiduciary duty
http://www.investmentnews.com/article/20130224/REG/302249982?utm_source=issuealert-20130224&utm_medium=in-newsletter&utm_campaign=investmentnews&utm_term=text
Article covers advisor risks. Risks to clients are even greater.

Financial Knowledge and Rationality of Canadian Investors by Cecile Carpentier, Jean-Marc Suret : SSRN "...Canadian investors' financial knowledge is limited. On average, they obtain a mediocre knowledge score; only 5% score above 66%. The vast majority of respondents scored between 40% and 57%. Significant gaps were noted regarding knowledge of risk and return of asset categories. Knowledge of past returns of the main asset categories is abnormally low, particularly for equity, an area where all of the respondents are involved. Mediocre knowledge of the performance of categories and of the concept of risk premium calls into question investors' financial planning ability. One out of five investors is unaware that the return of a small growth company comes not from dividends, but rather from a capital gain. One-third of investors are certain that they will receive future dividends from a company that usually pays them. Almost 30% of respondents are unaware that stock indices are greatly influenced by the returns of the largest capitalization stocks. Three-quarters of investors do not systematically compare the return on their portfolio with that of a stock market index. Half of the investors do not clearly grasp the link between lack of liquidity and share value. Many investors do not know that if they invest in the stocks of small companies listed on the TSX Venture Exchange, they might lose all their capital. The risks associated with shareholding are largely underestimated ....."http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2038930

Mutual Fund MERs and Cost to Customer in Canada: Measurement, Trends and Changing Perspectives by Investor Economics [This report, sponsored by IFIC, is particularly illuminating as it points out many of the issues facing retail mutual fund investors] Mutual Fund MERs and Cost to Customer in Canada: Measurement, Trends and Changing Perspectives*,* We continue to argue that it is the *structure* of the fees that is the dominant issue , not the Canada-US cost differential. The structure causes a irreconcilable conflict-of-interest that is not in the best interests of mutual fund investors or professional advisors.

Strengthening Investor Protection in Ontario - Speaking with Ontarians. The study, conducted on behalf of the independent OSC Investor Advisory Panel and the Investor Education Fund (IEF), explores the views of more than 2,000 Ontario investors regarding their relationships with their financial advisers and how they perceive and use investment product information and advice. Highlights of the study include:

- *While investors generally trust the advice of their financial advisers, two things highlight the skepticism that many investors feel. Only 20% of investors strongly agree that they generally trust their financial adviser's advice and 25% strongly agree (39% agree- 64% overall) that how a financial adviser is paid impacts the recommendations that they receive. Advisers need to give their clients greater assurance that their best interest is being served.*
- *There is strong support for a statutory best interest duty: 93% agree that it is needed (with 59% strongly agreeing that it is needed).*
- *Investors want strengthened regulation of financial advisers, including clearer professional standards on use of the title, rigorous educational requirements and ethics training, and stricter regulatory enforcement of the rules.*

- *An investor/adviser power imbalance exists for most but is particularly problematic for those who lack confidence in their financial literacy. This places advisers in a powerful position. The majority (58%) rely on their financial adviser as their main source of information. More than four in ten do not know how their adviser is being paid.*

Source: http://www.osc.gov.on.ca/en/Investors_nr_20130318_iap-adviser-investor-relationship.htm

Impact of mutual fund fees over time | WhereDoesAllMyMoneyGo.com
http://wheredoesallmymoneygo.com/detailed-breakdown-of-the-real-impact-of-mers-on-an-investment-portfolio-over-time/ Includes a spreadsheet too! Most people do not appreciate how much a 1% difference in fees can erode a nest egg over time. This article makes it real clear.