



**Comment letter on the Canadian Securities Administrators'  
DISCUSSION PAPER ON MUTUAL FUND FEES**

**From  
Steadyhand Investment Funds**

April 12, 2013

The Secretary  
Ontario Securities Commission  
20 Queen Street West, 19th Floor, Box 55  
Toronto, Ontario M5H 3S8  
E-mail: [comments@osc.gov.on.ca](mailto:comments@osc.gov.on.ca)

Me Anne-Marie Beaudoin, Corporate Secretary  
Autorité des marchés financiers  
800, square Victoria, 22e étage  
C.P. 246, tour de la Bourse  
Montréal, Québec H4Z 1G3  
E-mail: [consultation-en-cours@lautorite.qc.ca](mailto:consultation-en-cours@lautorite.qc.ca)

Dear Madam / Sir:

We would like to begin by offering our congratulations to the CSA for publishing a revealing and thorough review of mutual fund fees in Canada. The paper does a good job of explaining current industry practices and illuminating the need for change.

In this submission, we will advocate for significant change. We strongly believe the current structure of mutual fees should be dismantled. The payment for fund management and investment advice should be separated. Dealers, who provide advice to clients, should be left to determine how they will charge for their services.

Below we will provide some background and the reasoning behind our recommendation.

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## An Urgent Need for Change

*“The importance of trailing commissions as a source of revenue for advisors appears to have substantially increased over the years ... in 1996, [they] accounted for slightly more than one quarter of the advisor’s book of business. In 2011, their share is 64%.”*

*“The CSA Study found that ... only one-third of respondents [investors] indicated they were aware of trailing commissions.”*

- The CSA Discussion Paper on Mutual Fund Fees, December 13, 2012

When an investor buys a mutual fund, a large portion of the MER goes towards paying a sales commission and fee for investment advice (91% of mutual fund assets in Canada were acquired and held through channels involving an advisor). But clients don’t know how or how much they’re paying, let alone what services they should expect to receive.

*“Our financial advisor is such a nice man. Every year he takes us out for a wonderful dinner. I wish we could pay him in some way.”*

- Parent of a friend, April 3<sup>rd</sup>, 2013

It follows then that the less investors know about the fees they’re paying, the greater the chance their interests will be subordinated to those of the dealer. There are examples of conflicts of interest throughout the CSA paper. We don’t know the degree to which these misalignments work against the client, but from our understanding of the industry, occurrences are way too common.

*“There are those who know and those who don’t. All the advantages go to people who know.”*

- Glorianne Stromberg

The opacity of mutual fund fees creates an exceedingly wide gap between those who know (investment professionals) and those who don’t (investors). There should be no debate as to whether investors are well enough informed about their mutual funds fees. They’re not.

*“I’m looking to move my account. My advisor is switching me over to what he calls an asset-based fee of 1%. I’m pissed. I didn’t have to pay before.”*

- A prospective client, April 11, 2013

## **New Reporting Requirements Will Help**

As we've said in previous submissions, the biggest step the industry can take towards financial literacy and better client returns is clear and understandable reporting of fees and investment returns. We can try to educate investors about asset mix, security selection, valuation and market cycles, but if we don't link it all back to actual results, we won't get to where we need to be. Meaningful improvements to how investors pay for advice, in combination with the CSA's new rules around fee and performance reporting, will go a long way to providing that link. Canadians will be better investors as a result.

## **What Needs To Be Accomplished**

As the CSA looks at possible solutions, we think it should consider the following factors. Any solution(s) should be:

1. *Simple*. It should be easy for clients to understand.
2. *Transparent*. The fees should be staring the client in the face. Impossible to miss. The client shouldn't have to read regulatory documents or comb over transaction summaries to figure out what they're paying.
3. *A compensation system for advice that's designed and implemented by the people/firms who provide the advice*. Decisions on compensation should be made as close as possible to the point of contact with the client. It's not reasonable to ask the marketing department of a mutual fund company to determine how advisors will charge their clients for advice.
4. *Align the advisor as closely as possible with the client*. Compensation drives behavior. If compensation is based on sales, the client will be sold more products. If compensation is based on advice provided, the client will receive more advice.
5. *Cost effective*. The cost of operating any new structure should be low such that the dealers remain financially viable and clients benefit from lower fees over time.

## **Discontinuing the Current Practice**

We are strongly in favour of dismantling the current structure of mutual fund fees and letting the dealers, who are providing the advice, determine how they will charge for it. With regard to the potential solutions laid out in the 81-407 paper, this is Option vii – *Discontinuing the practice of advisor compensation being set by mutual fund manufacturers*.

We think this solution does the best job of meeting the criteria laid out above. It's simple and has the potential to be transparent. With simplicity will come lower costs.

There will be less opportunity for conflicts of interest between the client and advisor. From a compensation point of view, advisors will be indifferent as to whether their clients invest in bonds or stocks. They won't unduly benefit from switching clients between funds or have any reason to move clients from one fund class to another. Funds won't be purchased for any reason other than the quality of the offering (design, manager and fee) and its suitability for the client.

Separating out the advice charges will encourage mutual fund firms to differentiate themselves in ways that will lead to higher client returns. They will be forced to focus more on service, communication and management fees.

### **Responding To Concerns**

Naturally, there will be resistance to dismantling a system of compensation that's been built up over 25 years. Change is hard. It's uncertain. And the cost of changing over systems and marketing programs will be substantial.

As for cost, we noted above that the cost of operating a simple, understandable system of compensation will likely be less than the current structure. It's also important to remember that the cost of any transition will be one-time in nature. Indeed, it could be argued that now is a good time to invest in change because the industry is about to make systems changes related to the new requirements around fee and performance reporting.

In addition to the transition costs, we asked other fund company executives what the downside would be to discontinuing embedded commissions. In each case, the question was met with deafening silence. The people we queried had difficulty articulating reasons against unbundling. There was really only one substantive issue put forward.

*The current practice of embedding advice in the MER benefits small investors.* Small clients aren't paying nearly enough through their commissions and trailer fees to offset the cost of providing advice, but by charging larger clients too much, it all balances out. As the argument goes, if fund management and advice were charged for separately, small investors would be forced to pay the full cost of advice. They wouldn't be able to afford it and would be forced, or choose, to go without.

It's important to understand what the industry is saying with this argument. First, they're acknowledging that they're not telling people what they're paying and second, they're knowingly creating inequities between clients.

It appears the best argument the mutual fund industry has for keeping embedded commissions is they want to protect the investors who are benefitting from the subsidization and keep the investors who are providing the subsidy in the dark.

And what about the larger investors? The ones doing the subsidizing. Don't they deserve to know that they're overpaying? There is an underlying assumption that smaller mutual fund clients are disadvantaged. It has been our experience that in many cases the larger clients are the ones without a pension. They have less accumulated savings and are less secure in their retirement than many of our smaller clients.

We can't help but point out here that there is scant evidence that the industry even cares about the small investor, since the compensation formulas at most firms incent advisors to cull small accounts from their lists.

### **The Industry will Rise to the Challenge**

Over the last three decades, the wealth management industry has demonstrated a remarkable ability to innovate. It's created products, designed processes, written code and developed marketing plans with lightning speed. The list of examples is long and includes structured products, principal-protected notes, covered-call writing funds, wrap funds, T-series funds and so on. As long as the current subterfuge goes on with mutual fund fees, however, firms have no motivation to change or improve the delivery mechanism for advice.

We are a firm believer that new rules will breed new business models, both within the existing institutions and through the creation of new players. When the CSA levels the playing field between the client and advisor, the innovation machine will switch on and distribution models will be created to fit the new landscape. Perhaps Canada can develop a scalable, world class system for providing service and advice to individual clients.

### **Change with the Client in Mind**

We know the CSA is under intense pressure to stick with the status quo. But while a majority of industry players refuse to acknowledge there's a problem with clients' understanding of mutual fund fees, and is fighting vigorously to maintain the status quo, we encourage the CSA to look

at this issue from the perspective of the individual investor. From where they sit, the current situation is untenable.

But there's a way of investing in mutual funds, and other similar products, that's simpler and more transparent, more cost effective, less subject to conflicts of interest and exclusively promotes the pursuit of better client returns. Canadian investors need us to find that way.

Tom Bradley, President  
Steadyhand Investment Funds

1747 West 3<sup>rd</sup> Avenue  
Vancouver, British Columbia, V6J 1K5  
1-888-888-3147  
[www.steadyhand.com](http://www.steadyhand.com)

### **About Steadyhand Investment Funds**

Steadyhand is an investment company that works exclusively with individual clients. It has a straightforward line-up of mutual funds and offers clear-cut advice and simple tools to assist clients with their asset mix and portfolio strategy. Investors can deal directly with Steadyhand Investment Funds Inc., which is an MFDA dealer, or buy the funds through other dealers.

Steadyhand has offices in Vancouver and Toronto and manages approximately \$265 million on behalf of its clients.