Sage - Winter 2016/17

Learning about the costs of investment performance.

Early in 2017, all securities dealers and portfolio managers registered with any Canadian securities commission will be required to issue a couple of new disclosures which may hold a surprise for you.

As part of an ongoing effort to make the costs (and benefits) of investing clearer to Canadians, the Canadian Security Administrators (CSA) are requiring all investors to receive an annual report from their dealer(s) on

1) the actual performance of your investments during the previous year (in contrast to the annualized individual investment performance); and
2) the amount your dealer received over the previous year in fees, commissions, trailer fees and similar compensation for its role in the success (or otherwise) of your investments and fulfilling the regulatory duties associated with making the investments accessible to you.

The CSA is a nation-wide umbrella organization comprising the Ontario Securities Commission, the Québec Autorité des marchés financiers, and the other eleven provincial and territorial securities regulators. The CSA seeks to harmonize and improve regulations affecting all market participants, and to make a complex environment more transparent for investors. This program is called, somewhat transparently, "Client Relationship Management, Phase 2" or CRM2.

<u>Performance</u>

The usual measure of annual investment performance is a number that expresses the change in value of a fixed dollar amount of a certain investment between January 1 and December 31 of any year. Your personal investments that same year, if not done only on the first day, are certain to be different. This usual measurement, called "**time-weighted rate of return**', is being replaced in the new performance report with a "**dollar-weighted rate of return"** that informs you of the change in value of <u>your investments</u> in any investment account during the year. This includes extra investments, and disbursements/withdrawals in addition to any changes in the market value . You should compare your personal rate of return to the targeted return in your financial plan to ascertain if you are ahead or behind plan. For mutual funds, time weighted returns after costs will continue to be available to contrast your investment performance against benchmarks or other funds with similar objectives.

<u>Compensation</u>

Since we are usually shy to ask about compensation, or might have difficulty following complex compensation structures, the new report makes it easier to understand how much your advisor's firm earns from your investments. Depending on the investment, advisors typically receive a portion of the commissions, up-front payments or trailer fees (ongoing annual payments) that you will only now see detailed in dollars in the new compensation report. The on-going revenues are a percentage of your investment, hence aligning the dealer's and advisor's earnings with the performance of your investments.

The new reports must include all charges paid directly by the client/investor. This includes trade related amounts (front-end loads on purchases, switching in/out or transfer fees, etc.) as well as those ongoing ones mentioned above. Such fees are one thing when expressed as a percentage, but they may be quite large in dollar terms for some accounts, especially when compared to lacklustre (or negative) investment performance.

The average Canadian mutual fund account in 2014 was $44,000, while the average stock brokerage account was $71,000. For accounts consisting of funds with embedded commissions, the average dealer compensation is between 50 to 100 basis points (0.50 % to 1.00%), which is in the range of $225 to $700 annually.The requirement to report fees in dollars is not new for certain types of account expenses, including 'wrap' accounts or 'F' class funds, where fees are negotiated directly by the advisor with the client (typically a fixed percentage), or where these agreed charges are otherwise external to the cost of managing the investment and reported on regular statements.

To prepare the landscape for CRM2, over the past couple of years many investment firms have been adjusting (lowering) management fees for many of their funds, or creating new 'classes' of investments where the cost of fund management is mixed in with other, non-reportable costs. The banks have also been making discovery of investment costs more difficult by offering fund packages, robot advisory services and wrap accounts where total costs to the investor may be higher than they might have been before the reform and the effort to improve transparency. Similarly, some dealers have utilized the opportunity to increase their portion of revenues from investments from the typical 0.50% to 1.00% trailer fees of mutual funds to 1.00% to 1.50% on fee-based accounts.

If you are not certain how to read your new investment performance or dealer compensation reports, don't be shy about asking. Ask your advisor. Ask his/her competition. Ask a professional financial advisor who works for a fixed salary, rather than commissions. Look for an advisor who is alive, and responsive to your financial objective, not a 'robo-advisor' offering a limited choice of pre-packaged options.

<u>A member-centred approach</u>

While some investment firms reimburse some management expenses, especially to make new funds more attractive to investors, one Canadian firm has reimbursed over one million dollars in management expenses over the past three years. It also reimburses trailer fees for its own funds, thereby lowering costs and increasing returns for its investors. That firm is Tradex, an Ottawa-based mutual fund company that also sells a broad range of other mutual funds and savings instruments.

NAFR members are eligible to become members of Tradex — a new NAFR Preferred Partner and Canada's only not for profit dealer exclusively available to past and present members of the public service and their families. Tradex salaried experienced advisors are available to speak with you about your goals and a financial plan that meets your objectives.

***Robert Todd** is a member of NAFR's Ottawa Branch. He retired in 2008 after 35 years service in several departments. He has been a Tradex investor since 1992, and a Tradex Director since 2002.*