MUTUAL FUND MERs AND COST TO CUSTOMER IN CANADA: Measurement, Trends and Changing Perspectives

A study by Investor Economics for The Investment Funds Institute of Canada

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SECTION 1: Introduction

At the end of 1960 there were 65 different mutual funds in Canada with total assets of approximately $608 million. These funds were reported to have “administrative” expenses ranging from 0.23% to 2.30% and “acquisition charges” ranging from zero to 8.5% of the “offering price”.1

As the size and relative importance of the mutual funds industry in Canada has changed significantly in the past 50 years2, so too has the manner in which investors are charged for, and pay for, participating in the mutual funds marketplace. As such, it is now appropriate for an objective and detailed study to be undertaken of the cost of ownership (CoO) of retail mutual funds in Canada.

To this end, and to ensure that investors, advisors, policymakers and regulators have a knowledge base upon which to hold discussions centred on the issue of the cost of ownership, the Investment Funds Institute of Canada (IFIC) has engaged Investor Economics to examine the historic and current cost of acquiring, maintaining and liquidating investments in retail mutual funds. At the same time, and in order to facilitate a proper comparison between costs incurred by investors in the United States and Canada, Strategic Insight has been engaged by IFIC to document the cost of ownership in the United States.

1.1 Report Outline

The analysis is organized as follows. Section 2 is the Executive Summary which is provided to enable readers to develop a clear appreciation for the major elements of the CoO and the associated issues. Section 3 introduces the concept of the cost of ownership and provides brief background information to provide some context for the analysis. Section 4-8 monitors the cost of mutual fund ownership, its key components and the drivers of change. Section 9 adds the distribution channel perspective. Section 10 contains the list of survey participants and outlines the analytical processes used to generate the data presented in this report. A Glossary of Terms used in the study concludes the report.

1.2 Methodology

In order to arrive at an accurate and reliable measurement of the Canadian cost of fund ownership, Investor Economics has constructed a specialized model to measure the following determinants of the aggregated measure:

- Investor acquisition costs
- Ongoing costs
  - Embedded MER

2 At the end of July 2012, total mutual fund assets (including ETFs) were $844 billion. Investor Economics Insight, August 2012, pp 4.
- Unbundled (additional advice fees)

- Disposition costs

- The analysis also considered the following key factors affecting the realized investor cost:
  - Fund asset classes
  - Distribution channels
  - Advice model
  - Product structure
  - Fund series
  - Load structure
  - Holding period

All fund ownership cost measures used in the report have been calculated on an asset-weighted average basis. For details on the construction of the database for this analysis, please refer to the *Methodology* section in the Appendix.

1.3 Resources

In the process of developing the analysis and commentary, extensive use has been made of Investor Economics’ proprietary databases and inventory of industry information. These internal sources include product databases dedicated to stand-alone mutual funds, fund wraps, segregated funds, fund series, trailer fees and fund loads.

During the course of the study, we also made use of proprietary distribution databases that cover full-service brokerage, online/discount brokerage and various other financial distribution channels.

Proprietary data has been supplemented with statistical information by a sample of mutual fund companies active in the Canadian marketplace. Specifically, these firms have provided us with information covering the past five calendar years on the following:

- Redemption fees paid, amounts redeemed and assets at the time of redemption for different load options.
- Front-end fees (paid and waived) and gross sales associated with those fees.

Investor Economics also accessed publicly available information regarding various fund companies, including published annual reports, investment analysts’ reports, corporate websites and fund documents, as well as information obtained from other reliable industry sources.
SECTION 2: Executive Summary

2.1 The Position of Investment Funds in Canadian Financial Wealth

Over the past two decades, Canadian households have shifted their savings focus from one concentrated on bank deposits to one that embraces investment funds that provide access to equity and fixed income markets. By the end of 2011, long-term mutual funds and fund wraps moved their share from 6% at the end of 1990 to 29% in December 2011, with the majority of that share growth taking place in the first ten years of the period. In absolute terms, over the last decade, long-term funds and fund wraps grew from $496 billion in 2001 to $877 billion at the end of 2011.

This period of significant development also witnessed the introduction of a number of competing investment and deposit-based products, as well as new fund-based products, such as mutual fund wraps, which had an impact on the growth of traditional, stand-alone mutual funds. Twenty years ago, stand-alone investment funds accounted for all fee-based assets held by retail investors; the share held by stand-alone funds has since declined to less than one half.

2.2 The Cost of Ownership

The cost of ownership (CoO) of mutual funds is the sum of three distinct elements: acquisition costs, such as front-end load commissions; ongoing costs, both embedded and negotiated; and disposition costs, such as redemption fees. The adoption of the cost of ownership, rather than the management expense ratio (MER), as the most effective way to measure total investment expenses incurred by an investor over the life of an investment permits comparisons to be made between not only investment funds but across a wide range of competing vehicles.

The overall Canadian mutual fund CoO has been relatively stable in recent years although the elements within the CoO have changed significantly. The change in commission, or load, structures and the manner in which commissions are applied, that has taken place in the last two decades and the trend towards embedding the majority of investor costs within the fund MER are two of the major influences on the cost of ownership equation.

In 2011, 98% of mutual fund assets did not attract upfront charges and did not incur disposition costs.

In the 1990s, it is estimated that between 75% and 85% of all fund sales were made up of back-end load units. In recent years (2007 – 2011), there has been a noticeable return to funds carrying a front-end charge, with 71% of all load fund sales being represented by units of this type. Of those sales, however, 98% were effectively sold on a no load basis as no commission was charged at the time of purchase. It is also worth noting that no load funds claimed 69% of total industry gross sales in the same five year period.
2.3 Management Expense Ratio

As a result of the trend towards embedding most costs within the MER, the rate at which the MER is charged to the fund is a fair, albeit not comprehensive, representation of the overall CoO incurred by an investor. Despite the development of approaches to the separation of the cost of investment services from the costs of advice (such as F-series funds), a majority of funds sold in Canada are those in which almost all costs are embedded in the MER.

At the end of 2011, the overall asset-weighted CoO for Canadian mutual funds was 2.10%, a level slightly lower than the 2.14% recorded in 2006. It is the case, however, that increasing use of non-core fund series, such as F-series and D-series, and the overall shift to fee-based services by Canadian investors will lessen the importance of the MER as a cost measurement metric, and emphasize the applicability of the more complete CoO model.

The CoO of mutual funds is not constant across the various product types (including asset class, fund series and fund wraps) and distribution channels that are available to Canadian investors. For example, the average asset-weighted MER for a Canadian bond fund in 2011 was 1.36% compared to that for an international equity fund of 2.44%.

The introduction of unique series of funds, such as F-series and HNW-series, which are becoming more widely used as advisors move away from traditional business models, point to an industry that is aware of, and reacting to, competition from a wide range of financial institutions and instruments. Each unique series is designed to enable advisors to meet the evolving needs of various investor segments. For example, F-series funds are specifically designed to be held in a fee-based account at either a full-service brokerage firm or mutual fund dealer for which a separate charge will be made for advice and planning services. HNW-series, on the other hand, have largely a traditional MER in terms of structure although the client benefits from a discounted fee to reflect the size of the account.

Account size and access to planning and investment advice have a material influence on the MER. Understandably, when the cost of advice is uncoupled from the provision of investment management services, the MER will be lower. This is the case with F-series funds although, to date, it is generally the case that the combination of the MER and the advice fee negotiated between the advisor and the investor has not resulted in discernable savings to the investor.

2.4 Mutual Fund Distribution

The cost of distribution is largely built into the MER, and it is noticeable that during a period when the various major cost components of the MER, such as management fees and operating costs, were trending down, distribution costs represented by trailer fees paid to dealers remained unchanged. In 2011, the average trailer fee paid by long-term funds was 78 basis points, virtually unchanged from the 77 basis points recorded in 2006.
Since 2007, estimated fund company gross revenues, as defined by the asset-weighted MERs and average monthly fund industry assets, have grown at a compound average annual growth rate of 0.95%. Over the same period, the estimated distribution compensation component has expanded at a rate of 2.45%.

Retail investors access mutual funds through a range of distribution channels and the average cost of ownership varies from channel to channel. Canadian investors have the ability to choose between direct channels, such as purchasing directly from the fund manager, and advice channels, such as full-service brokerage. The channels where the average cost of ownership is above the benchmark rate of 2.10%, are the full-service brokerage channel (2.27%) and the financial advisor channel (2.38%). By comparison, the average cost of ownership for funds purchased through a branch-based advisor is 1.89%.

The lowest cost of ownership is achieved by investors who purchase directly from the fund manufacturer. The average cost of ownership for these investors is 86 basis points below the benchmark, although it is the case that the advice provided by the direct-to-public fund manufacturers is not comprehensive and is frequently limited to suitability and other issues required by regulation.

2.5 Conclusions

Up until the mid-1990s, Canadian retail investors had limited product choices and, as such, had only a moderate ability to shape the total costs that they would incur over the life of an investment. Over the past twenty years, there have been significant changes within the three primary participant areas within the mutual fund industry – governments and regulators, manufacturing and distribution.

Changes that have been introduced in recent years, generally as the direct result of a high level of competition rather than regulation, have provided retail investors with the opportunity to better manage and lower their investment costs. The decision by the majority of fund investors to use traditional advice channels in order to benefit from other services, or the need to qualify for certain products through meeting minimum investment guidelines, may have limited the extent to which some cost-saving measures and features have been adopted. The proliferation of no load funds, the growing use of online/discount brokerage firms for fund investments, and the emerging popularity of fee-based accounts, where the cost of advice and account maintenance is separated from the investment management costs, are three examples of options available to investors which may result in lower costs.

Unlike other sectors within the financial services industry, such as retail banking and life insurance, the mutual fund industry has not matured to the point where the marketplace is dominated by a few, very large participants, and where barriers to entry have been raised to limiting heights. Competition, if judged by the number of managers, the number of individual funds and the number of advisors able to sell mutual funds, has remained intense. By enabling this business environment, regulators have allowed the forces of competition to positively influence the cost of investment to
the extent that, despite the increased sophistication of the product, total investment costs have seen a modest decline.

2.6 Outlook

There is no current evidence that points to any future increases in the cost of ownership of mutual funds, other than those cost increases which may be caused through a shift to higher risk investments or investor preference for complex structures, such as those that include performance-driven compensation for fund managers.

As such, as has been the case in other countries, it is likely that economies of scale and competitive pressure will continue to move the costs in favour of the investor.
SECTION 3: Background

3.1 Historical Perspective on Fund Industry Growth

Over the past two decades, the composition of financial assets reported on the Canadian household balance sheet has been transformed through the influence of a number of factors including an aging population needing to supplement conventional pension income with high levels of personal savings. A further influence has been a greater willingness by savers to assume a degree of volatility in the value of their long-term savings. In addition to these demand-driven changes, various regulatory initiatives encouraging the banks and other deposit-takers to enter the retail investment business have had a material impact on the structure and availability of savings and long-term investment instruments.

One result of these changes has been a marked reduction in the use of deposit instruments as the primary vehicles for personal savings. As indicated in Figure 1 (below), despite an absolute increase of $700 billion, the share of personal financial wealth represented by both variable and fixed rate deposits has fallen from 68% in 1990 to 39% in 2011. The leading role in terms of long-term savings has now been taken by individual securities and investments funds which, when combined, have recorded a share increase from 29% in 1990 to 48% in 2011.

The shift to market-sensitive investments, away from those with an administered rate of return, reflects not only regulatory changes but also a period which has been highlighted by declining and persistently low interest rates and a generally positive investment climate. The trend also reflects the impact of the large cohort of the baby-boomers, who entered the accumulation phase of their household financial lifecycle at the beginning of the 1990s.

It is reasonable to suggest that the investment funds industry has been the main beneficiary of these trends, with the industry’s share of financial wealth moving from 6% at the beginning of the period to almost one-third at the end of 2011. In the process, investment funds also became a core savings vehicle within Canadian individual retirement savings. At the end of 2011, investment funds accounted for 42% of assets held in Registered Retirement Savings Plans (RRSPs), up from 31% in 1996.
Figure 1: Composition of Canadian Financial Wallet
Assets in billions of dollars

Figure 2 (below) illustrates the restructuring of the Canadian household financial wallet by monitoring the share of investment funds and deposits since 1990. The main thrust of the shift occurred in the 1990s, with the 2000s decade—and its two bear markets—delivering a slight rebound in the importance of deposits but no further meaningful gains for the share held by investment funds. Since the 2008-2009 market downturn the share of deposits has drifted up, highlighting the risk-averse stance of Canadian households and supporting the idea of an ongoing potential for substitution between the core components of the household financial wealth.
3.2 Expanding Competitive Landscape

The end result of the balance sheet restructuring is that the past 11 years have failed to deliver any significant increase in the penetration of the Canadian wealth portfolio by mutual funds. Since the beginning of the last decade, mutual funds have faced increasing competition from an expanding array of financial products vying for a share of the Canadian household wallet.

Figure 3 (below) expands the competitive view by tracing the relative growth of selected investment products that compete with mutual funds.
Figure 3: Comparing the Growth of Key Investment Products and Services
Indexed to 1999 = 100, assets in billions of dollars

The chart highlights the inroads made by other investment alternatives, such as exchange-traded funds (ETFs) and managed asset solutions, such as fund wraps, during the last decade. Notably, the majority of these offerings were not part of the financial wealth landscape 20 years ago. Having formed the centre of the fee-based asset universe, accounting for 100% of it in 1990, stand-alone funds—those not sold as part of managed asset solutions in which the advisor is not required to construct individual portfolios—have stagnated and their share has eroded to the point that they now account for less than half of fee-based assets.

Figure 4 (below) provides an additional perspective on the competitive environment for mutual funds by identifying the main product categories occupying the Canadian retirement income continuum. The exhibit reveals a still-evolving range of products and solutions targeting the retirement market opportunity.
Figure 4: Retirement Solutions Continuum—2011
Assets in billions of dollars

<table>
<thead>
<tr>
<th>Product Name</th>
<th>Deposits</th>
<th>Investment Funds</th>
<th>Alternative Income Solutions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Principal protected notes (PPNs/PAR)</td>
<td>$21.5</td>
<td>$25.8</td>
<td>—</td>
</tr>
<tr>
<td>Guaranteed Investment Certificate (GIC)</td>
<td>$478.4</td>
<td>$60.5</td>
<td>$17.2</td>
</tr>
<tr>
<td>Guaranteed Investment Account (GIA)</td>
<td>$42.5</td>
<td>$386.0</td>
<td>—</td>
</tr>
<tr>
<td>Payout annuities</td>
<td>$21.8</td>
<td>—</td>
<td>$1.9</td>
</tr>
<tr>
<td>Guaranteed Withdrawal Benefit (GWB)</td>
<td>—</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>Traditional segregated funds</td>
<td>—</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>Mutual funds*</td>
<td>—</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>Mutual funds**</td>
<td>—</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>Home Equity Lines of Credit (HELOC)</td>
<td>—</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>Reverse mortgages**</td>
<td>—</td>
<td>—</td>
<td>—</td>
</tr>
</tbody>
</table>

Product totals: $21.5 + $478.4 + $42.5 + $21.8 + $25.8 + $60.5 + $386.0 + $17.2 + — + $1.9 = $1,055.6

Guaranteed income products

*Mutual funds and exchange traded funds consist of fixed income, income balanced and equity income funds.
**Source: CHIP Home Income Plan.

3.3 Cost of Ownership

This growing competition for the savings dollars of Canadian households highlights the importance of developing a cost of ownership (CoO) framework capable of housing the variant cost elements of a broad range of financial products and solutions.

In the past, the analysis of the CoO of mutual funds in Canada focused almost exclusively on the level of fund management expense ratios (MERs). While this approach has proved useful in assembling cross-fund comparisons, it does not permit a complete and consistent measurement of the costs incurred by Canadian households through the ownership of various financial instruments, including deposits. The reasons include the lack of comparable expense information for some products, the absence of updated/ongoing information regarding their various cost components, the limited transparency of their distributor compensation formulas and the potentially meaningful transaction costs associated with their acquisition and disposition.

Figure 5: Cost of Ownership Framework

The proposed CoO framework outlined in Figure 5 is designed to serve as the basis for informed decisions concerning investor expenses, including those related to public policy and cross-product and cross-border comparisons. The CoO measure takes a holistic view of the customer cost experience by accounting for the transaction costs associated with the acquisition and the disposition of the product as well as the
ongoing costs represented by internal product expenses (embedded costs) as well as any other investor charges levied outside the product itself (unbundled costs). In this way, the CoO model levels the playing field in solving the cost-to-customer equation across a continuum of investment offerings available to savers and investors through a multiplicity of platforms and delivery channels. The CoO approach that is outlined above deals effectively with the majority of investment products where costs to investors (and, consequently, revenue to either manufacturers or distributors) are required to be fully disclosed. It is, however, more difficult to make comparisons between the CoO of mutual funds and deposit instruments where the major revenue component of deposits (the spread between the cost and use of the funds, or net interest margin) is not disclosed by the institution.

3.4 Trends in the Cost of Mutual Fund Ownership

In addition to being a period of rapid growth, the 1990s saw mutual funds progressively transformed from a predominantly commission-based product into a fee-based product. Figure 6 (below) traces the key milestones in the development of costs of mutual fund ownership and confirms the reduction in importance of the transactional fees over the course of the decade.

Figure 6: Evolution of Mutual Fund Cost-to-Customer

In addition to being a period of rapid growth, the 1990s saw mutual funds progressively transformed from a predominantly commission-based product into a fee-based product. Figure 6 (above) traces the key milestones in the development of costs of mutual fund ownership and confirms the reduction in importance of the transactional fees over the course of the decade. Recent years have witnessed further changes to the mutual fund pricing models, as the industry adapted its pricing and product structures to fit the new competitive paradigm.
Figure 7 (below) illustrates the changing environment by indicating the range of currently available fund product types, series and structures, targeting diverse client segments and distribution opportunities. Here, as well, the field is made up of offerings and fund structures that did not exist 20 years ago.

**Figure 7: The Proliferation of Fund Product and Series Structures**

Over the past three decades, the investment fund industry in Canada has witnessed an unprecedented number of changes to what is being offered to retail investors and how those investors access a widening range of investment options. These changes have been driven by a combination of innovation, changes in demand and regulatory and government action. These three drivers are dynamic not static and they will continue to influence the overall direction taken by the industry as well as the various costs incurred by those Canadian savers and investors who use investment funds.

**Key Takeaways — Section 3**

- The share of personal financial wealth held by deposits fell from 68% in 1990 to 39% in 2011.
- Over the same period, the share of investment funds increased from 6% to 31%, establishing them as core savings vehicles and the primary conduit to capital markets for the mass market and mass affluent households.
- Mutual funds face increasing competition from an expanding array of financial products. As a result, the share of personal financial wealth held by mutual funds has not shown a significant increase in recent years.
- The intense competition for the savings of Canadian households highlights the need to develop a comprehensive cost of ownership (CoO) framework able to house the cost elements of a broad range of financial products and solutions to facilitate cross-product and cross-border comparisons.
- The mutual funds industry offers a range of fund products, fund series and fund-based solutions, which reflect the needs of a various client segments and distribution channels.
SECTION 4: Measuring the Mutual Fund Cost of Ownership (CoO) in Canada

Having established the importance of creating and maintaining a comprehensive CoO measurement for the purpose of cross-product and cross-border comparisons, this section presents the results of our ongoing analysis of the cost-to-customer of Canadian mutual funds. The commentary focuses on key forces impacting the composition and the level of the mutual fund CoO in Canada.

Together with the U.S. metrics developed by Strategic Insight, the analytical outputs in Section 4-7 and Section 9, which outlines the cost of mutual fund ownership in key distribution channels, will act as inputs into the comparative analysis of the Canadian and the U.S. mutual fund cost of ownership.

Following the structure of the analytical framework outlined above, Figure 8 identifies the key components of the CoO equation from the perspective of the Canadian mutual fund investor.

Figure 8: Drivers of the Mutual Fund CoO

The costs associated with owning a mutual fund fall into two broad categories: transaction-related costs and ongoing costs. Transaction-related costs represent commission costs associated with the purchase and the disposition of mutual fund units. Fund-specific acquisition costs are front-end load sales commissions, which reflect the point-of-sale charges levied on investors. Disposition costs refer to the fees paid by investors redeeming their back-end load fund holdings prior to the expiry of the redemption schedule. (For detailed definitions, please refer to the Glossary of Terms in Section 10 of this report commencing on page 61)
Over the past 20 years, the importance of transaction-related costs to the overall CoO of mutual funds has declined in line with the significant decrease in the incidence of investors paying upfront sales commissions when purchasing a mutual fund. At the end of 2011, 98% of the mutual fund book of business was held by investors who did not incur any acquisition or disposition costs. As such, the majority of Canadian mutual fund investors do not face any financial penalty should they choose to sell their fund holdings. This is in contrast to other investment vehicles, such as equities or ETFs, which will likely attract acquisition and disposition costs if they are held in commission-based accounts. It is also the case that GICs redeemed prior to maturity attract early redemption penalties.

Ongoing costs include fund-specific embedded costs captured in the fund MER and ongoing service fees levied at the client account level. Other one-time fees may be incurred by investors at the time of purchase and redemption of the fund units as well as during the holding period. Examples of these fees include distributor-defined account opening fees and annual RRSP plan account fees. These fees are generally negligible, with their application being contingent on a number of factors related to the specific circumstances of individual investors, such as their choice of distribution channel, plan provider, advisor business model, type of plan, investment size and investor purchasing power.

Additional cost-to-customer considerations, such as trading expense ratios (TERs) and performance fees are discussed in Section 8.

4.1 Benchmarking the Industry-aggregate CoO

The aggregate benchmark for the CoO of mutual funds in Canada at the end of 2011, expressed as percentage of assets under management, was at 2.10%, a level almost unchanged from the aggregate CoO in 2006 (see Figure 9).

Figure 9: Overall Cost of Mutual Fund Ownership in Canada
Asset-weighted, expressed as a percentage of assets under management

![Bar chart showing CoO comparison between 2006 and 2011](chart.png)

A comparison of CoO across a range of investment alternatives in Figure 10 reflects a variety of potential cost outcomes. In keeping with our CoO model, the exhibit presents three types of investor expenses:
- The product-embedded expenses, such as MERs.
- Fees levied at the client account level that are not part of the product or solution’s internal expenses.
- Transaction costs associated with owning selected investments.

**Figure 10: CoO across Selected Fee-based Products and Managed Asset Solutions**

Alongside the mutual fund cost of ownership, **Figure 10** provides estimates of the cost-to-customer by using an exclusively fund- or exchange-traded fee-based brokerage account. In both cases, the composition of the investor costs is altered by the extraction of the distribution cost component from the fund MER and the replacement of that fee by a negotiated fee levied at the account level. This process (also known as unbundling) does not necessarily translate into significant investor cost efficiencies.

More meaningful investor cost savings are realized when the fee-based brokerage account is populated by low-cost vehicles, such as ETFs or index funds, both of which represent passively-managed strategies as opposed to actively managed. In this case, the account service fees represent two-thirds of the cost-to-customer, while ETF-embedded costs (in the form of the expense ratio) represent one-third of the cost-to-customer.

The two columns on the far right of **Figure 10** above outline the range of costs for investors who use two types of discretionary services offered by qualified full-service brokerage advisors, which are typically targeted at the mass affluent and upscale clientele. The all-inclusive fees shown in the exhibit represent the industry averages for the sample of full-service brokerage firms in the Investor Economics’ database. (For more on our methodology and assumptions, please refer to the Methodology section in the Appendix).

Importantly, the mutual fund CoO reflects the average transactional costs as measured for the entire industry. Meanwhile, the remaining examples featured in the exhibit reflect exclusively fee-based account types, in which investors typically do not incur
transactional fees. However, transactional accounts remain a dominant account structure at online/discount brokerage firms and roughly 45% of the assets administered by full-service brokerage advisors sit in commission-based accounts.

When profiling the cost-to-customer of investments held within transactional-type accounts, the length of the investment holding period and the extent of portfolio turnover are levers affecting individual client cost outcomes. This is particularly true for those investment vehicles that incur transaction fees at the point of entry and exit, such as equities or ETFs held in transaction-based accounts. This consideration is of particular relevance to active traders. For these types of investors, the CoO of a particular investment is driven by the transactional costs associated with the purchase and the disposition of individual securities, as well as the number of transactions occurring in a given period.

**Key Takeaways — Section 4**

- The cost of ownership can be divided into three specific areas: acquisition costs, ongoing costs and disposition costs.
- The aggregate cost of ownership of mutual funds in Canada in 2011 was 2.10% compared to 2.14% five years earlier.
- In fee-based brokerage accounts, the process of unbundling – extraction of the distribution cost component from the fund MER and the replacement of that fee by a negotiated fee levied at the account level – does not necessarily translate into significant investor cost efficiencies.
- For equities and/or ETFs held in transaction-based accounts, the length of the investment holding period and the extent of portfolio turnover impact individual client cost outcomes significantly.
SECTION 5: Acquisition and Disposition Costs

5.1 Mutual Fund Transaction Costs

The marginal change in the Canadian aggregate CoO over the five-year period between 2006 and 2011 belies the longer-term changes in the relative importance of its various components. Our review of the individual cost components begins with an examination of acquisition and disposition costs.

5.2 History of Loads in Canada

The past two decades have witnessed a decline in the importance of the transaction cost component for mutual fund owners.

The limited impact of the sales commissions and redemption fees on the cost-to-customer was not always the norm in the Canadian funds industry. In the 1980s, fund sales were dominated by the front-end load option, which could reach up to 9% of the initial investment.

The back-end, or deferred sales charge (DSC) load option, was introduced in the late 1980s and quickly gained popularity among advisors. The DSC structure replaced the investor-paid sales commission with a fund company-funded advisor payout in the 4%-5% range and an ongoing trailer fee to the advisor at half the rate of the front-end load funds. Investors faced a redemption charge for withdrawals in the first seven or eight years. According to data collected by Investor Economics in the second half of the 1990s, and supported by anecdotal evidence obtained from conversations with industry sales executives over the past two decades, the back-end load fund option accounted for between 75-85% of load fund sales throughout the 1990s.

The shift towards back-end loads exerted a suppressing effect on the level and importance of transactional costs for investors. However, in terms of the overall cost-to-customer, the trend was counteracted by the rise in fund management fees for load funds. The increase in load fund management fees reflected the higher distribution costs associated with the fund companies’ financing of the upfront sales payout to the advisors and the ongoing costs of the trailer compensation. In other words, in the course of the 1990s, the costs associated with compensation of distributors became increasingly internalized—or embedded—within the fund management fees. The impact of the rising costs of distribution on the management fees is difficult to quantify, as the majority of Canadian fund manufacturers opted for a single unit class—and a single management fee—for all load options.

In 1999, the load options expanded with the introduction of a low load option, also known as a short-term deferred sales charge (where the fund company pays the advisor a sales commission ranging from 1%-3%, but the load structure follows an abbreviated redemption schedule).

Completing the Canadian load landscape are no load funds. The emergence of the banks as major participants in the Canadian mutual fund industry has led to a higher
industry weighting of no load funds. In the past five years (2007 through 2011), no load funds accounted for 69% of industry gross sales. No load funds are sold without an initial sales charge and carry no redemption fees other than those fees paid if they are redeemed within 90 days from the date of the initial purchase (similar to funds purchased in the front-end load option).

5.2.1 Evolution of Load Structure Post-2000

Since 2000, a number of the factors listed in Figure 11 have weakened the appeal for back-end load funds. Against the backdrop of sluggish fund sales in the first half of the decade, the intensified competition for savings dollars resulted in advisors increasingly employing the zero front-end load approach (also known as the load-waived approach).

Figure 11: Key Factors Impacting Load Structures

5.2.2 Acquisition Costs

The load-waived approach to new sales is in line with the overarching trend towards greater emphasis by distributors on recurring, fee-based—as opposed to transaction-based—revenues. In this context, the zero front-end load option represents a type of fee-based solution, as it bases the advisor’s and distributor’s compensation on the recurring asset-based compensation in the form of front-end load fund trailers.

The zero front-end load model is now firmly entrenched. Based on sample of data received from eight companies representing 45% of front-end load fund gross sales in 2011, our analysis suggests that the majority of sales into front-end load options are now load-waived. In 2011, 98% of sales of front-end load funds did not incur sales commissions. Of the remaining 2%, investors accounting for 1% of front-end load fund assets paid less than 1% at the point-of-sale, with an average commission of
0.82%. The remaining 1% of assets incurred a sales commission in excess of 1%, with an average of 2.11%. In aggregate, the average commission paid for front-end load purchases that incurred an acquisition cost was 1.42%. This represents an annualized acquisition cost of 0.31% based on our assumed average holding period of 4.5 years (see Figure 13 on page 22).

5.2.3 Disposition Costs

Between 2007 and 2011, front-end load funds accounted for approximately 71% of load fund gross sales (see Figure 12). The traditional back-end load option accounted for 14% and low load funds for the remaining 15%. The low load option has gained sales momentum in recent years, largely at the expense of the traditional back-end load funds. (For explanations of the various load options, please refer to the Glossary of Terms.)

Figure 12: Percentage of Gross Sales by Load Type

The impact of the redemption fees for fund unitholders in the back-end or low load options has been constrained by the lower redemption rates for these load options relative to front-end and no load funds. Also contributing to the low incidence of redemption fees being charged to investors, which is confirmed by the data collected from a sample of 11 load fund manufacturers for the purposes of this project, is the waning importance of back-end load sales and the related mature profile of the existing back-end load fund book of business. This means that a growing share of the asset base is de facto “off schedule”, i.e. has been held past the expiry of the fund redemption schedule.

In 2011, 95.3% of back-end load assets did not incur redemption charges either because they were not redeemed at all or were redeemed after their redemption schedule had expired. For the 4.7% of assets that incurred a redemption fee, the aggregate charge was 1.87%. Recalibrating this average to reflect the various maturities (and the resultant levels of redemption fees paid) of the redeemed back-end load fund holdings and the associated relative redemption fee levels produces an effective average
redemption charge of 0.93% (see Figure 13). This fee becomes the input into our mutual fund CoO model. (For more details please refer to the Methodology section in the Appendix).

The effective disposition fees differ for traditional back-end and low load funds; 4.6% of the assets in the traditional DSC funds incurred, on average, redemption fees of 1.95%. Once adjusted for the holding period, the effective disposition fee was 0.93%. Also, 5.2% of assets held in the low load option redeemed prior to the expiry of the redemption schedule incurred average redemption fees of 1.05%, or 0.86% after the holding period adjustment.

5.2.4 Impact of Acquisition/Disposition Costs on CoO

To arrive at a fully costed annualized CoO measurement, the transactional costs must be considered in the context of the mutual fund holding period. In the case of mutual fund holders who pay either a one-time sales commission at the time of purchase of front-end load mutual fund units or a one-time deferred sales charge on the redemption of back-end load mutual fund units, we have conservatively assumed an average holding period of 4.5 years. This assumption is validated by our long-term tracking of redemption rates for back-end load funds.

Figure 13 summarizes the results of our analysis of the acquisition and disposition components for mutual fund investors in 2011.

Figure 13: Percentage of Industry Assets that Pay Acquisition/Disposition Cost-2011
Fees reported on an asset-weighted basis

The exhibit traces funds purchased and redeemed under the various load options. The analysis suggests that more than 98% of fund assets in 2011 did not incur an acquisition cost in the form of a front-end load sales commission paid by the client to the advisor, and were not charged a disposition cost in the form of a redemption fee. The “no acquisition/no disposition costs” pool captures assets held in no load funds, F-
series funds, front-end load funds sold with a 0% upfront commission (also known as load-waived sales) and back-end load funds (of both the traditional and low load varieties) whose redemption schedules have expired or those back-end load funds still on redemption schedule but not redeemed during 2011, thereby not incurring redemption fees.

Key Takeaways — Section 5

− Over the past 20 years, the importance of transaction-related costs to the overall CoO of mutual funds has declined.
− Costs associated with compensation paid to distributors have become increasingly embedded within fund management fees.
− In the past five years (2007 through 2011), no load funds accounted for 52% of industry gross sales.
− The low load option has gained sales momentum in recent years, largely at the expense of the traditional back-end load funds.
− During the course of 2011, 98% of mutual fund assets held by individual investors did not incur either acquisition or disposition costs.
− To arrive at a fully costed annualized CoO measurement, the transactional costs must be considered in the context of the mutual fund holding period.
SECTION 6: Management Expense Ratios (MERs)

MERs—the ongoing expenses charged to the fund—represented 95.5% of the cost of mutual fund ownership in 2011 (see Figure 14). As discussed earlier, in the 1990s the MER formula became a more relevant indicator of the ultimate cost-to-customer as a result of the lessening importance of mutual fund transaction costs and the practice of incorporating the distributor compensation within the fund management fees. In recent years, the rising importance in the unbundled fund series (F and HNW, and their combinations) for use in fee-based advice models has once again begun to slowly erode the value of MER as a measure of mutual fund cost-to-customer. This trend has been counteracted by the rise in the bank-sponsored no load funds where no transaction fees are charged and where the MER represents the investor CoO.

Figure 14: Percentage of Long-term Mutual Fund Assets for which CoO = MER

6.1 Key Factors Affecting MER Levels

Figure 15: Determinants of MER
Of the factors affecting the level of fund MER identified in Figure 15, the selection of the distribution channel through which mutual funds will be purchased—a decision that reflects the individual client’s desire and/or need for advice—represents a key determinant in the cost of ownership.

Figure 16 analyses the importance of the distribution cost component of the MER for two major asset classes. The analysis focuses on A-series load funds as data on distribution expenses is not readily available for no load funds. (For an explanation of the analytical model used to estimate the distribution component of the MER, please refer to the Methodology section in the Appendix.)

Figure 16: Estimated Cost of Distribution Embedded within MER of A-series Load Funds*

<table>
<thead>
<tr>
<th>Asset-weighted MER</th>
<th>Fixed income</th>
<th>Balanced and equity funds</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2006</td>
<td>2011</td>
</tr>
<tr>
<td>Fixed income</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Distributor</td>
<td>1.18</td>
<td>1.20</td>
</tr>
<tr>
<td>compensation</td>
<td>0.59</td>
<td>0.57</td>
</tr>
<tr>
<td>Other</td>
<td>1.77%</td>
<td>1.77%</td>
</tr>
<tr>
<td>Balanced and equity</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Distributor</td>
<td>1.41</td>
<td>1.44</td>
</tr>
<tr>
<td>compensation</td>
<td>1.00</td>
<td>1.00</td>
</tr>
<tr>
<td>Other</td>
<td>2.41%</td>
<td>2.43%</td>
</tr>
</tbody>
</table>

* Excludes Advisor-series funds offered by no load fund manufacturers

Our analysis of distribution costs, which include an allocation for the trailer fee and the financing of the advisor payout for the back-end and low load fund options, put their share of the average 2011 MER at 31.7% for fixed income funds and 40.9% for balanced and equity. In 2011, the average asset-weighted trailer paid by long-term load funds was approximately 72 basis points, unchanged from 2006.

Stated trailer fee levels have remained virtually unchanged for the past two decades. For front-end load option assets, most equity and balanced funds pay a 1% annual trailer fee to advisors. Fixed income trailers lie in the range of 0.50% to 0.75%, depending on the specific asset class. The trailer fee levels are halved for back-end load purchases (see Figure 17).

Figure 17: Typical Trailer Fees by Load Structure

<table>
<thead>
<tr>
<th>Asset class</th>
<th>Front-end</th>
<th>Back-end</th>
<th>Low load</th>
</tr>
</thead>
<tbody>
<tr>
<td>Canadian bond</td>
<td>0.50%</td>
<td>0.25%</td>
<td>0.25%</td>
</tr>
<tr>
<td>High yield bond</td>
<td>0.75%</td>
<td>0.25%</td>
<td>0.35%</td>
</tr>
<tr>
<td>Canadian balanced</td>
<td>1.00%</td>
<td>0.50%</td>
<td>0.50%</td>
</tr>
<tr>
<td>Equity income</td>
<td>1.00%</td>
<td>0.50%</td>
<td>0.50%</td>
</tr>
<tr>
<td>Canadian equity</td>
<td>1.00%</td>
<td>0.50%</td>
<td>0.50%</td>
</tr>
<tr>
<td>International equity</td>
<td>1.00%</td>
<td>0.50%</td>
<td>0.50%</td>
</tr>
<tr>
<td>U.S. equity</td>
<td>1.00%</td>
<td>0.50%</td>
<td>0.50%</td>
</tr>
</tbody>
</table>
Since 2007, fund company gross revenues as defined by the MERs and fund industry assets have grown at a compound average annual growth rate of 0.95%. Over the same period, the estimated distribution compensation component has expanded at a rate of 2.45%.

6.2 Key Components of Canadian MER

Figure 18 identifies the key components of the Canadian fund MER (for an explanation of the analytical model used to measure the key components of the MER, please refer to the Methodology section in the Appendix.) On average, management fees, which include the distribution component, account for more than three-quarters of the industry-aggregate fund MER. While other components of the CoO have moderated over time, the distribution component of fund management fees has remained virtually unchanged. Beyond compensation for distributors, the fund’s management fees cover portfolio management expenses (which may be outsourced to external sub-advisors), direct and allocated costs associated with marketing and manufacturing of the fund and the fund company profit margin.

Figure 18: Composition of MER—2011

Fund operating expenses and sales taxes on management fees paid by the fund complete the MER model. Operating expenses shown in this exhibit represent the overall average of stand-alone funds and mutual funds of funds.
Figure 19: Operating Expenses by Asset Class

<table>
<thead>
<tr>
<th>Asset class</th>
<th>Operating expenses</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2006</td>
</tr>
<tr>
<td>Stand-alone funds</td>
<td>0.23%</td>
</tr>
<tr>
<td>Fixed income funds</td>
<td>0.13%</td>
</tr>
<tr>
<td>Mortgage</td>
<td>0.25%</td>
</tr>
<tr>
<td>Canadian bond</td>
<td>0.10%</td>
</tr>
<tr>
<td>Foreign bond</td>
<td>0.14%</td>
</tr>
<tr>
<td>High yield bond</td>
<td>0.23%</td>
</tr>
<tr>
<td>Balanced funds</td>
<td>0.19%</td>
</tr>
<tr>
<td>Income balanced</td>
<td>0.15%</td>
</tr>
<tr>
<td>Canadian balanced</td>
<td>0.22%</td>
</tr>
<tr>
<td>International balanced</td>
<td>0.28%</td>
</tr>
<tr>
<td>Equity funds</td>
<td>0.25%</td>
</tr>
<tr>
<td>Equity income</td>
<td>0.24%</td>
</tr>
<tr>
<td>Canadian equity</td>
<td>0.23%</td>
</tr>
<tr>
<td>International equity</td>
<td>0.29%</td>
</tr>
<tr>
<td>U.S. equity</td>
<td>0.22%</td>
</tr>
<tr>
<td>Mutual funds of funds</td>
<td>0.16%</td>
</tr>
</tbody>
</table>

As indicated above, operating expenses account for the costs associated with running the fund, including—but not limited to—unitholder reporting, regulatory filings, recordkeeping, audit, legal and custodial fees, and other charges and costs incurred by the fund.

On average, in 2011 operating expenses contributed 19 basis points (0.19%) to the asset-weighted MERs, accounting for 9% of the 2011 MER metric. With few exceptions, operating expenses, which currently range between 9 basis points (Canadian bond) and 31 basis points (international equity) have recorded a modest decline over the past five years (see Figure 19 above).

In recent years, a number of fund sponsors have fixed the fund administration fees in terms of percentage points to be charged on the fund’s assets. Currently, companies using the fixed administration fee approach account for $400 billion and more than 1,000 funds.

Fixing the administration fee has the potential to achieve greater transparency of fees and their predictability for the retail investor. In exchange for a fixed administration fee, the fund company typically agrees to pay all of the operating expenses of the fund except for expenses related to the independent review committee, regulatory requirements, taxes, borrowing costs and portfolio transaction costs. However, as the fund’s asset base increases, the fixed fee practice may prevent the investor from benefiting from economies of scale realized by the fund manager.
6.3 Key Forces Impacting Change in Level of MER

Figure 20 expands on the conceptual view of the MER drivers with a five-year tracking of asset-weighted average MERs for the various asset classes and product structures. The asset-weighted MER decreased by 4.3 basis points (0.043%) during the period.

Figure 20: Asset-weighted MER by Asset Class

<table>
<thead>
<tr>
<th>Asset class</th>
<th>2006</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Long-term funds</td>
<td>2.12%</td>
<td>2.08%</td>
</tr>
<tr>
<td>Stand-alone funds</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fixed income funds</td>
<td>2.10%</td>
<td>2.06%</td>
</tr>
<tr>
<td>Mortgage</td>
<td>1.48%</td>
<td>1.46%</td>
</tr>
<tr>
<td>Canadian bond</td>
<td>1.39%</td>
<td>1.36%</td>
</tr>
<tr>
<td>Foreign bond</td>
<td>1.77%</td>
<td>1.74%</td>
</tr>
<tr>
<td>High yield bond</td>
<td>1.73%</td>
<td>1.74%</td>
</tr>
<tr>
<td>Balanced funds</td>
<td>2.01%</td>
<td>2.03%</td>
</tr>
<tr>
<td>Income balanced</td>
<td>2.25%</td>
<td>2.24%</td>
</tr>
<tr>
<td>Canadian balanced</td>
<td>2.07%</td>
<td>2.12%</td>
</tr>
<tr>
<td>International balanced</td>
<td>2.40%</td>
<td>2.22%</td>
</tr>
<tr>
<td>Equity funds</td>
<td>2.23%</td>
<td>2.26%</td>
</tr>
<tr>
<td>Equity income</td>
<td>2.07%</td>
<td>2.12%</td>
</tr>
<tr>
<td>Canadian equity</td>
<td>2.24%</td>
<td>2.28%</td>
</tr>
<tr>
<td>International equity</td>
<td>2.38%</td>
<td>2.44%</td>
</tr>
<tr>
<td>U.S. equity</td>
<td>2.06%</td>
<td>2.14%</td>
</tr>
<tr>
<td>Mutual funds of funds</td>
<td>2.27%</td>
<td>2.16%</td>
</tr>
</tbody>
</table>

The changes in MERs were the result of both deliberate action by fund managers as well as a change in the share within the asset class between load and no load funds.

The six sub-sections that follow address the impact of the changes in key factors on the industry-aggregate MER.

6.3.1 Asset mix: shift to fixed income

Of all the MER change drivers, the change in asset mix has had the greatest impact on the industry-aggregate MER. The more risk-averse stance by Canadian households has translated into a greater allocation to fixed income and balanced funds over the last five years. The preference for Canadian funds over those holding non-Canadian assets has also had an impact. Collectively, the asset mix shifts have contributed approximately 10 basis points to the decrease in the asset-weighted MER of long-term funds.

The level of MER varies depending on the fund’s asset class. For example, at year-end 2011, the average asset-weighted MER for fixed income funds was 1.46% compared to 2.03% for balanced and 2.26% for equity funds (see Figure 20). Beyond the prevailing management fee levels, the broad asset class MERs also reflect the changes in the detailed asset class composition of their asset base.
The asset-weighted average MER metrics belie the wide range of individual fund MERs within each asset class, suggesting a range of options – e.g. no load vs. load, actively-vs. passively-managed mandates etc. Figures 21a and 21b below show the dispersion of MERs for A-series funds in the Canadian bond fund and Canadian equity multi-cap categories.

Figure 21a: Canadian Bond Funds MER Dispersion
A-series load and no load, number of funds

![Figure 21a](image)

Figure 21b: Canadian Equity Multi-Cap Funds MER Dispersion
A-series load and no load, number of funds

![Figure 21b](image)

Common themes among low MER outliers in Figures 21a and 21b are fund companies absorbing fees and large funds investing in lower-cost mandates, such as government bonds. Funds included in the high MER outlier group, on the right side of the figures, suffered from significant net redemptions that have caused a significant shrinkage of a given fund’s asset base and the related increase in the expense ratio.
6.3.2 Management Fees

In the past five years, the asset-weighted management fees for 23 detailed asset classes tracked by Investor Economics have declined, while management fees for seven asset classes have increased (see Figure 22 below). At 2011 year-end, the asset-weighted management fees for Canadian bond funds sat at 1.14%, down from 1.20% in 2006; management fees for Canadian balanced funds were 1.84%, down from 1.90%. International equity global funds recorded a decline of 5 basis points.

During the period, 26 fund manufacturers lowered the fund management fees of their funds.

Figure 22: Management Fees for Selected Asset Classes

<table>
<thead>
<tr>
<th>Asset class</th>
<th>2006</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stand-alone funds</td>
<td>1.75%</td>
<td>1.68%</td>
</tr>
<tr>
<td>Fixed income funds</td>
<td>1.26%</td>
<td>1.22%</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mortgage</td>
<td>1.41%</td>
<td>1.43%</td>
</tr>
<tr>
<td>Canadian bond</td>
<td>1.20%</td>
<td>1.14%</td>
</tr>
<tr>
<td>Foreign bond</td>
<td>1.52%</td>
<td>1.41%</td>
</tr>
<tr>
<td>High yield bond</td>
<td>1.39%</td>
<td>1.42%</td>
</tr>
<tr>
<td>Balanced funds</td>
<td>1.70%</td>
<td>1.66%</td>
</tr>
<tr>
<td>Income balanced</td>
<td>1.51%</td>
<td>1.53%</td>
</tr>
<tr>
<td>Canadian balanced</td>
<td>1.90%</td>
<td>1.84%</td>
</tr>
<tr>
<td>International balanced</td>
<td>1.98%</td>
<td>1.74%</td>
</tr>
<tr>
<td>Equity funds</td>
<td>1.84%</td>
<td>1.82%</td>
</tr>
<tr>
<td>Equity income</td>
<td>1.71%</td>
<td>1.72%</td>
</tr>
<tr>
<td>Canadian equity</td>
<td>1.88%</td>
<td>1.87%</td>
</tr>
<tr>
<td>International equity</td>
<td>1.94%</td>
<td>1.90%</td>
</tr>
<tr>
<td>U.S. equity</td>
<td>1.72%</td>
<td>1.74%</td>
</tr>
<tr>
<td>Mutual funds of funds</td>
<td>1.98%</td>
<td>1.80%</td>
</tr>
</tbody>
</table>

6.3.3 Load Structure

Figure 23: Asset-weighted MER by Load Structure

<table>
<thead>
<tr>
<th>Asset class</th>
<th>2006</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Long-term funds</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Load</td>
<td>2.32%</td>
<td>2.24%</td>
</tr>
<tr>
<td>No load</td>
<td>1.90%</td>
<td>1.91%</td>
</tr>
</tbody>
</table>

Another factor impacting the industry-aggregate is the industry’s load structure. MERs for no load funds are typically below those reported by the comparable investment mandates for load funds. Beyond the major Canadian banks, whose funds industry share advanced by 17% between January 2000 and June 2012, other no load fund sponsors include associations and direct sellers. Non-core fund series, such as F-, D- and HNW-series, are also typically distributed in no load format.
6.3.4 Taxes

Canadian mutual fund MERs ratios include taxes that are paid on most of the components of the MER, including management fees and nearly all operating expenses (see Figure 24). Since 1991, the taxes levied on the MER are the federally regulated Goods and Services Tax (GST) as well as provincial sales taxes at varying rates.

The Canadian sales tax landscape as it pertains to mutual funds has undergone changes in the past decade. GST rates declined from the original 7% to 6% in 2006 to 5% in 2008, contributing to a 4 basis point decline in the industry-aggregate MER between 2005 and 2008.

In 2010, British Columbia and Ontario introduced the Harmonized Sales Tax (HST), at rates of 12% and 13%, respectively. The HST is also in place in Newfoundland, Nova Scotia and New Brunswick. This has resulted in raising the effective tax rate on mutual fund management fees to 10%. (The effective tax is an asset-weighted rate based on the geographical distribution of mutual fund assets).

A number of fund companies introduced a separate non-HST series of their funds for unitholders outside of those jurisdictions. However, the majority of fund sponsors employ a blended tax rate (by taking into account the assets held within and outside HST jurisdictions), which is applied all unitholders.

Figure 24: Estimated Tax Component of MER

![Bar Chart]

On average, it is estimated that taxes accounted for one-tenth of the industry-aggregate MER, contributing 0.19% to the mutual fund average asset-weighted MER in 2011, up from 0.13% in 2006.
Key Takeaways — Section 6

− In 2011, the MER represented 95.5% of the cost of mutual fund ownership, down from 96.9% in 2006, reflecting the rise in importance of the unbundled fund series (F and HNW, and their combinations).
− This trend has been offset by the rise in bank-sponsored no load funds where no transaction fees are charged and where the MER represents the CoO.
− The overall asset-weighted MER declined from 2.12% in 2006 to 2.08% in 2011.
− The distribution channel through which funds are purchased—which reflects the need for advice—the asset class, the fund series and the size of the investment are key CoC determinants.
− Trailer fees have been almost unchanged in the past two decades. In 2011, the average asset-weighted trailer fee paid by long-term funds was approximately 78 basis points.
− Fund sponsors representing $400 billion in assets have fixed administration fees in terms of percentage points to be charged on the fund’s assets.
− Factors contributing to a decline in the asset-weighted MER include a shift to fixed income funds, a decline in management fees and increased market share held by no load funds.
− Higher taxes counteracted the decline in asset-weighted MERs.
SECTION 7: Other Factors Affecting the Cost of Ownership of Mutual Funds

Other major factors that have contributed to the change in the overall asset-weighted MER include the expansion of non-core series and the shift to fund wrap solutions.

7.1 Fund Series

The expansion in non-core series which generally feature lower MERs (Figure 25) is also contributing to a reduction in the industry-aggregate MER. The development of multiple fund series has introduced a greater degree of flexibility with respect to investor pricing and advisor compensation options. Series F-, D- and HNW have grown consistently faster than A-series over both the medium- and short-term, yet the overall pool of money in the multi-series structures remains modest at just over 4% of industry assets.

Despite the rapid pace of expansion in the non-core series assets in recent years, A-series funds still make up 95.6% of the industry long-term fund assets which limits the impact of the non-core series on the industry-aggregate MER. Figure 26 monitors the asset base in F-, D-series and HNW-series.

Figure 25: Asset-weighted MER by Series

<table>
<thead>
<tr>
<th>Asset class</th>
<th>2006</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Long-term funds</td>
<td>2.12%</td>
<td>2.08%</td>
</tr>
<tr>
<td>A</td>
<td>2.14%</td>
<td>2.13%</td>
</tr>
<tr>
<td>D (Online)</td>
<td>0.42%</td>
<td>0.91%</td>
</tr>
<tr>
<td>F</td>
<td>1.21%</td>
<td>1.13%</td>
</tr>
<tr>
<td>HNW</td>
<td>1.34%</td>
<td>1.29%</td>
</tr>
</tbody>
</table>

Figure 26: Mutual Fund Assets in Non-core Series
Long-term mutual fund assets, in billions of dollars

A-series: $522.5 in 2006, $570.6 in 2011
The original concept of multi-series design was pioneered in Canada in the early 1990s, but attracted limited attention at the time. The concept was re-introduced to the market in an expanded version in 1999. Today, virtually all mutual fund companies offer multiple series of fund units in order to assist advisors to more accurately customize the financial solutions developed for their clients. The availability of various fund series also enables advisors to retain traditional supplier relationships while, at the same time, changing their business model.

A-series represent the original series of funds and target all distribution channels and types of investors. The non-core series target different types of investors and specific distribution opportunities.

**Figure 27** provides a side-by-side comparison of asset-weighted MERs for F-, D- and HNW-series, with the no load and load versions of A-series.

**Figure 27: MERs by Funds Series for Selected Asset Classes**

<table>
<thead>
<tr>
<th>Asset class</th>
<th>A-series Asset-weighted MER (2011)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Load</td>
</tr>
<tr>
<td><strong>Stand-alone funds</strong></td>
<td></td>
</tr>
<tr>
<td>Canadian bond</td>
<td>1.09%</td>
</tr>
<tr>
<td>Income balanced</td>
<td>1.09%</td>
</tr>
<tr>
<td>Canadian balanced</td>
<td>1.17%</td>
</tr>
<tr>
<td>Equity income</td>
<td>1.20%</td>
</tr>
<tr>
<td>Canadian equity</td>
<td>1.18%</td>
</tr>
<tr>
<td>International equity</td>
<td>1.37%</td>
</tr>
<tr>
<td>U.S. equity</td>
<td>0.96%</td>
</tr>
<tr>
<td><strong>Mutual funds of funds</strong></td>
<td>1.39%</td>
</tr>
</tbody>
</table>

The series capsules below summarize the key characteristics of each series and their cost-to-customer parameters. Additional series, which are excluded from this analysis, address institutional opportunities. For detailed definitions of each series, please refer to the *Glossary of Terms*.

### 7.1.1 F-series

F-series are designed for use in fee-based programs and 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. A total of 1,530 fund products are offered in F-series, 56% more than five years ago. F-series represent approximately 3% of industry assets.

In the 2000s, the F-series funds faced growth challenges, as their original major price concession—or the F-series management fee discount versus the A-series—was not considered a sufficient incentive for advisors to use them in fee-based accounts targeting higher-end clients. In recent years, fund manufacturers have started to reduce F-series management fees, a trend likely accelerated by the growing use of ETFs in fee-based brokerage accounts. At the end of 2011, the asset-weighted MER of F-series was 1.13%, down from 1.21% in 2006 (see **Figure 25**).
As indicated in Figure 28a, F-series growth has accelerated in the past five years, supported by the rapid expansion of fee-based advice models, such as fee-based brokerage (FBB) and discretionary advisor managed (AM) programs. Figure 28b highlights the higher-end nature of investors using these managed account platforms.

**Figure 28a: F-Series Assets Held in Fee-based Programs**
Assets in billions of dollars

![Chart showing F-series assets growth from Dec 2006 to Dec 2011 with CAGR of 15%]

**Figure 28b: Average Account Size**
In thousands of dollars

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2011</th>
<th>Average account minimum</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fee-based brokerage</td>
<td>$275</td>
<td>$225</td>
<td>$100</td>
</tr>
<tr>
<td>Advisor-managed</td>
<td>$400</td>
<td>$360</td>
<td>$200</td>
</tr>
</tbody>
</table>

The overall average CoO for investors holding mutual funds in FBB and AM accounts is estimated at 2.09% in 2011 (see Figure 29 below). Given that the overall mutual fund cost-to-customer in 2011 was 2.10%, and the industry-aggregate MER stood at 2.08%, the analysis provides an empirical foundation for a view that the unbundled fee models have not generally translated into lower investor costs. (For more analysis of unbundled fee models, please see page 50 in Section 9.)
7.1.2 HNW-series

HNW-series target high-end investors and feature a relatively high investment minimum (typically $100,000 or higher) and a discounted management fee. A total of 346 fund products are offered in HNW-series, double the number five years ago. Assets in HNW-series accounted for 1% of the industry total at the end of 2011 and have grown at a 23% CAGR during the past five years.

At 1.29%, the MER of HNW-series is at a marked discount to A-series (see Figure 27 on MERs above) and has exhibited a downtrend since 2006 across most asset classes, likely reflecting the impact of the inroads made by competitive product alternatives, such as ETFs.

7.1.3 D-series

D-series funds are designed for “do-it-yourself investors” operating through online/discount brokerage or ebanking platforms and feature a discounted management fee relative to the A-series version of the same fund. In certain cases, an investment minimum is set significantly higher than for A-series (e.g., at $10,000). A total of 62 fund products are offered in D-series, four times as many as were available five years ago. The series finished 2011 with approximately $2 billion in assets, or 0.3% of the industry total, growing at a compound annual growth rate (CAGR) of 43% in the past five years.

The pricing approach of D-series can be gleaned from the MER discount relative to the corresponding original series (see Figure 27 above). The asset-weighted MER for all D-series funds was 0.91% at December 2011, compared to 1.76% for the A-series for the same group of funds. This lower management fee level is evident across all asset classes in which D-series is offered, with the MER discount ranging from 35% to well over 40%.
7.2 Product Structure: Shift to Pre-assembled Advice Solutions (Fund Wraps)

Reflecting the growing importance of pre-assembled solutions, fund wraps have captured nearly 80 cents of each dollar flowing into the mutual funds industry between 2007 and 2011. Figure 30 monitors the growing importance of fund wraps to the fund industry’s book of business.

Figure 30: Impact of Shift to Fund Wraps
Assets in billions of dollars

As demonstrated by the MER of 2.16%, pre-assembled fund wraps carry an MER premium relative to stand-alone funds. This is a reflection of the distinct fund wrap asset class mix (equities are present in all but the most conservative of portfolio risk profiles) and the expanded value proposition which includes a client risk profiling process, overlay management, portfolio rebalancing and enhanced client and advisor reporting and support. The asset-weighted MER of the fund wrap programs measured in this study (those based on mutual funds) has declined by 0.11% in the past five years.

The MER for an increasing number of fund wraps has been approaching the asset-weighted MER of their underlying fund building blocks. This has resulted in a decrease in fund wrap MERs in the past five years.
Key Takeaways — Section 7

– The development of multiple fund series has introduced a greater degree of flexibility with respect to investor pricing and advisor compensation options.
– F-series growth has accelerated in the past five years in concert with the expansion of fee-based advice models, such as fee-based brokerage and advisor managed programs, and further supported by the reduction of F-series management fees by a number of fund manufacturers.
– Impact of the expansion of non-core series on the industry-aggregate MER is still limited due to the dominating presence of A-series funds.
– Fund wraps have captured nearly 80 cents of each dollar flowing into the mutual funds industry between 2007 and 2011.
– The MER for an increasing number of fund wraps has been approaching the asset-weighted MER of their underlying fund building blocks.
– The increased importance of fund wraps which carry a MER premium relative to stand-alone funds (reflecting a higher equity weighting and expanded value proposition) counteracted the decline in industry asset-weighted MERs.
SECTION 8: Other Investor Cost Considerations

This section addresses two specific cost factors that may impact the overall CoO. One of the factors—performance fees—only impacts investors who hold a position in a relatively small group of funds while the other has universal application to funds with any equity content.

8.1 Performance Fees

Funds that charge performance fees generally seek absolute returns and use hedge fund-like strategies. Strategies commonly employed include short-selling, the use of derivatives (not only as hedging instruments, but also to gain exposure to certain asset classes or investment strategies) and securities lending. Most of these strategies are not available to investment managers of a typical long-only mutual fund.

Because of their distinctive fee structure and limited universe, funds with performance-based fees were not included in our calculation of the industry aggregate MER. At the end of 2011, the 92 funds that charged performance fees collectively held $18.5 billion in assets.

Performance fees permit the investment manager’s compensation to be aligned with fund performance when outperforming a given benchmark, commonly referred to as the hurdle rate. If the fund has beaten the benchmark, the typical performance fee is 10% of the fund’s excess return over the benchmark. This fee is paid directly by the fund and is included in the MER, resulting in a higher expense ratio.

Figure 31a: MER for Funds with Performance Fees

<table>
<thead>
<tr>
<th>Year</th>
<th>MER</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>3.44%</td>
</tr>
<tr>
<td>2007</td>
<td>3.40%</td>
</tr>
<tr>
<td>2008</td>
<td>2.96%</td>
</tr>
<tr>
<td>2009</td>
<td>2.34%</td>
</tr>
<tr>
<td>2010</td>
<td>3.21%</td>
</tr>
<tr>
<td>2011</td>
<td>2.25%</td>
</tr>
</tbody>
</table>

Funds with performance fees may also have a high-water mark (which represents the highest peak in value of the fund) that must be exceeded before performance compensation is available to the manager. There are no downward adjustments in compensation for below-benchmark performance.

The majority of these funds are equity-centric. The asset-weighted MERs of funds that charge performance fees were elevated during the bull market years and during the 2010 market rebound, when managers were able to capitalize on market opportunities. Conversely, the MERs of funds charging a performance fee were largely aligned with
their comparative broad asset class MERs (i.e., non-performance-fee funds) during the 2008-2009 and 2011 market downturns.

Figure 31b: MER of Funds that Charge Performance Fees by Asset Class

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Stand-alone funds</strong></td>
<td>91</td>
<td>3.44%</td>
<td>2.25%</td>
<td>-1.19%</td>
</tr>
<tr>
<td><strong>Fixed income funds</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mortgage</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Canadian bond</td>
<td>4</td>
<td>–</td>
<td>1.07%</td>
<td>N/A</td>
</tr>
<tr>
<td>Foreign bond</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>High yield bond</td>
<td>4</td>
<td>–</td>
<td>1.13%</td>
<td>N/A</td>
</tr>
<tr>
<td><strong>Balanced funds</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income balanced</td>
<td>7</td>
<td>3.40%</td>
<td>2.78%</td>
<td>-0.62%</td>
</tr>
<tr>
<td>Canadian balanced</td>
<td>2</td>
<td>2.63%</td>
<td>1.59%</td>
<td>-1.04%</td>
</tr>
<tr>
<td>International balanced</td>
<td>2</td>
<td>–</td>
<td>3.36%</td>
<td>N/A</td>
</tr>
<tr>
<td><strong>Equity funds</strong></td>
<td>70</td>
<td>3.50%</td>
<td>2.64%</td>
<td>-0.87%</td>
</tr>
<tr>
<td>Equity income</td>
<td>5</td>
<td>2.42%</td>
<td>2.61%</td>
<td>0.18%</td>
</tr>
<tr>
<td>Canadian equity</td>
<td>43</td>
<td>3.66%</td>
<td>2.71%</td>
<td>-0.95%</td>
</tr>
<tr>
<td>International equity</td>
<td>18</td>
<td>3.35%</td>
<td>2.12%</td>
<td>-1.23%</td>
</tr>
<tr>
<td>U.S. equity</td>
<td>4</td>
<td>3.03%</td>
<td>2.76%</td>
<td>-0.28%</td>
</tr>
<tr>
<td><strong>Mutual funds of funds</strong></td>
<td>1</td>
<td>–</td>
<td>2.34%</td>
<td>N/A</td>
</tr>
</tbody>
</table>

Figure 31c: MER Dispersion of Funds that Charge Performance Fees
Total number of funds at 2011

- 72% of assets
8.2 Trading Expense Ratios

Brokerage fees and commissions charged to the fund as a result of trading activity within the portfolio are part of a separate metric known as the trading expense ratio (TER). The TER largely reflects the costs associated with commissions paid for the purchase and sales of equity securities. Fixed income securities are not represented in the TER as the commissions paid to the broker/dealer on the trading of fixed income securities are embedded in the price of the security. (For an explanation of the methodology used to calculate TER, please refer to the Methodology section in the Appendix).

Figure 32a: TER by Year

As illustrated in Figure 32a above, the aggregate industry level TERs ranged from a low of 0.12% in 2006 to a high of 0.16% in 2009, likely a reflection of the bear market and the subsequent volatility. Since then, industry-aggregate TERs have decreased although they have remained above 2006-2007 levels. While each fund employs unique trading tactics, the majority of funds report a TER of less than 30 basis points.

Figure 32b: Industry TER Dispersion
Total number of funds
SECTION 9: Comparison of Mutual Fund CoO by Distribution Channel

Figure 33 highlights our estimates of the cost of mutual fund ownership by distribution channel and advice model. The narrative provides an in-depth look at our methodology, data sources and assumptions used to arrive at the channel-aggregate measures.

Figure 33: Mutual Fund CoO by Distribution Channel

9.1 Overview of Mutual Fund Distribution

Retail investors access mutual funds through a wide array of distribution channels. Figure 34 charts the absolute dollar magnitude and recent growth of long-term mutual funds in each retail distribution channel. (For a detailed description of each channel, please refer to the Glossary of Terms.) The advice channels are responsible for the majority of mutual fund assets in Canada. However, it is the case that access to certain advice channels, such as full-service brokerage, and/or specific products offered may be limited through minimum account size requirements.

Figure 34 (below) also provides an additional perspective by tracing the relative importance of mutual funds to each channel. The financial advisor channel is the largest single conduit for the delivery of mutual funds, and also the one in which mutual funds constitute the highest weighting in the book of business.
Figure 34: Long-term Mutual Fund Asset Trend by Distribution Channel
Assets in billions of dollars

<table>
<thead>
<tr>
<th>Channel</th>
<th>2006</th>
<th>2011</th>
<th>5-yr CAGR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Branch direct</td>
<td>$81</td>
<td>$96</td>
<td>3.4%</td>
</tr>
<tr>
<td>Online/discount brokerage</td>
<td>$20</td>
<td>$21</td>
<td>0.6%</td>
</tr>
<tr>
<td>Direct-to-public</td>
<td>$28</td>
<td>$28</td>
<td>-0.2%</td>
</tr>
<tr>
<td>Branch advice</td>
<td>$101</td>
<td>$148</td>
<td>7.8%</td>
</tr>
<tr>
<td>Financial advisors</td>
<td>$263</td>
<td>$235</td>
<td>-2.2%</td>
</tr>
<tr>
<td>Full-service brokerage</td>
<td>$138</td>
<td>$168</td>
<td>4.0%</td>
</tr>
</tbody>
</table>

### Share of mutual fund assets of total AUA within each channel (2006-2011)

<table>
<thead>
<tr>
<th>Channel</th>
<th>2006</th>
<th>2011</th>
<th>5-yr CAGR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Branch direct</td>
<td>12%</td>
<td>12%</td>
<td>87%</td>
</tr>
<tr>
<td>Online/discount brokerage</td>
<td>12%</td>
<td>9%</td>
<td>78%</td>
</tr>
<tr>
<td>Direct-to-public</td>
<td>87%</td>
<td>78%</td>
<td>45%</td>
</tr>
<tr>
<td>Branch advice</td>
<td>45%</td>
<td>47%</td>
<td>69%</td>
</tr>
<tr>
<td>Financial advisors</td>
<td>69%</td>
<td>61%</td>
<td>20%</td>
</tr>
<tr>
<td>Full-service brokerage</td>
<td>20%</td>
<td>21%</td>
<td></td>
</tr>
</tbody>
</table>

In the full-service and online/discount brokerage channels, mutual funds are but one component of an open architecture shelf that includes a broad array of investment products and services. These include individual equities and bonds, cash and deposits, alternative fund products (such as ETFs) and, in the case of the full-service brokerage channel, insurance products and non-discretionary and discretionary managed asset programs.

In the deposit-takers' branch-based channels (branch direct and branch advice), mutual funds and mutual fund wraps co-exist with deposits issued by the parent deposit-taker. In the branch advice channel, mutual funds comprise nearly half of the total client assets under administration (AUA). In the branch direct channel, 11% of the assets are held in mutual funds.

At the end of 2011, total mutual fund assets purchased through branch direct and branch advice sales forces totalled $244 billion, an amount greater than assets held through financial advisors ($235 billion), and considerably more than fund assets held in accounts at full-service brokers ($168 billion). It is evident that the major banks will exert increasing influence over all aspects of the CoO of mutual funds in Canada. It is also worth noting that several banks have begun to build a presence in the mutual fund...
advice channels outside their branch networks, which could result in their influence extending beyond the confines of their proprietary networks.

9.2 Channel Analysis

The overall mutual fund CoO for a specific channel is a reflection of the mix of load structures, the asset class mix of fund holdings and the availability of alternatively priced account structures. The channel capsules below summarize our analysis and identify the key factors impacting the cost of owning mutual funds in each channel.

9.2.1 Branch-based Channels: Mutual Fund CoO in Branch Direct Channel

The branch direct channel is made up of personal banking officers and other employees with similar responsibilities. If appropriately registered, they initiate mutual fund transactions at the request of customers and provide limited advice. The channel’s share of mutual fund assets was 14% at the end of 2011.

Figure 35: Mutual Fund CoO in Branch Direct Channel

The branch direct channel is exclusively focused on proprietary mutual funds. Additionally, it differs from the branch advice channel in that the share of total mutual funds held in mutual fund wraps, while still relatively high, is lower than that of the branch advice channel (33% versus 50%). This difference in mix is evident in the slightly lower cost of ownership. However, the relative importance of funds through this channel is heavily diluted by the channel’s primary focus on deposits.
9.2.2 Mutual Fund CoO in Online/Discount Brokerage Channel

The online/discount brokerage channel delivers investment products and associated services through centrally managed technology platforms. The channel’s share of mutual fund assets was 3% at the end of 2011.

Figure 36: Mutual Fund CoO in Online/Discount Brokerage Channel

While the online/discount brokerage firms offer fewer avenues to hold mutual funds than the full-service brokerage channel, there are a number of options that impact the CoO. Front-end load, back-end load and no load mutual funds can all be held or transferred into and purchased within an online/discount brokerage account. Most online/discount brokerages have allowed the purchase of front-end load mutual funds with a zero front-end load since the late 1990s. As a result, the load-waived FEL sales option has become the dominant load structure in the channel. Bank-sponsored and independent investment counselor no load funds are also available in the channel.

Online Mutual Funds

Most major online/discount brokerage firms offer mutual funds without trading commissions. However, there are some exceptions. Some distributors charge a trading commission on certain fund families (generally no load.) Online/discount brokerages also apply distributor-based, short-term trading fees, which are defined at the end of this section.

Exclusive Series

Three online/discount brokerages offer a special series of mutual funds (E- or D-series of bank-sponsored mutual funds) featuring a lower MER relative to the A-series versions of the same funds. These special series—designated D-series in our nomenclature (please see the Glossary of Terms for the full definition and description in Section 5)—currently make up one-tenth of total mutual fund assets in the online/discount brokerage channel.
9.2.3 Mutual Fund Cost of Ownership in Direct-to-public Channel

The direct-to-public channel is represented by a small group of firms that includes private investment counsellors and other specialist firms. The channel’s share of mutual fund assets was 4% at the end of 2011.

**Figure 37: Mutual Fund Cost of Ownership in Direct-to-public Channel**

The direct-to-public channel is, by definition, exclusively focused on proprietary funds. The distinction with the proprietary mutual fund focus of the branch direct channel is that these proprietary funds are generally distributed solely through the manufacturers’ direct-to-public sales process. With no acquisition or disposition costs, the CoO is simply the MER that these funds carry. The singular distribution focus helps contain the MER levels. However, as in other distribution channels, MERs are variable on a manufacturer-by-manufacturer basis.

The largest fund complexes in this channel also charge the lowest MERs among participants and serve to keep the channel’s asset-weighted MER low. Additionally, in aggregate, the direct-to-public channel has a significantly higher fixed income weighting than the mutual fund business of other channels, which also reduces the overall level of the asset-weighted average MER.
9.2.4 Branch-based Channels: Mutual Fund CoO in Branch Advice Channel

The branch advice channel is a creation of the major banks and credit unions where 13,500 in-branch advisors are engaged primarily in the provision of investment and financial planning and activities associated with the implementation of those plans. The channel’s share of mutual fund assets was 21% at the end of 2011.

Figure 38: Mutual Fund CoO in Branch Advice Channel

![Diagram showing the calculation of CoO in the branch advice channel]

The branch advice channels of the deposit-takers are varied in their regulatory approach. The presence of IIROC platforms in the channel allows for a broader mix of investments including third-party mutual funds. A number of branch advice organizations have allowed third-party funds on their shelf. However, the channel remains primarily focused on no load proprietary mutual funds and deposits. The relatively significant weighting in deposits represents the biggest departure from the full-service brokerage and financial advisor channels. The branch advice channel is also a significant distributor of packaged mutual fund solutions, i.e. fund wraps.

For the majority of no load mutual fund holdings (apart from those firms that may have some third-party funds on the platform), the CoO is represented by the fund MER. As with other channels, this is an asset class-driven cost weighted by the mix of asset classes in the channel. The channel’s focus on mutual fund wraps is germane to the weighting exercise and has been reflected in the weighted cost for the channel.
9.2.5 Mutual Fund CoO in Financial Advisor Channel

The financial advisor channel consists of commission- or fee-based advisors that offer financial planning, third-party/proprietary investment funds and insurance services. The channel’s share of mutual fund assets was 34% at the end of 2011.

Figure 39: Mutual Fund CoO in Financial Advisor Channel

The cost of mutual fund ownership in the financial advisor channel closely resembles the stand-alone component of mutual funds in the full-service brokerage channel. The cost elements are the same. One of the key differences of the channel, and the practices of its advisors, is that it is largely aimed at the mass market and the mass affluent client segments, in contrast to the higher-end focus of the full-service brokerage channel. Unbundled pricing models, such as fee-based accounts, are generally less frequently offered. This is evident in the mix of load structures within the financial advisor channel, which shows a higher share of assets under the DSC structure than in the full-service brokerage channel. Additionally, the financial advisor channel has a higher weighting of equity mutual funds than the full-service brokerage channel.
9.2.6 Mutual Fund CoO in Full-service Brokerage Channel

The full-service brokerage channel is made up of IIROC member firms that have client-facing advisors with a retail offering of directly-held securities and fee-based managed asset solutions, including discretionary management. The channel’s share of mutual fund assets was 24% at the end of 2011.

**Figure 40: Mutual Fund CoO in Full-service Brokerage Channel**

As indicated in Figure 40, mutual funds can be held within the full-service brokerage channel in several ways, reflecting both the choice of the investor and the practice model of the advisor. Mutual funds can be held within a transaction account in which all the previously described load structures are available, or as a component within a fee-based program in which the client pays a fee based on the average of all assets held in the program.

**Figure 41** highlights the growing importance of fee-based solutions by tracking the current asset levels and recent growth rates for the fee-based programs that can hold individual securities and mutual funds. These programs are the non-discretionary fee-based brokerage (FBB), discretionary advisor managed (AM), separately managed wraps (accounts) (SMW) and in-house managed wraps (IHMW). The investment minimums for these programs range from $100,000 to $500,000.
Mutual Funds in Fee-based Brokerage Accounts

Mutual funds held in an FBB or AM program are subject to an asset-based fee. The preferred distributor option is to use F-series mutual funds. A number of full-service brokerage firms permit A-series holdings of load mutual funds to be transferred into an FBB or AM program as part of the process of converting transactional holdings into a fee-based program. In such cases, the A-series series mutual fund holding are treated as non-billable assets. As a result, they do not incur the program fee.

With respect to new sales, generally only F-series mutual funds are allowed to be held in the program account unless a given fund is not available in this series. Conversion of A-series load fund assets to F-series is encouraged and in several programs this conversion must take place within a specified period. (For more discussion on series of mutual funds, please refer to page 33 in Section 7.)

Fee-based Pricing Structures

Fee-based brokerage fee structures fall into two broad categories: blended pricing and asset class-based pricing.

The blended model, increasingly the pricing model of choice, applies a tiered approach to fee determination regardless of the specific asset and product allocation within the
account. Figure 42 presents the asset tiers and the corresponding range of fees across the full-service brokerage firms for FBB programs. This approach allows the advisor to negotiate the pricing of the fee-based relationship and separate it from the asset mix recommendation. All assets except those designated as non-billable are treated equally from a fee perspective.

Figure 42: Fee Schedules

<table>
<thead>
<tr>
<th>Portfolio size ($ thousands)</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Mid-point</th>
<th>Trades*</th>
</tr>
</thead>
<tbody>
<tr>
<td>$100 to $250</td>
<td>1.50% - 2.25%</td>
<td>2.00% - 2.75%</td>
<td>1.75% - 2.50%</td>
<td>15 to 100</td>
</tr>
<tr>
<td>Average</td>
<td>1.72%</td>
<td>2.44%</td>
<td>2.08%</td>
<td>35</td>
</tr>
<tr>
<td>$250 to $500</td>
<td>1.00% - 1.75%</td>
<td>1.50% - 2.25%</td>
<td>1.38% - 2.00%</td>
<td>35 to 100</td>
</tr>
<tr>
<td>Average</td>
<td>1.33%</td>
<td>2.03%</td>
<td>1.68%</td>
<td>50</td>
</tr>
<tr>
<td>$500 to $1,000</td>
<td>0.75% - 1.25%</td>
<td>1.50% - 2.00%</td>
<td>1.25% - 1.63%</td>
<td>45 to 100</td>
</tr>
<tr>
<td>Average</td>
<td>1.05%</td>
<td>1.88%</td>
<td>1.46%</td>
<td>75</td>
</tr>
<tr>
<td>$1,000 to $2,000</td>
<td>0.50% - 1.00%</td>
<td>1.25% - 2.00%</td>
<td>1.00% - 1.50%</td>
<td>65 to 225</td>
</tr>
<tr>
<td>Average</td>
<td>0.89%</td>
<td>1.64%</td>
<td>1.27%</td>
<td>140</td>
</tr>
<tr>
<td>$2,000 to $5,000</td>
<td>0.50% - 0.85%</td>
<td>1.25% - 2.00%</td>
<td>1.00% - 1.38%</td>
<td>Negotiable</td>
</tr>
<tr>
<td>Average</td>
<td>0.73%</td>
<td>1.56%</td>
<td>1.14%</td>
<td></td>
</tr>
</tbody>
</table>

*Trades reflect the range and median trade ceiling level for each balance range and excludes programs with no limits.

By contrast, the asset class-based models vary in terms of the number of specific asset classes that can be priced separately. The most prevalent models distinguish equity and fixed income, although others distinguish cash, fixed income, equities and mutual funds. ETF distinction is available, though it is rare. If the asset-class based approach is selected, the individual asset class prices are still determined based on the overall value of the portfolio. For example, $10,000 F-series mutual funds in a $300,000 FBB account would be charged a lower fee than $100,000 F-series mutual funds held in a $150,000 FBB account on the same asset class-based pricing platform.

Figure 43 (below) presents the overall FBB and AM fees computed for the programs belonging to the Big Six bank-owned, full-service brokerage firms and six other firms. The annualized rates are asset-weighted and are derived from detailed revenue and asset reporting by managed asset products for each of the 12 firms.
Role of Discounting

Brokerage firms generally provide a minimum/maximum fee range for each asset tier. Advisors are often free to price an account within that range. If pricing occurs at the minimum, firms do not view this as discounting. There appears to be near-universal pricing movement towards or at the scheduled minimums for a given asset tier.

Discounting below the minimum for a specific asset level requires various levels of approval (branch manager, regional, national sales) and will result in a range of payout treatments on the discounted fee. This treatment could see the advisor and the firm share the discount via the grid mechanism or could see the advisor absorb the entire cost of the discount in terms of payout.

Excess Trading Commission

FBB programs typically specify trade ceilings, with the trades in excess of the ceiling incurring a commission. Excess trading commissions typically range from just under $100 per excess trade to $150 per trade, but can be higher. FBB accounts hitting the trade ceiling are rare and the overall impact on cost is immaterial. Excess trading commissions are included in the computation of the overall FBB and AM fees presented in Figure 43.

The number of free trades increases with account size (see Figure 42). However, FBB program sponsors do not consider that a large volume of free trades to be an important value proposition of the program. Mutual fund trades within the FBB program are usually counted as a full trade and as such, if that trade crosses the threshold, there is an excess trading commission charged.

All FBB programs with trade ceilings have a generous allotment of time-limited, set-up trades that do not count towards the threshold and do not add to the cost of conversion from transactional to fee-based accounts.
9.3 Other Cost Considerations

Beyond the four key cost drivers, other costs—primarily one-time costs or annual fees—may be applied to mutual fund holdings and transactions across distribution channels. These fees fall into two broad categories: Administration and transaction fees.

9.3.1 Account administration fees

These fees are associated with the custodial and administrative costs related to registered accounts. Mutual fund registered accounts, which are set up within the various registered specimen plans of the fund’s manufacturer, rarely charge an administration fee. However, on full-service or online/discount platforms or on third-party self-directed platforms which are used in the financial advisor channel, annual administration fees may apply. The fees are incurred at the account level and do not apply specifically to mutual funds. The fees range from $50-$75 per annum for a typical self-directed TFSA or RESP to $125 to $150 per annum for a self-directed RRSP, RIF, LIRA, LIF, LRIF, LRSP etc. Fees for multiple registered accounts, e.g. an RRSP or a LIRA, are usually discounted by 50% for additional accounts. Fees may also be waived depending on the assets under administration, particularly in the online and full-service brokerage channels.

9.3.2 Account transaction fees

These include fees for closing an account and deregistering a self-directed plan by withdrawing all the assets in a plan or transferring all the assets to a competing institution’s plan (either in-kind or proceeds). These fees are typically between $100 and $135, with transfer to a competing institution more costly than de-registration. Fees for partial withdrawals from a registered plan are typically $25.

9.3.3 Mutual fund transaction fees

Short-term trading fees established by the manufacturer (STTF) come into play on all mutual funds (excluding money market) on trades made within a specified time frame after purchase. Periods vary from seven to 90 days. The STTF is determined as a percentage of the trade and ranges from 1% to 2% of the redemption value.

Short-term trading fees are also charged by distributors in the online/discount brokerage channel when mutual funds are traded within 30 to 90 days of the original purchase. These are in addition to any STTFs charged by the fund company, and are generally in the range of 1% of the redemption value or $45 per trade, whichever is greater. Fees can also be charged on the purchase of no load funds by distributors in the full-service brokerage or the financial advisor channels at up to $75 per purchase.

The application of these administration fees occurs at the broad self-directed account level rather than the individual product level. Additionally, the application of the fees at a fixed annual amount can be waived depending on the size of the account or the relationship. Similarly, the short-term trading activity targeted by STTFs and the no
load purchase of mutual funds in intermediated advice channels are not behaviours representative of the majority of mutual fund investors.

### Key Takeaways — Section 9

- Canadian investors can access mutual funds through a variety of direct and advice channels.
- The CoO varies between the various distribution channels reflecting the differences in the value proposition and extent of advice.
- The cost of owning a mutual fund through either a financial advisor or full-service broker is above the average CoO.
- Mutual funds can be held in a transaction-based account or within a fee-based program.
- Fee-based programs are increasingly popular within the brokerage channel but have attracted little attention in the financial advisor channel.
- Access to most fee-based programs is limited to individuals with minimum investments of $100,000.
- Most online/discount brokerages have allowed the purchase of front-end load mutual funds with a zero front-end load since the late 1990s.
- Special series of funds structured for the online/discount channel are available at some online/discount brokerage firms (D-series). The MER of these funds is lower than the original series of the funds.
SECTION 10: Conclusion

An increasing number of Canadian households rely on mutual funds to provide a safe haven for their savings, be they for some future purchase or, more importantly, for the funding of their retirement. As individuals become increasingly responsible for the accumulation and management of retirement assets, it is expected that mutual funds and fund-based solutions will play a critical role in both individual and institutional pension programs. As a result, the issue of obtaining value for the cost of investment has become increasingly important to investors, partly as a reflection of the low interest rates and the low and uncertain rates of return which have been experienced in recent years.

Opportunities to lower costs

Up until the mid-1990s, Canadian retail investors had limited product choices and, as such, had only a moderate ability to shape the total costs that they would incur over the life of an investment. Over the past twenty years, there has been significant change in the three primary participant areas within the mutual fund industry – government, through regulation and taxation; manufacturing, through the development and management of products; and, distribution, through the expansion of both direct and advice channels.

The changes that have been introduced, as the result of competition rather than regulation, have provided retail investors with the opportunity to better manage and lower their investment costs. However, the decision to use advice channels by a high percentage of investors has limited the extent to which various cost-saving measures have been adopted. The proliferation of no load funds, the growing use of online/discount brokerage firms and the growing popularity of fee-based accounts, where the cost of advice and account maintenance is separated from the investment management costs, are examples of the choices available to investors which can lead to a lower cost of ownership.

A competitive business environment

Unlike other sectors within the financial services industry, such as retail banking and life insurance, the mutual fund industry has not matured to the point where the marketplace is dominated by a few, very large participants, and where barriers to entry have been raised to limiting heights. Competition, if judged by the number of managers, the number of individual funds and the number of advisors able to sell mutual funds, has remained intense and there is no immediate prospect that this situation will change.

By enabling this open business environment, those responsible for the maintenance of an orderly market for retail investment services have allowed competition to positively influence the cost of investment to the extent that, despite the increased sophistication of the product, total investment costs have seen a modest decline. It
is also apparent that, unlike in the United States, distribution costs, in the form of trailer fees paid to advisors by fund companies and fees negotiated directly between investor and advisor, have not been as overtly influenced by competition as have manufacturing costs.

**Lower costs have led to gain in share**

Distribution channels that provide access to mutual funds at lower than industry average cost are gaining share over channels that have been slower to adapt to the changing demands of the investor. At the same time, manufacturers that have failed to offer investors the opportunity to lower their CoO, other than through the size of their portfolio, have been challenged to retain the interests of advisors and investors alike.

There is no evidence that points to any future increases in the Cost of Ownership other than that generated through a shift to higher risk investments. As such, it is likely that economies of scale and competitive pressure will continue to move the costs in favour of the investor.
SECTION 11: Appendix

11.1 List of Survey Participants

AGF Investments Inc.
Brandes Investment Partners & Co.
Dynamic Funds
Fidelity Investments Canada ULC
Franklin Templeton Investments Corp.
IA Clarington Investments Inc.
Investors Group Inc.
Invesco Canada Ltd.
Mackenzie Financial Corporation
Manulife Financial Corporation
PFSL Investments Canada Ltd.
Russell Investments Canada Limited

11.2 Notes on the Methodology

11.2.1 CoO Project Database Construction and Exclusions

Figure 44: Exclusions to Investor Economics Mutual Funds Universe
Assets in billions

<table>
<thead>
<tr>
<th>Category</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>institutional_series</td>
<td>$242</td>
</tr>
<tr>
<td>Account level management fee</td>
<td>$49</td>
</tr>
<tr>
<td>ETFs</td>
<td>$43</td>
</tr>
<tr>
<td>Money Market</td>
<td>$38</td>
</tr>
<tr>
<td>Performance fee funds</td>
<td>$19</td>
</tr>
<tr>
<td>LSVCC</td>
<td>$2</td>
</tr>
<tr>
<td>Investor Economics</td>
<td>$806</td>
</tr>
<tr>
<td>Mutual Fund Universe</td>
<td>$596</td>
</tr>
</tbody>
</table>

Note: The above mentioned criteria are not mutually exclusive. Some series of funds excluded from the analysis belong to more than one grouping.

The primary database used in the Mutual Fund Cost of Ownership project is the Investor Economics Multiclass Database which sources data from each fund’s Management Report of Fund Performance filings. Data gathered includes mutual fund assets under management; MERs, TERs, and management fees.
The data included in the Multiclass Database universe is broken down by each fund series, or class of shares, according to the naming convention of the issuer. Investor Economics employs a proprietary nomenclature whereby all series of funds have been categorized into distinct groupings based on the objectives of the series or class of share in question.

Certain funds captured in the database have been excluded. The overarching objective behind the exclusions was to make the dataset as homogeneous as possible in terms of the pricing mechanism and to target audience and distribution channels utilized by the funds included in the database. To achieve this, the following products or series have been excluded from the analysis.

**Institutional series of funds:** Mutual funds used as the underlying investment for segregated funds, fund wraps, principal protected notes and by institutional investors are issued in institutional series (or classes of shares). Management fees are typically discounted, reflecting the nature and size of the relationship and the fact that no advisor compensation is embedded in the MER. Institutional series of mutual funds accounted for $242 billion in assets at December 2011 and 1,521 funds.

**Series of funds charging management fees at the account level:** For these funds, the MER reflects only operating expenses, while management fees and advisor compensation are charged at the account or fund wrap level. Funds that charge the management fee at the account level represented $49 billion in assets and 570 funds at December 2011.

**Exchange-traded funds (ETFs):** Open-ended investment funds that typically track a benchmark index and are listed on an exchange. Unlike regular mutual funds, the net asset value (NAV) of an ETF unit is not calculated daily and fund units can be traded at a discount or premium to the NAV throughout the trading day. The expense ratios of ETFs are lower than that of regular mutual funds, as ETFs are generally passive investments and the majority do not include any embedded compensation. ETFs accounted for $43 billion in assets and 229 funds at the end of 2011.

**Money market funds:** Funds that invest in short-term securities maturing in one year or less. The objective of such a fund is to act as a low-risk, cash-equivalent vehicle. Money market funds are not typically held by investors with a long-term horizon. Money market funds accounted for $38 billion in assets and 129 funds at December 2011.

**Mutual funds subject to performance fees:** These funds pay a fee to the investment manager when a determined benchmark is exceeded. During the years in which a fund achieves an excess return, the performance fee may have a material impact on the level of the MER. Performance fee funds accounted for $19 billion in assets and 92 funds at December 2011.

**Labour-Sponsored venture capital corporations (LSVCC):** Corporations created to provide venture capital financing. Units of the underlying investments of these corporations (Labour-Sponsored Investment Funds or LSIF) are not actively traded and, as a result, may be subject to liquidity restrictions. MERs charged to these funds
are often well above the level of regular mutual funds. LSVCCs accounted for approximately $2 billion in assets and 82 funds at December 2011.

11.2.2 CoO in Fee-based Accounts Offered through Full-service Brokerage

The comparative cost of holding only F-series mutual funds in a fee-based brokerage account (FBB) is the MER of the F-series funds and the average annual fee attached to account. The average fee of 96 basis points that has been used in this analysis is based on the blended rate that arises from all assets held in FBB accounts. The average account size is approximately $275,000. When added to the 113 basis points MER of the mutual funds, the cost of holding F-series mutual funds in FBB accounts is 209 basis points.

The calculation for a FBB account holding only ETFs is similar; the average ETF MER of 42 basis points plus the 96 basis points average annual fee across all FBB assets results in an overall cost of 138 basis points.

11.2.3 Redemption Charges

To determine the holding period of DSC or low load sales options, data was collected from 11 companies, representing $135.1 billion in DSC and low load assets at December 2011. This amount is equal to approximately 74% of the market. The aggregate redemption charge was calculated by dividing back-end and low load redemption fees by the assets redeemed. An aggregate rate of 1.9% represents the typical fee charged upon redemption.

In order to make this redemption charge comparable on an annual basis, the fee was adjusted to account for the period during which the funds were held. Our survey data classified DSC and low load assets, redemptions and redemption fees by maturity (number of years remaining until the fund units were no longer subject to a redemption charge). This approach enabled redemption charges to be adjusted by the holding period at various points in the schedule. The aggregated effective annual disposition fee was asset-weighted to arrive at 0.93%.

11.2.4 Decomposing the Canadian MER

The weight of the components of the industry MER were determined through the utilization of data from Investor Economics’ Multiclass Database. The asset-weighted management fee of 1.70% was calculated using data from 3,889 funds or 95% of the series of funds in our database.

Using the provincial distribution of mutual fund assets, the effective tax rate was determined by multiplying the tax rate in each jurisdiction by their share of AUM. An effective tax rate of 10% was applied to represent the tax component of the MER. The residual component of the MER was attributed to operating expenses.
11.2.5 Determining the Distribution Component

The initial step in calculating the distributor compensation component of the MER was the determination of the asset mix in terms of various load structures including front-end, back-end on-schedule, back-end off-schedule, low load on-schedule and low load off-schedule.

Once determined this mix was applied to the fixed income, balanced and equity categories. It was assumed that, other than for some back-end and low load assets, full trailer fees of 50 basis points for fixed income and 100 basis points for balanced and equity categories would be paid by the fund companies. Typically, back-end and low load assets which are still on-schedule pay half-trailers. Amortizations of 54 basis points for back-end and 30 basis points for low load assets were assumed.

Total distributor compensation (trailer + amortization of any advisor commission) was asset-weighted among load structures to capture all components. The asset-weighted distributor compensation is displayed as a portion of the categories’ MER.

11.2.6 Trading Expense Ratio (TER)

Whereas MERs differ by mutual fund series, the TER is calculated at the fund level and is the same across all series. As such, 1,782 unique funds out of a total 2,215 were represented in our TER calculation. The assets of these funds accounted for $492 billion 83% of the $596 billion mutual fund universe used as the basis for our analysis in this report.
SECTION 12: Glossary of Terms

Distribution Channels

1. Branch advice (BA)
The branch advice channel is a creation of the major banks and credit unions and accounts for $314 billion in client assets. 13,500 in-branch advisors are engaged primarily in investment and financial planning. Advisors are predominantly registered to the MFDA arm of deposit-takers, although some BA advisors are registered through IIROC.

2. Branch direct (BD)
This channel is made up of personal banking officers and employees with similar responsibilities. They initiate mutual fund transactions at the request of customers and provide limited advice. Individuals in the branch direct channel may move into the firms’ branch advice channel.

3. Financial advisor (FA)
The FA channel is the most varied of the channels. It is made up of a wide range of firms including registered dealer firms; unregistered, fee-only planning firms; and life insurance distributors. These business models have varying degrees of independence and different product shelf capabilities. In the dealer category, models range from those with dedicated sales forces to firms with a high degree of product independence.

The FA channel also includes insurance distribution firms through which licensed insurance agents distribute life insurance products and segregated funds. The majority of these insurance distributor firms (approximately 300) are managing general agencies.

4. Full-service brokerage (FSB)
In terms of assets, FSB is the largest intermediated channel. The channel includes those IIROC member firms that have client-facing advisors with a retail offering of directly-held securities and fee-based managed asset solutions, including discretionary management. The open architecture and investment dealer registration allow these firms to distribute the widest range of investment products and wealth management solutions of any channel. Over 10,000 advisors operate in the full-service channel, though the number of firms operating in the channel continues to be reduced by consolidation.

5. Online/discount brokerage (ODB) and direct-to-public
This channel delivers products and its value proposition largely through centrally managed technology platforms. The channel is dominated by bank-owned firms although some small firms operate in the deep discount and specialized sectors. This channel is growing rapidly in terms of both assets under administration and the number of users.
The direct-to-public channel is represented by a small group of firms that include private investment counsellors and specialist firms. The share of the mutual fund market represented by this channel is modest.

6. Private investment counsel (PIC)
The firms in this channel are firms registered directly with the provincial securities regulators as portfolio managers. Advisors in this channel are typically registered as advising representatives at a portfolio management firm and must meet the discretionary PM requirements. With over 250 individual firms, the channel is fragmented. Many of these firms are small, principal-owned firms or small private client operations attached to large institutional asset management firms. There are also several IIROC member firms in this channel that we consider to be part of the PIC channel rather than the FSB channel because of their singular focus on discretionary management for the high-end client segment.

Load options
Load options refers to various types of sales commissions that are payable by the investor to their financial advisor, either directly or indirectly via the fund, at the time of investment in a mutual fund. Mutual funds are offered in two broad categories, load and no load structures.

Load structures:

1. Front-end sales charge
A sales commission negotiated between the investor and his/her advisor. This charge typically ranges from 0% to 5% and is payable directly to the advisor by the investor. The payment of this commission if applied, reduces the initial amount invested in the fund.

2. Low load sales charge
The mechanics of this load are similar to the deferred sales charge structure (see below) but follow an abbreviated redemption schedule. The sales commission payable by the fund to the advisor at the time of investment ranges from 1% to 3%.

3. Back-end load /deferred sales charge (DSC)
The sales commission is borne indirectly via fund expenses (included in the MER). The fund company pays the advisor a sales commission, typically 5% of the initial investment.

4. No load
This fund structure does not provide for the payment of a sales commission to the advisor at the time of investment.

5. Trailer fees
These are fees payable to the dealer and, subsequently to the advisor, to compensate the dealer/advisor for the maintenance of the relationship with the investor. Trailers typically range from 0.5%-1.0% for front-end load and 0.25%-0.5% for back-end and low load funds.
Money market funds
Money market funds invest mainly in money market instruments with a maturity of one year or less. Due to the transactional nature of money market funds, which have a short holding period when compared to long-term offerings, this asset class has been excluded from the analysis. Money market funds can be classified into three separate categories, namely Canadian, U.S. and International.

Mutual fund series or classes of shares

Mutual funds are often issued in multiple series that provide different options in terms of advisor compensation (embedded, excluded or discounted). Each series of mutual fund is associated with distinct pricing objectives.

The primary fund series are:

1. A-series
   This series represents the original class of units issued by a fund.

2. Advisor series
   This series is made up of units of an original no load fund with a sales commission and an embedded trailer fee.

3. D-series
   This series of funds is sold exclusively by bank-owned fund companies through the online/discount brokerage channel. The embedded trailer fee of the corresponding no load fund is reduced or eliminated in recognition of the lack of an ongoing advisory relationship with the investor.

4. F-series
   This series is available to investors who maintain a fee-based account. The embedded trailer compensation is removed from the MER; any fee charged by the dealer/advisor is paid directly by the investor.

5. HNW-series
   This series of funds has replaced the institutional series in the retail channel and targets the high net worth investor. Management fees are lower than the original series and, in most cases, are negotiable between the investor and the fund company. In the context of this project, HNW-series excludes any assets attributed to institutional series (originally termed I/O-series) and focuses exclusively on the retail HNW clients. The analysis also disregards HNW pools or funds whose MERs reflect only operating expenses and are used as part of a high-end fund wrap program.

6. T-series
   This series of funds offers a proportionate return of capital to create tax-efficient cash flows for the investor.
Managed asset solutions
These include fund wraps, fee-based brokerage, advisor managed, in-house managed wraps, separately managed wraps, hedge funds, pooled funds, separately managed accounts, estates and trusts, and universal life.

Fund wraps
Fund wraps are fee-based programs that use investment funds as building blocks. For this project, fund wraps refer to mutual fund of funds that use only mutual funds as underlying blocks.

Acronyms

TFSA – Tax Free Savings Account
RESP – Registered Education Savings Plan
RRSP – Registered Retirement Savings Plan
RRIF – Registered Retirement Income Fund
LIRA – Locked-in Retirement Account
LRIF – Locked-in Retirement Income Fund
LRSP – Locked-In Retirement Savings Plan