Monitoring Trends in Mutual Fund Cost of Ownership and Expense Ratios

A Canada—U.S. Perspective
2017 Update

September 2017 update to the 2012 study by Strategic Insight for The Investment Funds Institute of Canada
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Introduction

This report has been commissioned by The Investment Funds Institute of Canada (IFIC) as an update to the data, analysis and information originally developed in 2012 as part of a study into the cost of ownership (CoO) of mutual funds in Canada and the United States.


The 2015 summary, and the larger report on which it was based, *Mutual Fund MERs and Cost to Customer in Canada: Measurement, Trends and Changing Perspectives*, proposed an analytical framework for comparisons of the total CoO incurred by mutual fund investors in the United States and Canada, and presented a high-level comparison of CoO measures in both countries. The framework identified and highlighted the impact of structural differences between the United States and Canadian mutual fund industries, including scale, distribution channels, taxation and distributor compensation models.

This updated report should be read alongside the original, larger study which provided a thorough discussion of the methodology and industry context required to consider the development of the mutual funds CoO in Canada and the United States. This report does not include a full update of the model, although the methodology has been refreshed to account for recent developments in the CoO of mutual funds.

The updated information contained in this report has been developed by Strategic Insight personnel in Canada and the United States using data from both proprietary and public sources. Every effort has been made to ensure both accuracy and consistency to enable users of the report to develop a clear understanding of developments that have taken place over the past two years.

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2 The data for the United States presented in this report includes information sourced from the Investment Company Institute (ICI) as well as Strategic Insight’s SIMFUND database, which contains observations such as assets, net flows, fees for mutual funds for the last 20 years. Data on fees external to fund TERs for the United States was sourced from Cerulli Associates.
Key Takeaways

- In both Canada and the United States, mutual fund assets under management (AUM) increased by nearly 20% over the two-year period ended December 2016.

- The average total cost of ownership of actively managed mutual funds for clients using advice-based distribution channels in Canada was 2.14% at the end of 2016 (1.96% when the impact of taxes was excluded). The average cost of ownership for clients investing in actively managed mutual funds in the United States, which do not levy taxes, was 1.95%.

- The cost of ownership in Canada has declined by 6 basis points and by 5 basis points for the median cost ownership in the United States, since our previous update in 2014.

- There are differences between the two markets in the manner in which investors typically pay for the services they receive from fund manufacturers and advisors.
  - In Canada, the management expense ratio (MER) generally includes trailing commissions (ongoing fees paid to distributors) and applicable taxes. The embedded fee structure is used by mutual funds that currently account for approximately 80% of all fund assets in Canada.
  - In the United States, the total expense ratio (TER) does not include taxes, as there is no equivalent to the harmonized sales tax (HST) tax structure. Also, due to the prevalence of the unbundled fee-based model, a majority of the fund series do not include trailing commissions.
    - Approximately 80% of mutual fund gross sales across all advice channels outside of employer group pension schemes are accounted for by fee-based accounts. In such accounts, ongoing fees are generally charged at the account level.

- In Canada, the relative importance of point-of-sale commissions (embedded or not) in the distributor compensation formula has been on the decline. In 2015 and 2016, more than 96% of net flows were estimated to have been generated by either no load funds, or front-end load options with waived fees. If all mutual fund industry assets are taken into consideration, no load funds and front-end load options with waived point-of-sales commissions accounted for 83% of industry assets at the end of 2016, a share that has grown over time (77% in 2014).

Assets and flows

Since the end of 2014 (the last time this report was updated), mutual fund asset growth and sales have been irregular in Canada. In 2015, mutual fund net flows reached a record high of C$56.8 billion against a backdrop of growing capital market valuations. In 2016, however, net flows were relatively weak compared to previous years, and capital markets were volatile. Over the two-year period ended December 2016, mutual fund assets grew by 8.4% annually, adding a total of C$199.7 billion over the two years (C$90.9 billion in 2015 and C$108.8 billion in 2016). Of the total asset growth during the two-year period, 48.8% reflected inflows of new money with the balance being driven by market effect.

The mutual fund industry in the United States reached approximately US$15 trillion in total assets at December 2016, up 3% since the end of 2014. Investor demand within the United States, however, bifurcated sharply over the period between active and passive strategies. Active long-term mutual funds experienced approximately US$300 billion of net outflows during 2016, following $230 billion in net redemptions in 2015. At the same time, passive mutual funds attracted just over US$200 billion and US$170 billion of net inflows in 2016 and 2015, respectively. In addition, passive ETFs garnered a combined US$480 billion of net flows during the two-year period.

In the context of this report, the CoO of mutual funds in the United States takes into account only active mutual funds held in advice relationships. Both passive mutual funds and ETFs are excluded. While both passive product structures account for a growing share of industry assets in the United States, active funds still account for the majority of long-term fund assets. Active funds in the U.S. held $10 trillion of total assets at the end of 2016, representing two-thirds of total long-term mutual fund and ETF assets. Given these realities, the CoO denominator has been adapted to permit a direct and relevant comparison to the Canadian mutual funds industry, which is largely focused on actively managed mutual funds sold by financial advisors. For a more comprehensive note on the methodology employed in this research, please consult the original study Monitoring Trends in Mutual Fund Cost of Ownership and Expense Ratios, A Canada – U.S. Perspective, published in November 2012.

In Canada, the trend toward asset allocation solutions has continued unabated since the end of 2014. Fund wrap portfolios outsold stand-alone funds in both 2015 and 2016, accounting for 99.4% of the net flows over the period. Specifically, fund wraps attracted C$87 billion compared to the C$0.54 billion in net flows for stand-alone funds.

Load options and share classes

In terms of share classes, distributor adoption of fee-based accounts (particularly in the full-service brokerage (FSB) channel) has resulted in rapid asset growth in F-series funds. Share classes with relatively high minimum investments and relatively lower pricing, typically intended for high net worth (HNW) investors, also grew rapidly in the
two-year period under review. At the end of 2016, F- and HNW-series accounted for a combined 21.2% of mutual fund assets, compared to 16.6% at the end of 2014.

The trends identified in terms of load options in the previous update of this report remain in place. No load funds have continued to gain ground in Canada, a trend accelerated by the above-described growth in F-series. In 2015 and 2016 combined, more than 96% of mutual fund net flows went into funds that did not pay a point-of-sale commission to the advisor. The deferred sales charge (DSC) option was in net redemptions during the same period. The front-end load option accounted for C$6.7 billion in net flows during the two-year period, nearly triple the total inflows of all load options combined (C$2.3 billion). Both anecdotal evidence and data obtained in 2016 from MFDA-licensed distributors support the assertion published in the original 2012 issues of this report: advisors generally waive the front-end fees in front-end load funds.

In the United States, the evolution of the marketplace to an externalized fee-for-advice business model has made no load share classes the dominant pricing structure through which investors' access mutual funds. No load share classes accounted for over 80% of gross long-term fund sales in both 2015 and 2016. At the same time, funds sold with any level of point-of-sales compensation to advisors made up only 12% of total sales during each year. In terms of net assets, no load classes represented 80%, or US$9.6 trillion, of total long-term mutual fund assets in the United States at the end of 2016.
Pricing

Since 2015, Canadian mutual fund companies have adjusted the pricing of many of their products at an unprecedented pace. An acceleration of a number of trends that had been in place for several years prompted fund companies that account for nearly 90% of industry assets to lower the cost of their funds (see Figure 1). Such trends included a shift to fee-based accounts, primarily in the FSB channel; enhanced visibility and transparency of the cost of mutual funds after the implementation of CRM2 disclosure; the rising acceptance and proliferation of lower-priced products, such as passively-managed ETFs; and the growing scale of the business.

Figure 1: Mutual Fund Pricing Initiatives Proliferate
Changes between 2015 and June 2017

During this period, fund companies reduced the pricing of their products in a variety of ways, including the lowering of management fees, trailer fees, administrative expenses and the lowering or eliminating performance fees and—a new development in the pricing front—through the introduction of preferred pricing programs by nine firms.

Preferred pricing programs provide an automatic tiered discount to unitholders who have a certain level of assets with the fund company. The typical minimum threshold that triggers the discount is $100,000. Additional information and analysis on how these pricing programs are implemented and reflected in the total CoO of funds can be found in the following section.
Using the Cost of Ownership as the Analytical Framework for Canada–United States Comparisons

In analyzing the cost of ownership (CoO) in Canada and the United States, the original studies published by Strategic Insight in 2012 adopted a comprehensive view of costs associated with the ownership of mutual funds: the CoO framework (see Figure 2). This view reflected investor costs included in the reported fund expense ratios—characterized as the total expense ratio (TER) in the United States and the management expense ratio (MER) in Canada—as well as, importantly, costs residing outside the reported fund expense formulas.

The holistic nature of the CoO concept stems from the inclusion of cost elements at each stage of the fund ownership cycle: at the time of purchase (acquisition costs); during the investment period (ongoing costs, both charged to the mutual fund and directly to the investor, minus any rebates); and at the time of redemption of fund units (disposition costs).

The Canadian CoO framework has been updated in this issue to account for some of the aforementioned preferred pricing programs. These programs are executed in two ways: through specially priced share classes or through rebates.

- In the case of preferred pricing programs based on specially-priced share classes, unitholders are automatically switched to the appropriate fund series based on the total assets at or above a minimum amount they have with the fund company. In that case, the discount is entirely reflected in the share classes’ MER.
When the preferred pricing program is executed via rebates, unitholders receive additional units of the funds they own on a regular basis, based on their total investment with the fund company. In that case, the discount is not reflected in the reported MER, but resides outside of the cost metrics reported by mutual funds. Strategic Insight collected data from the firms offering preferred pricing programs under this modality to quantify the impact on the total CoO. The data used in calculating the impact of rebates account for approximately 45% of the total mutual assets under administration of the firms offering rebate-based preferred pricing programs.

The relative importance of the multiple variables that determine the CoO depends, to a great extent, on the distribution channel used to purchase units in the fund; the load option selected; the series of mutual fund units purchased by the investor; the amount invested; and the type of account (e.g. fee-based brokerage) in which the fund is being held.

While the primary difference between mutual sales in Canada and the United States is that most funds in Canada have embedded distribution fees unlike the in the United States where most funds are sold with an unbundled fee structure, the various elements of the CoO framework apply equally to both jurisdictions.

The original 2012 study suggested that the CoO framework, which had been developed for the purpose of producing a United States versus Canada comparison, can also serve as an analytical platform for investor cost comparisons across other countries. As a validation of this point, we note that a similar framework was adopted in the U.K. by The Financial Services Consumer Panel to illustrate the cost of ownership in the study Investment Costs—More Than Meets the Eye³.

The growing complexity and customization of fund pricing in Canada, and newer pricing developments in the United States (such as clean shares), suggests that in the future precise tracking of the CoO metric will become a more complex exercise. The process of unbundling of advisor fees from the MER and TER, the increasing ability to adjust fee levels depending on the size of the investment and the importance of a given client to the advisor, will result in progressively divergent fee levels for investors that will be increasingly challenging to monitor without a robust and comprehensive data-gathering process.

³ See https://www.fs-cp.org.uk/sites/default/files/investment_discussion_paper_investment_cost_and_charges.pdf
Key Elements of the Canadian Management Expense Ratio (MER) and the Total Expense Ratio (TER) in the United States

The use of the CoO framework enables industry participants and other observers to neutralize the impact of differences in the composition of TERs in the United States and Canadian fund MERs. Figure 3 explores these differences by providing a side-by-side view of the main cost elements included in Canadian mutual fund MERs for the most prevalent fund series ("original series") and TERs in the United States for those funds used by advisors operating fee-for-advice business models.

Figure 3: Key Elements of Canadian MERs (for Original Series of Fund Units) and TERs in the United States (for Series Used by Advisors Using Fee-based Platforms)

Currently, the main difference between the Canadian MER and the American TER resides in the inclusion—or exclusion—of the ongoing distributor (and financial advisor) fees from the reported fund expense ratio.

The practice of embedding such ongoing fees (referred to as trailing commissions or trailers) within the mutual fund management fees is the prevalent approach in Canada for the share classes that account for the majority of industry assets. An embedded fee structure is used by mutual funds that currently account for approximately 80% of all...
fund assets in Canada. The unbundled fee-based model has been growing rapidly in Canada although it is still relatively small when compared to its use in the United States.

In the United States, the majority of mutual fund sales made through a financial advisor are associated with unbundled fee-based accounts. Fees for service are generally charged at the account level on an asset-weighted basis, although even there we are observing a growing multitude of pricing and service proposition models. As such, these account management fees are not included in the TER metrics reported by mutual funds in the United States. Another key difference between the two jurisdictions is that almost all elements in the Canadian MER attract value-added or sales taxes. By contrast, in the United States, no value-added taxes are levied on the key components of the TER.

The more recent change in the CoO equation in Canada was the introduction of the aforementioned preferred pricing programs. There is no comparable discount mechanism in the United States at the fund company level. As shown in Figure 3, the discounts executed with rebate-based pricing programs are not included in the MER.
Cross-country Comparison of Mutual Fund Investor Costs

Advice channels account for more than 80% of Canadian mutual fund asset holdings. Similarly, in the United States (excluding funds held through employer-sponsored retirement plans which represent an estimated 26% of mutual fund assets), approximately 80% of investors rely on a financial advisor exclusively, or for a significant portion, of their investments.

Figure 4 updates the comparable CoO for clients in advice channels in the United States and Canada. As was concluded in 2012, the cost of ownership of funds in advised relationships in Canada—both commission- and fee-based—is at a comparable level to the average CoO incurred by a typical fee-based investor in the United States who has chosen to be guided by a financial advisor.

In the two years since the 2015 update of this report, the CoO of mutual funds has declined both in the U.S and Canada. As explained above, most Canadian mutual fund companies have taken steps to reduce their management fees and other fund expenses. This has resulted in an aggregate asset-weighted pre-tax CoO of funds that is six basis points lower in 2016 than was reported in 2014. The rate of taxes levied on funds has remained unchanged during the period.

Figure 4: Cost of Actively Managed Mutual Fund Ownership for Clients Using Advice Channels—Canada (all compensation models) and the United States (unbundled, fee-based compensation)—2016

*Note: This reflects an industry aggregate and is not specific to advice channels
**For all account types

4 http://www.icifactbook.org/ch7/17_fb_ch7#retirement
Additionally, the rebates associated with preferred pricing programs (not available in Canada in 2014) contributed to lowering the CoO of funds by an average of six basis points for those unitholders receiving the rebates. When calculated against all the industry assets reviewed for this study, rebates from preferred pricing programs lowered the pre-tax cost of ownership by a fifth of one basis point.

In the United States, the cost of ownership of mutual funds also declined during the period in review. Similar to the Canadian experience, the decrease was due to reductions in the funds’ total expense ratio (TER, the embedded fees mutual fund companies charge to access their products). Both the high- and low-range of typical portfolios’ embedded fund fees was 10 basis points lower in 2016 than in 2014. Fees for service external to the TER were less impacted by cost compression, remaining consistent as compared to 2014 at between 1% and 1.5% (with external fees applied to both large and small accounts, detailed further in Figure 8 later in this report, largely unchanged over the past several years). This has resulted in the median CoO in the United States declining to 1.95% from the 2% previously reported two years ago.

When compared head-to-head, the average CoO of funds was 19 basis points higher in Canada than in the United States at the end of 2016. The difference is largely reflected in the taxes levied on embedded costs and other fees. If taxes are excluded, the average Canadian cost of ownership is 1.96%, nearly equal to the estimated average in the United States.

An important caveat, however, is that the CoO of funds presented in Figure 4 includes only advice channels. The overall cost of ownership declines considerably (particularly in the United States) when funds that are purchased without advice, such as through employee-sponsored retirement plans, online/discount brokerages or directly from fund manufacturers, are included.

**Differences in the CoO equation**

Over the past two decades, advisor compensation in Canada and the United States has shifted away from a reliance on sales commissions paid at the time of purchase toward a greater propensity to charge asset-based fees throughout the duration of the investment. Despite this similarity, there are structural differences in the approaches taken in Canada and the United States.

In Canada, ongoing fees for distribution and financial advice are generally “bundled” within a fund’s MER alongside fees for investment management, administration and operations, all with the addition of the cost of applicable taxes. Contrastingly, in the United States, the most common approach is the fee-for-advice model in which investors pay a negotiated ongoing fee directly to the distributor. These fees are charged in addition to the fees embedded in a fund’s embedded cost and comprise the total expense ratio.

The cost in the United States as shown in Figure 4 reflects the dominant fee-for-advice model, and includes a range for external (unbundled) fees. These fees can range from up to 1.5% of managed assets charged annually for smaller investment accounts, such as through employee-sponsored retirement plans, online/discount brokerages or directly from fund manufacturers.

Source: Cerulli Associates
as those below US$100,000, down to approximately 1.0% for larger investments, such as those over US$1 million. In the United States, external fees are charged to investors along with the underlying average fund TERs estimated at 0.75%—the TER does not include any distributor fees (for more detail and examples of fee schedules in fee-for-advice models in the United States, please see page 33 of *A Perspective on the Evolution in Structure, Investor Demand, Distribution, Pricing, and Shareholders' Total Costs in the United States Mutual Fund Industry*).

By adding these two cost components, Strategic Insight estimates the average cost of ownership for mutual fund relationships guided by a financial intermediary in the United States to be approximately 1.95%. This cost may vary, however, depending on the size of the relationship, family of funds, and the portfolio asset mix. For United States investors with accounts under $100,000, the CoO may reach 2.3% or higher, due to the impact of fees external to the TER.

The Canadian CoO measure has been assembled as an asset-weighted average representing all types of accounts sold through advice-giving distribution channels. This average CoO accounts for the impact of transactional charges and fund-embedded fees (MER) and unbundled fees levied at the account level.

As mentioned earlier, the analysis suggests that the total cost of ownership of funds in advised relationships in Canada is at a comparable level to the average cost of ownership incurred by a typical fee-based investor in the United States who has chosen to be guided by a financial advisor.

This analysis, combined with the findings of the Strategic Insight research in 2012 and the 2015 update, also suggests that a move to unbundled fee-for-advice models has not resulted in a direct reduction of investor costs of mutual fund ownership. The cost reduction was largely the result of declines in underlying fund management fees.

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6 Source: Cerulli Associates
8 For more on this topic, please refer to the original study by Strategic Insight, *A Perspective on the Evolution in Structure, Investor Demand, Distribution, Pricing, and Shareholders' Total Costs in the U.S. Mutual Fund Industry, November 2012*. 
Additional Considerations for Comparisons of the Cost of Mutual Fund Ownership in the United States and Canada

Beyond the difference in the prevalence of the unbundled, fee-based, advice-giving models in the United States and Canada, the original study highlighted important structural differences that should be taken into account when developing cross-border comparisons of the cost of mutual fund ownership. This section provides updates on selected issues.

The importance of mutual funds to individual savings: A 2016 update

In both countries, mutual funds represent a significant portion of household financial wealth in terms of investible assets and serve as the main gateway to capital markets for the household sector. This is particularly the case for households in the mass- and mid-market wealth segments (those with less than $500,000 in investable assets).

As indicated in Figure 5, mutual funds in Canada and the United States account for a comparable share of total personal investible assets. In both countries, mutual funds are a key component of retirement accounts, such as RRSPs in Canada and 401(k) accounts in the United States. The most notable difference between the two countries is the order of magnitude of the asset base of both mutual funds and total financial wealth.

Figure 5: Long-term Mutual Funds as Percentage of Financial Wealth
As of December 2016

Range of investor choices reflects market forces and scale: A 2016 update

The more mature and larger United States fund marketplace generally offers a broader array of options to investors than is the case in Canada, particularly in terms of investment mandates. For example, regulators in the United States have permitted a wider range of investment strategies (including liquid alternatives) to be delivered via the mutual fund structure to retail investors.

The difference in the scale of the two industries is illustrated in Figures 6 and 7 below. The mutual fund industry in the United States is approximately 10 times larger than its Canadian counterpart. The gap between the total assets of the two industries underlines the ability of mutual fund manufacturers and distributors in the United States to take advantage of economies of scale in assets, client numbers, revenue and access to capital in order to pursue both innovation and pricing initiatives at a pace and scale not easily achieved by smaller jurisdictions, such as Canada.

Figure 6: Long-term Mutual Fund Assets under Management
In billions of dollars, December 2016

Scale is a factor known to impact the pricing of goods and services in both countries, as explained in a report of the Standing Senate Committee on National Finance9.

The relative size of the market is also an important issue for distributors. Similarly to the United States, the Canadian financial services industry offers a number of distribution conduits, including advice-based, entirely self-directed and self-assisted models. The relative difference in the size of the assets under administration in the different distribution channels in both countries is typically between 10 to 15 times.

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9 [https://sencanada.ca/content/sen/Committee/411/NFFN/rep/rep16feb13-e.pdf](https://sencanada.ca/content/sen/Committee/411/NFFN/rep/rep16feb13-e.pdf)
The sheer scale of the mutual fund industry in the United States has enabled pioneering innovations in fund delivery, such as "fund supermarkets"\textsuperscript{10}, several of which administer over US$100 billion. The CoO of mutual funds in this channel is generally significantly lower than the average of 1.95\% for advice-based distribution. This channel format is currently absent from the Canadian retail investment landscape.

Figure 7 provides another perspective on the differences in scale between mutual fund companies and individual funds in both markets. At the end of 2016, there were three fund managers in the United States with assets under management which eclipsed the entire Canadian mutual fund industry.

**Figure 7: Assets of 20 Largest Mutual Fund Complexes and Mutual Funds in the United States and Canada**
December 2016 assets, in millions of Canadian dollars

<table>
<thead>
<tr>
<th></th>
<th>Canada</th>
<th>United States</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mutual fund assets</td>
<td>$1,320</td>
<td>$12,092</td>
</tr>
<tr>
<td>Assets of 20 largest fund managers</td>
<td>$1,136</td>
<td>$10,700</td>
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<tr>
<td>Share of mutual fund assets</td>
<td>86%</td>
<td>88%</td>
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**Average Assets**

<table>
<thead>
<tr>
<th></th>
<th>Canada</th>
<th>United States</th>
</tr>
</thead>
<tbody>
<tr>
<td>Largest 5 fund managers</td>
<td>$122,793</td>
<td>$1,396,954</td>
</tr>
<tr>
<td>Largest 10 fund managers</td>
<td>$94,959</td>
<td>$872,712</td>
</tr>
<tr>
<td>Largest 20 fund managers</td>
<td>$58,184</td>
<td>$535,018</td>
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</table>

The second table explores the potential for economies of scale at the fund level in the United States, where the ability to spread certain costs across a larger asset base may have a meaningful impact on the cost-to-customer.

**Figure 7 (continued): Assets of 20 Largest Mutual Fund Complexes and Mutual Funds in the United States and Canada**
December 2016 assets, in millions of Canadian dollars

<table>
<thead>
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<th>Canada</th>
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</thead>
<tbody>
<tr>
<td>Mutual fund assets</td>
<td>$1,320</td>
<td>$12,092</td>
</tr>
<tr>
<td>Assets of 20 largest funds</td>
<td>$206</td>
<td>$2,919</td>
</tr>
<tr>
<td>Share of mutual fund assets</td>
<td>16%</td>
<td>24%</td>
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**Average Assets**

<table>
<thead>
<tr>
<th></th>
<th>Canada</th>
<th>United States</th>
</tr>
</thead>
<tbody>
<tr>
<td>Largest 5 funds</td>
<td>$17,303</td>
<td>$250,314</td>
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<tr>
<td>Largest 10 funds</td>
<td>$13,568</td>
<td>$191,022</td>
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<tr>
<td>Largest 20 funds</td>
<td>$10,325</td>
<td>$145,934</td>
</tr>
</tbody>
</table>

\textsuperscript{10} An investment firm or brokerage that offers investors a wide array of mutual funds from different fund families. Investors benefit by obtaining access to an extensive range of top-performing funds, as well as by receiving a consolidated statement of all their mutual fund holdings.
The Effect of Asset Levels on the Cost of Ownership

For more modest account sizes, the average Canadian mutual fund cost of ownership in advice channels can be lower than the United States. This is the result of the potentially higher fee-based account fee ranges for investors in the United States. Emerging competitive pressures in the United States, however, are pushing the fee-for-advice levels toward the lower end of the fee range.

In Canada, fees charged to clients using non-discretionary fee-based brokerage and discretionary advisor managed accounts have remained fairly static over the past five years, in part due to the significant expansion of the fee-based model across the FSB channel. Fees in the full-service brokerage channel vary by company, program and client asset tier but generally range from 0.6% to 1.75%. The nil to slight decline in weighted fees for fee-based programs was, in part, caused by the gradual increase of average balances in fee-based programs as the expansion captured a greater range of advisor practices and clients. That factor was coupled with advisor reluctance to raise fees as they transitioned clients from commission-based accounts into non-discretionary fee-based programs and from the latter to discretionary fee-based programs.

The increased fee-based penetration in FSB has resulted in more traction for mutual funds in both non-discretionary and discretionary fee-based programs. At the same time, F-series mutual funds experienced a decline in management fee levels as fund companies recognized the growing importance of fee-based accounts in the channel.
In both Canada and the United States, most distributors and mutual fund firms offer a lower price point for clients with mutual fund holdings in a specific fund above certain asset thresholds. These discounts are applied either via discounted share classes and/or by lowering the level of fees in fee-based accounts. **Figure 8** shows the typical price points by account size in both countries. The segments in both countries overlap to the extent possible given the available data for each jurisdiction, and reflect the average fees of mutual fund series relevant to each segment plus account and, if applicable, servicing fees. Pricing in this figure does not reflect a wide range of discretionary managed solutions typically available to HNW investors.
Based on this sample, compared to the United States, Canadian mutual fund manufacturers and distributors offer very competitive mutual fund and advisory fees to clients investing between a range of C$100,000 and C$1 million. In Canada, this segment is often referred to as the mass-affluent.

According to Strategic Insight in the United States, the fee discount becomes more significant when client assets reach C$1 million and that the discount deepens further for multi-million dollar accounts. In Canada, the reported level of mutual fund fees for accounts with more than C$1 million does not fully reflect the variety of pricing approaches for the high end. For example, beyond the C$1 million threshold, some fund companies use institutional/HNW fund series (or share classes) with negotiated management fees. The MERs filed for these negotiated series generally reflect only the operating expenses of the funds, and are therefore not included in this analysis due to the lack of data required to make them comparable to other series with embedded compensation. Depending upon their relative presence in the marketplace, if those HNW series could be taken into account, the price point available to accounts above the $1 million threshold would be somewhat lower than what is shown in the chart.

A number of other factors associated with the composition of each market, in terms of household wealth accumulation, and the products and services available to HNW clients also contribute to the explanation of why the level of fee discounts in both countries differs for each client segment. These factors include the difference in size and composition of the HNW communities in Canada and the United States; the nature of investment options available to HNW households; and the role of mutual funds in discretionary managed solutions. In the past five years, while funds have gained traction in discretionary advisor managed portfolios in Canada, they remain well behind the levels held in the discretionary “rep-as-portfolio manager” programs in the United States.
Disclaimer

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