CANADIAN INVESTORS' COURSE

Session 8 – The Investment Industry Overview

Commentary

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As you will learn in the CIC course, *all* investing involves some level of risk. Future results can be dramatically different from what you might expect of an investment at the outset. The same is possible regarding the opinions expressed herein. **One opinion we believe in MOST STRONGLY is the benefit of consulting an investment professional before investing.** Also, not ALL advisors are alike. We suggest you view Sessions 8 and 9 of our CIC course on the 'Investment Industry' to become fully aware of ALL the various types of licenced investment professionals which exist in Canada, the services they can offer and the different ways they may charge fees and/or receive compensation for the services they provide.

Canadian Investors' Course

Mutual/Segregated Funds

Mutual/Segregated Funds can be purchased via:

- No-load – no commission charged to buy or sell the funds. Best practice. Most Advisors do this now.

- Low-load – Fund seller receives a hidden fee of 1% to 2%, investor must hold funds for 2 years before they are free of the penalty of having to pay back the commissions

- Deferred sales charge(DSC) – 5% commission paid to seller and is hidden, investor will pay a penalty to pay back the commission if funds are sold early (usually 6 to 7 years). Free after that.

- Front end commission – Fund seller charges an upfront fee that you see (1% to 2%), the investor can sell the funds free of charge anytime.

Trailer fees and How you should purchase

Mutual/Segregated Funds

The MER (Management Expense Ratio) of a Mutual/Segregated Fund includes internal charges known as trailer fees that are paid to the Mutual/Segregated Fund sellers. If, for example, the MER on a mutual fund is 2.25%, the management fee would be 1.25% and the trailer fee is 1% every year.

If the Funds are designated as 'F' Class then these funds do not contain the typical trailer fee of 1% and they carry a lower MER to reflect this. F-Class funds are purchased only in 'Fee-Based' accounts (with a fee on all the assets in the account).

If Funds are sold to investors via Deferred Sales Charge, the seller would receive a 5% **hidden** commission, **up-front**, then the seller's trailer fee every year of 0.5%...

Isn't a 1% annual trailer fee generous enough for most mutual fund sellers?

Where available, investors should purchase mutual funds via the **NO-LOAD STRUCTURE ONLY**.

Ask about no-load Mutual/Segregated Funds … and compare them to "load" alternatives!

Ask QUESTIONS before you buy.

Bonus Structures

For Industry players that receive a bonus structure, generally it comes in two forms:

1. Sellers are given a quota structure, and bonuses or compensation can grow as different sales levels are attained
2. Bonuses based on volume of sales through the year and retention of investors funds
3. See the cartoon at the beginning of the commentary…

*****Some mutual fund sellers at Banks get paid a 1% or 2% commission on the dollar amount invested at Banks**.**

****Always ask the seller, how they are compensated.**

CRM2 – the Age of fee disclosure has come

What is CRM2

CRM2 – **Client Relationship Model**, phase 2 requires disclosure of fees paid to your advisors and charged to investors.

Disclosure of fees is not a new practice for IIROC licensed Advisors who practice portfolio management via fee-based accounts. The only hidden fee products in these types of accounts are "F"-Class mutual funds and ETFs. Ask your Fee-based advisor to show you how they disclose all fees in these accounts.

The biggest difference in fee disclosure will be with mutual funds in transactional accounts: MERs have been hidden until recently. Going forward, fees earned by the dealer, such as trailer fees from mutual funds will be disclosed in Dollars and cents. However, the total MER will continue to NOT be disclosed.

Should CRM2 be known as 'CRM/2' or 'CRM ½'?

New law regarding fee disclosure came into effect in 2017. Unfortunately, full fee disclosure will likely be spread over a two year (or longer) period, with another CRM phase to be implemented in 2018. This next phase may require disclosure of all fees charged in mutual funds (the total MER). It is also possible that this may be further delayed.

Follow the sessions in this course to educate yourself on all fees in all financial products.

<u>Example</u>

$178,000 portfolio of mutual fund with MER of 1.90%

Total fees charged for the year on this amount, assuming amount remains stagnant all year (for simplicity of calculation), is $178,000 X 1.90% = <u>**$3,382**</u>. This is what you actually paid. It is intended that new, future, rules will lead to the complete disclosure of this MER, as a dollar amount.

Fees paid to the dealer are disclosed under the current CRM2 legislation, eg: $178,000 X 1% = <u>**$1,780**</u>. Ask your Advisor or Banker to calculate the <u>**entire fee**</u> charged including those not disclosed. They can provide this number to you.

Many Canadians could be surprised by this: many Mutual Fund investors have believed the hidden financial product fees were small or, non-existent! WRONG!

***UNFORTUNATELY, the Insurance industry is not affected by CRM2 (even as of the January 2018 timeframe). Consequently, segregated mutual funds, which are Insurance products, are NOT required to disclose MERs or other hidden commissions charged. Be aware of this when Advisors and Agents offer you Segregated (SEG) funds. Ask about the 'LOAD' charged and request that they calculate (in dollars) the total annual fees.**

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