FAIR | Canadian Foundation *for* Advancement *of* Investor Rights

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Canadian Money Market Funds – Zero Returns

EXECUTIVE SUMMARY

Most Money Market Funds (MMFs) not making money. Canadians hold $56 billion in money market funds earning almost nothing. In the six months to year end 2009, the average Canadian MMF earned just 0.02% after costs, before the impact of inflation and taxes. The average return for the 30 and 60 days ending December 31 was 0.0%.

One-quarter of funds losing money. 68 funds – one quarter of all Canadian money market funds – lost money in the three or six months to December 31, 2009. The losses were not large - the biggest loss was 0.65%, and most losses were less than 0.1. Most of the losses were concentrated in small segregated (insurance) MMFs; none of the top 60 (by assets) MMFs lost money. Investors often have other reasons for holding segregated funds, including principal protection and death guarantees.

$300 - $500 million opportunity cost. By not looking more closely at their current returns and the fees that they are being charged, and by not shifting their funds into higher-yielding premium savings accounts, Canadians are missing out on potential interest income of $300 - $500 million. The calculations can be found further on in this report.

Why are Canadians not switching out of MMFs? Many Canadians invest in MMFs for short-term liquidity needs and are not seeking to maximize their returns. Some are locked in by high “exit fees” on funds with back-end loads. Other reasons include insufficiently clear disclosure about current fees and returns; safety and an implied guarantee; habit, convenience and inertia; and lack of financial advisor incentive. Canadians are switching out of MMFs, but slowly: about $2 to $2.5 billion a month is being transferred from MMFs both to deposit accounts and to longer-term stock and bond funds.

Fund economics don’t work in this low interest rate environment. Since interest rates declined to almost zero in March, 2009, most Canadian MMFs would be losing money had they not reduced their fees. The average fee (Management Expense Ratio or MER) for all Canadian money market funds is 0.99%. The top 10 funds charge an average MER of 0.62%. Yet the current wholesale rate of interest available to the MMFs on Government Treasury bills is only 0.57%. To avoid reporting negative returns and scaring investors in this safe asset class, most funds have cut their MERs.

RECOMMENDATIONS AND CONCLUSION

This report looks at the performance of Canadian money market funds. A future report will examine the development of the MMF industry and the regulatory environment in which it operates in Canada, with comparisons to other jurisdictions. Our near-term recommendations follow; more suggestions about regulatory reforms will be presented in a future report.

Improve disclosure of returns and fees. Investors should be notified when the return on a "safe" investment turns negative, and when fees are being cut. The current requirements - one-time disclosure of fees in the simplified prospectus, and semi-annual reports on total fees paid by the funds - are not prominent enough to serve investors properly. There does not appear to be any requirement to inform investors that MMFS are producing zero or even negative returns.

Advisors should consider switching clients to higher-yielding alternatives. Investment advisors should act in their clients' best interest and consider recommending to their clients that they switch from MMFs to alternatives like CDIC-insured premium savings accounts, if there are no other compelling reasons to keep their clients in MMFs.

Greater investor awareness of what is happening in their accounts. Investors should stay current and well-informed about their accounts and financial alternatives, and not solely rely on their advisors.

PERFORMANCE OF CANADIAN MONEY MARKET FUNDS - SUMMARY

	Average (Total)	Top 10 Funds Average	Benchmark: 91-Day Treasury Bill
3 MONTHS	0.00	0.06	0.06
6 MONTHS	0.02	0.13	0.13
1 YEAR	0.22	0.55	0.49
3 YEARS	2.00	2.42	2.64
10 YEARS	2.42	2.77	3.26
CURRENT YIELD		0.18	0.18
MER	0.99	0.62	

Source: Globefund.com. Performance for the period ending December 31, 2009. Top 10 funds ranked by assets under management. Yields as of January 19, 2010.

What are Money Market Funds?

Money market funds are investment vehicles that focus on providing safe, short-term returns for investors. They come in a variety of forms including mutual funds, segregated (insurance) funds that invest in money markets, and short-term fixed income mutual funds.

Canadian money market mutual funds represent about 10% of the Canadian mutual funds industry, by assets. [1] Segregated insurance money market funds constitute 3.5% of the larger segregated funds market.[2]

U.S. money market funds were launched in 1971 as "turbo-charged deposit accounts" at a time when bank savings rates were regulated at artificially low levels. The industry persuaded regulators to allow the use of a fixed Net Asset Value, which helped convince investors that their money would not fluctuate in value and therefore was "as safe as cash." Paying market interest rates allowed investment dealers to gain a larger share of their customers' investments.

Varieties of Canadian Money Market Funds

There are a number of different types of Canadian money market funds.

Canadian money market mutual funds are not allowed to hold securities with maturities longer than 364 days; their weighted average maturity must not exceed 90 days. Investments are restricted to federal and provincial bonds, bank-backed commercial paper, corporate bonds, and floating rate notes. MMFs are allowed to keep a fixed price known as a fixed Net Asset Value - usually set at $10/unit, but occasionally at $1. They accumulate their interest daily and pay it monthly, but the underlying price of the units does not change.

Treasury money market mutual funds are required to hold only Federal and Provincial Treasury bills, with no corporate debt or commercial paper. These are a more conservative variation of money market mutual funds that typically offer slightly lower yields.

US Dollar money market mutual funds. Some Canadians with US dollar assets prefer to hold some of their short-term investments in US dollars. Thirty-five US$ funds are offered by Canadian financial institutions, with US $4 billion under management. 86% of those assets – US $3.4 billion – are in the hands of RBC, TD and CIBC.

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[1] Investment Funds Institute of Canada, December 2009 statistics.
[2] Canadian Life and Health Insurance Association, Feb./2010 interview.

Segregated money market funds are offered by insurance companies and other money managers. They are sold by insurance agents through contracts known as individual variable insurance contracts (IVIC). Investors do not access the segregated funds directly, but rather allocate their fund choices through the contracts. IVICs typically come with guarantees of 75% or 100% of the principal amount at maturity, and may contain a death guarantee, reset privileges, guaranteed minimum withdrawals, and other benefits. In return for the guarantees and other benefits, segregated MMFs typically have higher – sometimes much higher – MERs. Segregated MMFs are allowed to own a wider range of investments with somewhat longer maturities. They are required to mark their prices to market so their values fluctuate.

For more detailed comparisons of money market mutual funds, Segregated MMFs, and competing savings vehicles such as Premium Savings Accounts and Short Term Fixed Income Funds, see the condensed table below and a fuller comparison in Appendix 1.

Regulation of MMFs and Competing Instruments

Money Market Mutual Funds	Segregated Money Market Funds (SFs)	Premium Savings Accounts
▪ 95% of assets must be invested in accredited short-term investments. ▪ Maturity no longer than 1 year; dollar-weighted term to maturity up to 90 days. ▪ No guarantees. ▪ Price typically set at $10 or $1 per unit.	▪ 95% of assets must be invested in accredited short-term investments. ▪ Maturity up to 25 months (government securities); dollar-weighted term to maturity up to 180 days. ▪ Guaranteed (at contract maturity) at 75% or 100% of the amount invested. ▪ Unit price fluctuates with daily changes in NAV.	▪ Governed by bank deposit rules. ▪ No specific rules about maturities. ▪ CDIC insures up to $100,000. Backed by general bank reserves. ▪ No fluctuation in price.

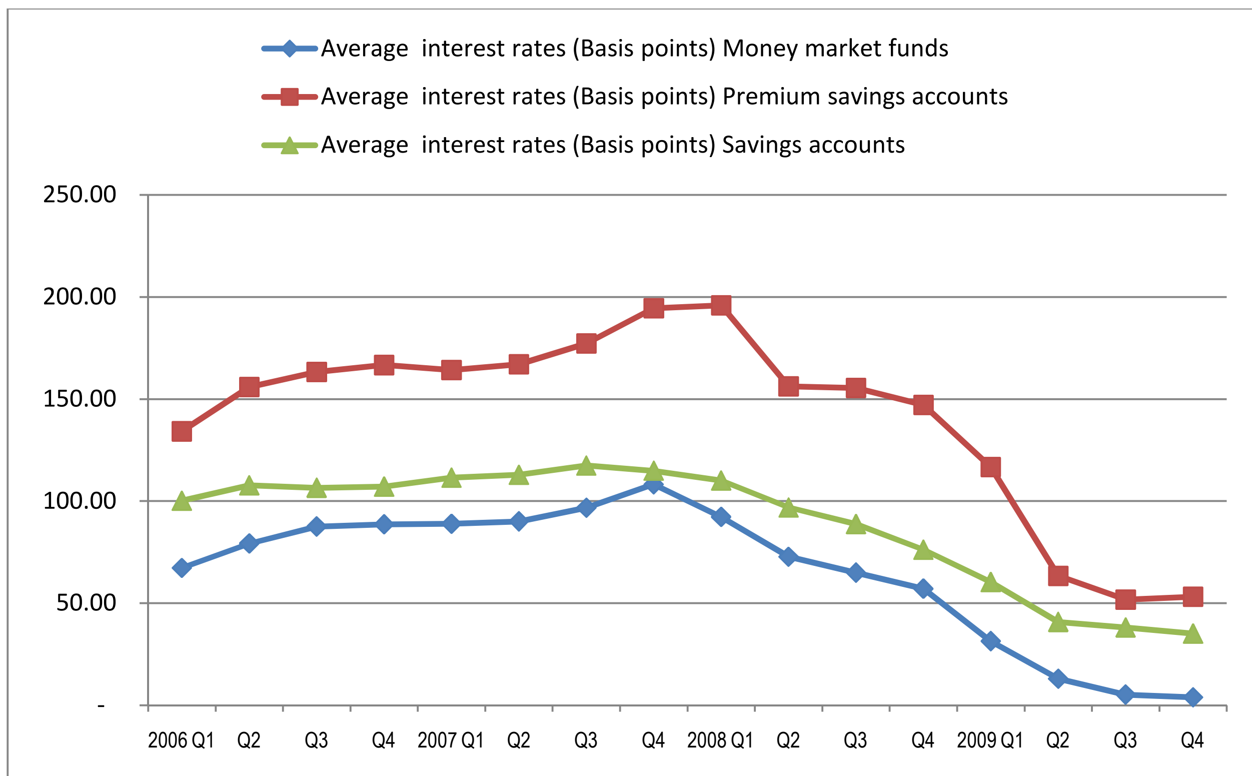
Competing Products

Money market funds compete directly with deposit instruments like regular and premium savings accounts, and indirectly with other “almost cash” instruments such as short term fixed income funds. Those deposit instruments are much larger: as of June, 2009, Canadians held $466 billion in (primarily savings account) deposits and another $488 billion in fixed term deposits like Guaranteed Investment Certificates (GICs).

Traditional savings and chequing accounts pay little or no interest, particularly on small balances. At $319 billion in assets (at June, 2009), these traditional accounts are more than twice the size of premium savings accounts, with $146 billion. Premium savings accounts assets are growing very rapidly – 36% in 2009, 24% in 2008, 18% in 2007. They now account for 32% of all deposits, up from 23% in 2005.[3]

In Canada, the battle for deposits heated up over the past five years. ING, President's Choice Financial, and other non-traditional banks raised rates to compete for the savings of Canadians. The big banks responded with their own higher-yielding premium savings accounts. As the following chart shows, those **premium savings accounts have been paying more than MMFs for the past three years**, while traditional savings accounts trailed MMF returns. Most premium savings accounts continue to offer more attractive rates of returns than money market funds. See the list of current premium savings accounts rate in Appendix 2.

AVERAGE DEPOSIT RATES VS. MONEY MARKET FUND YIELDS



Source: Data from Investor Economics and Cannex.com

What allows premium savings accounts to offer higher rates? Competitive pressure to hang on to their lucrative retail customers in the face of competition is the main driving force. As other

[3] Investor Economics, Deposit and Fixed Income Advisory Service, Fall 2009

financial institutions with higher rates began to attract more of their core retail customers, the big banks launched new products and increased their rates to retain their hold on the customers' mortgage, personal loan and other business.

A regulatory quirk is another reason. Accounting and regulatory requirements allow financial institutions to treat all retail deposits as long-term capital. Money market mutual funds are off-balance sheet liabilities and not included in the calculation of capital – although that could change under the new IFRS accounting standards. At times when long term capital is scarce or especially expensive, deposit-taking financial institutions have an incentive to pay a higher rate of interest on their deposits. The deposits, even at interest rates much higher than those paid on MMFs, are still a cheap alternative to other long-term financing options open to these institutions.

Short Term Fixed Income Funds. Short Term Fixed Income Funds (STFIFs) invest primarily in short-term government or corporate bonds, mortgages, commercial paper and other short term instruments. They typically offer higher yields and have longer maturities up to 3.5 years, compared to 90 days for MMFs.

STFIFs are not a separate legal category of funds, simply a classification.[4] There are no specific rules governing them beyond the larger rules governing all mutual or segregated funds, but they have to meet certain criteria to be included in the classification. They have floating NAVs and are not allowed to call themselves money market funds.

Globefund.com lists 114 short term fixed income funds, the largest with $3 billion in assets at the end of 2009. STFIFs have been growing as investors stretch for yield. In periods of declining interest rates, steep yield curves or narrowing spreads (i.e. corporate bonds trading at smaller premiums to benchmark Government of Canada bonds) they can offer much higher returns than MMFs. But STFIFs are also more exposed to interest rate changes and credit changes, and pose greater risks of capital loss.

[4] All Canadian mutual and segregated funds are classified by the Canadian Investment Funds Standards Committee to standardize classifications of Canadian-domiciled mutual funds. Here is the definition of the Canadian Short-Term Fixed Income from their website: Funds in the Canadian Short Term Fixed Income category must invest at least 90% of their fixed income holdings in fixed-income securities denominated in Canadian dollars with an average duration of less than 3.5 years. In addition, these funds must invest primarily in investment grade fixed-income securities, such that the average credit quality of the portfolio as a whole is investment grade (BBB or equivalent rating or higher) and not more than 25% of the portfolio's holdings are invested in high yield fixed income securities. For purposes of the category definition, up to 30% of a Fund's assets may be held in Foreign Fixed Income products which will be treated as Canadian content provided that the currency exposure on those holdings is hedged into Canadian Dollars.

MISSING OUT ON POTENTIAL ANNUAL INTEREST INCOME OF $300-$500 MILLION

By continuing to hold money market funds rather than shifting into widely available premium savings accounts, Canadians are missing out on potential annual interest income of $300 to $500 million. Here's the quick calculation:

The average Canadian money market fund now yields between 0 and 0.1%. The top 10 MMFs by assets average 0.18%. Eight of the top 10 money market investments yield about 0.10% annually, while two outliers have prospective returns closer to 0.5%.

The big banks in Canada offer premium savings accounts with annual interest rates of 0.5% to 1.0%. Some non-traditional banks and trust companies pay daily interest savings rates of 1.2% to 1.5%. A handful of on-line only financial institutions are at 2.0% (Ally Bank) and 2.1% (People's Trust).

Note that these savings accounts, unlike money market funds, are backed (up to $100,000) by the Canada Deposit Insurance Corporation. Some also have minimum deposit requirements. See a long list of premium savings deposits rates in Appendix 2.

A 0.57% increase in the interest earned on the $55.7 billion invested (January 31, 2010) in Canadian money market funds would produce an extra $317 million in annual interest income. That represents the difference between the 0.18% average yield on the top 10 money market funds and the 0.75% rate available at some of Canada's major banks.

It is not hard to come up with much larger estimates. A 0.90% rate differential produces an extra $500 million in potential interest income. That calculation uses a current yield of 0.10% for MMFs and a 1% rate on premium savings accounts available at some banks and many other financial institutions.

It is of course simplistic to assume that all funds would be transferred. Our calculations give an idea of the magnitude of the opportunity cost of keeping funds in low-yielding MMFs. Some of the obstacles to Canadians selling their MMFs include:

- Pulling segregated MMFs out of contracts could lead to foregone guarantees and penalty charges.
- Investors who hold MMFs through Deferred Sales Charge accounts (many shifted from equity funds but stayed in the same "family" of funds) would incur penalty charges up to 7% upon sale, overwhelming the benefit of slightly higher interest income.
- Many Canadians hold their investments through RRSPs, and cannot easily transfer their funds without incurring extra fees, delays and additional paperwork.

Once interest rates start to rise, money market funds might narrow the differential to Premium Savings Accounts and even outperform. MMFs adjust to higher interest rates quite quickly, as their investments roll over. Deposit accounts at financial institutions tend to be "sticky" and slower to raise rates, depending on the competitive environment.

HOW POPULAR ARE MMFS?

At the end of 2009 Canadians held $58.3 billion in 257 different Money Market Mutual and Segregated Funds. That number is down from a peak of $74 billion in October, 2008, but still represents a very large sum of savings.

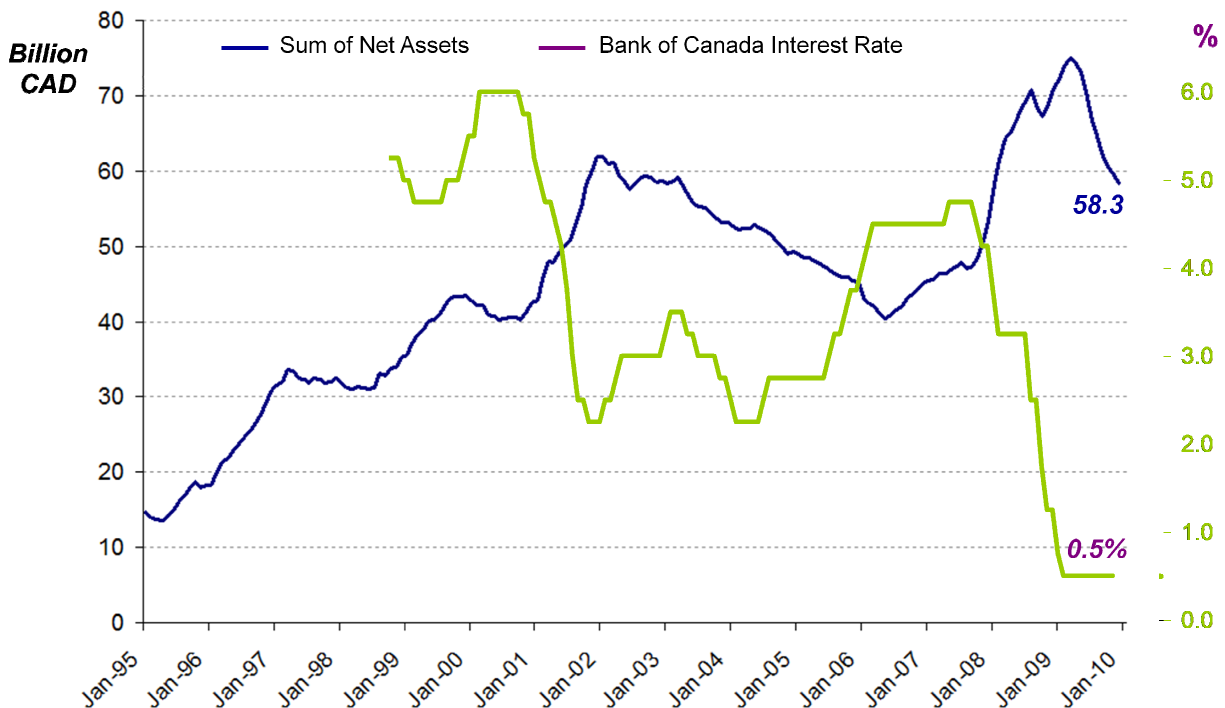
The big banks dominate the Canadian money market industry. RBC, the leader in this segment, has over 1 million money market fund customers. 80% or more of the market is composed of retail investors. Small businesses and corporations taking advantage of MMFs' professional cash management abilities comprise the rest. The U.S. $3.4 trillion money market fund business is quite different; 65% is controlled by institutional funds.[5]

On December 31, 2009, the top 10 Canadian Money Market Funds had average assets of $3.6 billion (ranging from $1.0 to $10.5 billion), accounting for 62% of all Canadian money market fund assets. Appendix 3 lists the performance of the top 10 funds by assets, as well as the best and worst performers by rate of return.

Flows of investor funds in and out of MMFs seem driven less by interest rates than by the performance of the stock and bond markets. When markets decline sharply, investors take refuge in money market funds, regardless of the actual returns. When markets improve, investors divert their funds from these safer, short-term instruments into longer oriented bond and stock funds.

[5] Sources: FAIR Canada interviews with Investment Funds Institute of Canada and Canadian money market managers; Investment Company Institute, Research Fundamentals, April 2009, p. 7.

CANADIAN MONEY MARKET FUNDS, 1995-2009



Source: Assets from Investment Funds Institute of Canada; interest rate is Bank of Canada's bank rate.

WHY CANADIANS HOLD MONEY MARKET FUNDS

Why do Canadians still hold $56 billion (at Jan. 31, 2010) in money market funds returning almost nothing? Particularly when they have safe alternatives that offer them a (slightly) higher rate?

Many Canadians invest in MMFs for short-term liquidity needs, or as a safe place to "park" their funds pending decisions about longer term investments. Some are not return-sensitive. Average holding periods are typically 8 to 10 months but can range widely.

Most Canadian investors probably don't know that current money market returns are essentially zero and, in the case of some insurance segregated MMFs, the returns are negative.

When Canadian investors discover these facts, learn about alternative savings products or get more comfortable investing in longer terms products, they are voting with their feet (albeit slowly). Money market funds have been declining by $1-$3 billion a month from their peak of

$74 billion in March, 2009. Money is being shifted into higher-yielding instruments or into longer- term investments like equity and bond funds.

There are a number of reasons why Canadians continue to hold Money Market Funds:

- **Safety.** The global financial crisis and resulting collapse in equities scared many investors. Meagre or even zero returns in MMFs are still more attractive than the sizable declines posted by virtually all equity funds in 2008.

- **Implied guarantee.** Even though MMFs are not backed by the Canada Deposit Insurance Corporation, there is an implied guarantee from the sponsors that they will make investors whole. While the money market sector as a whole tends to gain funds when economic and financial worries increase, the mix shifts. In less stable economic times, investors shift their money market funds from smaller firms to the biggest, safest banks.

- **Convenience.** MMFs are a very liquid cash alternative.

- **Habit.** Historically, MMFs have earned better returns than alternative cash investments, although that has not been true over the past several years.

- **Inertia.** For most investors, MMFs are a relatively small portion of their portfolio. Accessing higher-yielding investments does not seem to be worth the trouble. And for smaller investments, earning an extra half a percentage point of interest might not be sufficiently appealing to justify taking action.

- **Lack of knowledge.** Anecdotal evidence points strongly to the conclusion that most Canadians are unaware of the fees they pay and, indeed, of what their returns are.

LACK OF FINANCIAL ADVISOR INCENTIVE

Most Canadian financial advisors have no monetary incentive to gain from switching their clients into higher-yielding instruments, particularly ones that aren't "captured" by their own firm. Some mutual funds salespeople do not have access to high interest accounts.

Money market funds typically pay trailer fees of 0.25% to the advisor, while deposits do not. This is less of a factor in the current ultra-low interest rate environment, when many MMFs have cut or suspended both MERs and trailer fees.

Some new deposit products offered through FundSERV, the clearinghouse for selling mutual funds, offers the best of both worlds: higher rates for the investor and a small trailer fee to the advisor. Many advisors have shifted their clients' short-term funds into competing instruments like premium savings accounts or short-term fixed income funds.

EXIT FEES CAN BE A PAINFUL INCENTIVE TO STAY

Some Canadian investors are locked in to their current mutual or segregated funds by high exit fees associated with back-end loads. Many independent mutual fund companies and insurance companies (but NOT the banks or their discount brokerage arms) sell their funds through Deferred Sales Charges (DSCs) that do not charge up-front commissions. Instead investors pay a back-end load or exit fee when they sell. The fee is based on a sliding scale: typically 5-7% in the first year, declining by 0.5-1% each year to 0 if the investment is held for 7 years.

The financial services industry loved the idea of Deferred Sales Charges. Fund investors get to have all their cash work for them by avoiding front-end load commissions. Investors are encouraged to take a long term approach to investing by penalties on early withdrawals. The financial advisor gets paid a generous up-front commission (typically 5%) on such sales as well as a reduced trailer fee (typically 0.25% rather than 1.0%). Everyone wins, was the theory.

The practice has worked out somewhat differently. DSCs can lock investors into under-performing funds, in order to avoid the painful exit tax. Note that about half the funds charge the back-end load on the original amount invested, not the current market value. Investors eager to bail out of equity funds following the crash of 2008 could face onerous fees to get out.

Transfers within the same funds family avoid triggering the back-end load. So those 2008 equity market refugees could shift their investments to the same firm's money market fund. Even if the returns on the MMF are close to zero, that still beats the alternative of paying Deferred Sales Charges of 4% to 6% - often on the original amount invested, which had declined by 30% or 40%!

PERFORMANCE OF CANADIAN MONEY MARKET FUNDS - SUMMARY

	Average (Total)	Top 10 Funds Average	Benchmark: 91-Day Treasury Bill
30 DAY	0.00	0.02	0.02
3 MONTH	0.00	0.06	0.06
6 MONTH	0.02	0.13	0.13
1 YEAR	0.22	0.55	0.49
3 YEARS	2.00	2.42	2.64
10 YEARS	2.42	2.77	3.26
20 YEARS	4.10	n/a	4.92
Assets ($M)	227	3,631	
Current Yield	0.10	0.16	0.18
MER	0.99	0.62	

Source: GlobeFunds, cross-checked with Morningstar. All figures are in percentages except assets. 30 day, 3 month and 6 month numbers are actual (not annualized); all other figures are annualized. Yields are current as of Jan. 19, 2010. All performance numbers are as of December 31, 2009. Top 10 funds ranked by assets. Averages are arithmetic for all 257 funds, not weighted by assets.

DECENT HISTORICAL RETURNS, NOW DROPPING

The average Canadian money market fund returned 2% compounded annually over the past three years, 2.42% over 10 years, and 4.1% over the past 20 years. The top 10 funds performed better: 2.4% over the past three years, 2.77 over 10 years.

However, those returns have been falling substantially over this past year. The average return for all 257 Money Market Funds in the Globefunds database for the thirty and sixty days ending December, 2009 was zero. Six month returns were a little better – a positive 0.02%. One year figures rose slightly to 0.22%. Note that all returns are net of the funds' expenses but before the very real costs of inflation and (except for registered accounts) taxes.

Since most of Canadian investor money is held in the largest (mostly bank-owned) money market funds, it is important to focus on their performance. The top 10 funds had slightly higher returns than those for all funds: 0.02% for 30 days, 0.06% for 3 months, 0.55% for the year.

Most MMFs underperform the benchmark

The average Canadian money market fund has consistently underperformed the benchmark 91-day Treasury bill – a risk-free short-term investment in Government of Canada paper. The top 10 funds have matched the index over the past short-term (30 days, 3 and 6 months) and beaten the one-year benchmark. However, they have lagged over the longer term.

Canadian MMFs are allowed to hold other short-term assets that offer higher yields than 91-day Treasury bills (T-bills). The list includes federal and provincial bonds that mature in less than one year, corporate bonds, floating rate notes and Asset Backed Commercial Paper. All investments must have maturities of less than one year.

Holding higher-yielding investments improves MMFs' competitive position versus T-bills. On the other hand, posted T-bill rates do not include fees, while MMFs do. Most brokers do not charge their clients a commission for direct purchases of T-bills; they may make money off the spread between the wholesale and retail rate. Over time, those fees lead to many funds lagging the benchmark.

Hard to Differentiate Performance

The restrictions on the potential investments of money market funds leads to relatively small differences in their performance. Among the top 10 money market funds by assets, rates of return for the year ended December 31, 2009 mainly ranged between 0.32% and 0.61%. The top performer, BMO Premium, earned 1.05%; the bottom performer in the top 10, CI Money Markets, earned 0.19%.

The worst performing fund, Acuity Short Term Income, lost 0.39% in the three months and 1.3% in the year ending December 31. The top performing fund, United Cash Management Pool W, earned 0.31% in the three months ended December. Compared to the equity and even bond worlds, where differentials are much more significant, these are not huge differences. Of course, differentials between savings accounts, even premium savings accounts, are also not large.

Fees (discussed at greater length below) are a crucial differentiator. It is not a coincidence that the top money market funds in Canada by assets have some of the lowest fees available. None of the top 10 funds have MERs above 1%; the lowest is 0.32%. By contrast, the bottom 10 funds by performance have fees ranging from a low of 1.21% to a high of 2.3%.

Another important differentiator is risk profile. Some funds hold larger percentages of Asset Backed Commercial Paper (ABCP). Those funds not facing liquidity issues due to redemptions are able to move towards slightly longer term, less immediately liquid investments. Appendix 3 contains the detailed performance of the top 10 Canadian MMFs by assets, as well as the top 10 best- and worst-performing funds, ranked by returns in the past three months.

FEES

The average Management Expense Ratio for all 257 Canadian Money Market Funds is 0.99%. The top ten funds had average fees of 0.62%. Funds with less than $25 million in assets had average MERs of 1.06%.

The averages contain wide variations. There were 51 funds with quoted MERs at 1.4% or higher as of Dec. 31/09 – fully one-eighth of all funds. That figure does not include a number of funds that had officially lowered their MERs to 0 temporarily, in order to avoid losing money and not "break the buck."

The lowest fees were charged by some of the largest funds. RBC Premium Money Market, by far the industry leader with $10.5 billion in assets, charged 0.34%. The second largest MMF, TD Premium Money Market charged 0.32%. Both those funds require minimum initial investments of $100,000.

The fee "leaders" in the high fee world are the segregated funds. They offer some or all of the following features not available in other products: principal guarantees at maturity, death benefits, resets, guaranteed minimum withdrawals, shelter from probate charges. These features incur additional charges. There are several segregated funds that charge fees of 1.8%, 1.9%, even 2.3%.

Note that institutional money market funds pay much lower fees. They benefit from economies of scale and from the bulk purchasing power of aggregating their clients. For example, the Faculty Pension Plan at the University of British Columbia charges a 0.13% MER for its money market fund.

POSITIVE RETURNS – VERY DIFFICULT IN THIS INTEREST RATE ENVIRONMENT

Current rates make it almost impossible for Canadian money market funds to deliver positive returns to shareholders after fees. Government T-bill rates available to the banks range from

18 basis points for one month to 55 basis points for one year. Short-term bonds offered by banks and other high-rated entities offer slight premiums. Slightly riskier commercial paper has a further step-up in interest – 35 basis points for one to three months, rising to 80 basis points for a year. But the differences are quite minimal in the current interest rate environment.

All Money Market Funds face the cost of administration and of servicing their accounts. Many have historically paid a trailer fee to the selling advisor of 12 to 25 basis points from their MER. That trailer fee has been widely suspended in the face of ultra-low interest rates.

FEE REDUCTIONS AVOID NEGATIVE RETURNS

So how do fund companies manage to report positive returns, when their gross returns available from Treasury bills and other investments are below their stated Managed Expense Ratios? They are able to do so by cutting their fees.

At current interest rates, virtually all fund companies have cut their MMF-related fees. Usually they do not make big public announcements. They cut just enough to offset their costs, and to ensure that their returns do not turn negative.

Fund companies report their MER in their simplified prospectus. That fee cannot be adjusted upwards without formal approval at a unit holders' meeting – but it can be adjusted downwards at any time, without having to immediately disclose that information.[6] The total fees paid are disclosed in the annual and semi-annual financial statements of the fund.

A number of fund companies are continuing to operate with undeclared temporary fee cuts, in the expectation that rising interest rates will help bring their business model back onside. But Canadian investors should not have to rely on the kindness of their financial institutions to prevent them from losing money.

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[6] If the fees were waived or otherwise absorbed by the fund, the fund manager must disclose what the MER would have been without waiver, how long the waiver of fees will continue and how it might be terminated. See Part 15 of NI 81-106 *Calculation of MER* under s. 15.1(2). There is a school of thought that says that such fee changes are "material changes" that would be considered "important by a reasonable investor in determining whether to purchase or continue to hold securities of the investment fund." See Form 81-106F1, Part A, Item 1 (e).

AVOIDING "BREAKING THE BUCK"

By custom, Canadian money market funds are allowed to have fixed Net Asset Values of $10/unit. The price of the unit always remains at $10; the holder receives monthly distributions of the interest income after expenses (the MER). In the U.S., virtually all Money Market Funds are priced at $1; hence the origins of the term "breaking the buck."

What if the interest rate is so low that it fails to cover the MER? Almost all dealers have recently dropped their fees to avoid that scenario. Several have announced a permanent reduction in fees. Others have moved to implement temporary reductions without formal announcements.

What would happen if a fund broke the buck? Investors do not want to hear that their cash alternative is less safe than putting the money in a bank savings or chequing account – or their mattress. They would desert that product – and the manager's other offerings – in droves. The reputational and business risk is too great to justify a financial institution taking the risk.

We have not had a case in Canada of any money market funds breaking the buck. In the early 1990s, Altamira, then an independent mutual fund company, came close to that scenario. Altamira was caught with slightly longer term paper at a time when interest rates were rising rapidly. Altamira could not adjust rapidly enough. The company moved quickly to inject other funds into its MMF but the situation caused a scare. Rumours circulated that other bank-backed MMFs were also caught offside, but their parent banks quickly injected additional funds.

The same happened to Canadian MMFs during the non-bank Asset Backed Commercial Paper freeze of August, 2007. Twenty-four Canadian MMFs (but none of the Big 5 banks) had exposure to this paper – some held as much as one-quarter of their assets in non-bank ABCP. All of the funds moved to purchase that paper at full face value, in order to avoid breaking the buck.

On September 16, 2008, the day after Lehman Brothers went bankrupt, the oldest U.S. money market fund broke the buck. The Reserve Primary Fund launched the first U.S. MMF in 1971. 14% of Reserve Primary Fund's assets were tied up in Lehman-related paper that it could not immediately liquidate, so it posted a closing price of $0.97 that day. Investors promptly withdrew 60% of the fund's assets. Two days later, mutual fund giant Putnam suspended all withdrawals from its $12.3 billion Prime Money Market Fund.

That week, $300 billion was pulled out of all U.S. money market funds. Investors were convinced that the sky was falling. In order to stop the widespread panic from paralyzing the entire $3.4 trillion US money market industry and further aggravating the credit crisis, the US

Federal Reserve issued a blanket guarantee for all US money market funds on September 19, 2008. Interestingly, that guarantee recently expired, with no untoward effects in the market.

SUMMARY AND CONCLUSION

While there are certainly many valid reasons for holding money market funds, we suspect that many Canadians are not paying sufficient attention to the current very meagre or non-existent rates of return. Most Canadian MMFs are not making money. Fully one-quarter of all 257 Canadian C$MMFs are actually losing money.

Money Market Fund economics don't work in this ultra-low interest rate environment, when average MERs exceed the available wholesale rate of interest. Shifting into higher-yielding Premium Savings Accounts could increase Canadians' potential interest income by at least $300 million and possibly $500 million a year.

FAIR Canada calls for the following changes:

Improve disclosure of returns and fees. Investors should be notified when the return on a safe "savings account" type investment goes to zero or turns negative, and when fees are being cut. The current requirements - one-time disclosure of fees in the simplified prospectus, and semi-annual reports on total fees paid by the funds - are not prominent enough to serve investors properly.

Advisors should consider switching clients to higher-yielding alternatives. Investment advisors should act in their clients' best interest and consider recommending to their clients that they switch from MMFs to alternatives like CDIC-insured premium savings accounts, if there are no other compelling reasons to keep their clients in MMFs.

Greater investor awareness of what is happening in their accounts. Investors should stay current and well-informed about their accounts and financial alternatives, and not solely rely on their advisors.

APPENDIX 1

Comparison of Money Market and Short-Term Funds

	MONEY MARKET FUNDS (MMFs)	SEGREGATED MONEY MARKET FUNDS (SFs)	SHORT-TERM FIXED INCOME FUNDS (STFIFs)
REGULATION	MMFs are regulated by the provincial securities regulators [Securities Act, R.S.O. 1990, c.S.5, NI 81-101 and NI 81-102].	SFs are governed by federal and provincial insurance laws. [Insurance Companies Act, S.C. 1991, c.47; Insurance Act, R.S.O. 1990, c.1.8].	STFIFs are regulated by the provincial securities regulators. [Securities Act, R.S.O. 1990, c.S.5, NI 81-101 and NI 81-102].
DESCRIPTION	MMFs are types of mutual funds that invest in qualified short-term investment products. Investors can redeem their securities at any time directly from the fund.	*A.k.a. "indi*vidual variable insurance contracts" (IVICs), SFs usually have features of both a life insurance policy and a mutual fund.	STFIFs are funds that invest in short-term debt obligations. Bond Funds invest their assets in short-term government bonds, commercial bonds and commercial paper.
ISSUED BY	Banks, mutual fund companies, other financial institutions	SFs can be accessed only through an insurance contract (IVIC). They can be offered by different financial institutions.	Banks, mutual funds companies, other financial institutions
INVESTMENT REQUIREMENTS	MMFs must invest 95% of their assets in accredited short-term investments including Treasury bills, short-term federal and provincial government bonds, corporate commercial paper, and Bankers' Acceptances.	SFs invest 95% of their assets in accredited sho*rt-term investments.*	90% of funds in Canadian assets. Overall investment grade; no more than 25% in high yield bonds.
MATURITY REQUIREMENTS	MMFs cannot hold investments with maturities longer than 364 days. Their dollar-weighted term to maturity cannot exceed 90 days.	Maturity of less than 13 months (or 25 months for government securities) and a dollar-weighted term to maturity up to 180 days.	Average maturity must not exceed 3.5 years.
GUARANTEES	None	The maturity value of the contract is guaranteed (at 75% or 100% of the amount invested, depending on the specific policy) after a number of years (usually 10 years).	None
OTHER REQUIREMENTS	N/A	The life insurance and mutual fund characteristics of a SF must be kept separate from one another.	N/A
UNIT PRICE	Fixed Net Asset Value, usually at $10, occasionally $1/unit. Does not fluctuate	Fluctuates with daily changes in Net Asset Value.	Fluctuates with daily changes in Net Asset Value.

APPENDIX 2

High Interest Deposit Accounts

Financial Institution – Name of Account	Interest Rate (%)	Minimum Balance ($)
ATB Financial – Springboard Savings Account	0.75	0
Achieva Financial – Daily Interest Savings	1.85	0
Alterna Bank – Daily Step High Interest	0.90	0
Amex Bank of Canada – Investment Savings Account	1.00	0
B2B Trust – High Interest Savings Account	0.75	0
BMO Bank of Montreal – Smart Saver (2)	1.00	5,000
Bank of Nova Scotia – Scotia Power Savings Account (2)	1.00	5,000
CIBC – eAdvantage Savings (2)	1.00	5,000
CIBC – Bonus Savings Account (2)	0.75	3,000
Caisses Desjardins – Compt a Haut Rendement Desjardin (4)	0.50	25,000
Caisses Desjardins - Compt a Haut Rendement Desjardin (6)	1.10	100,000
Canada Life – Daily Interest Account	0.25	0
Canadian Tire Bank – High Interest Savings Account	1.35	0
Citibank – C$ Citibank Savings Account (3)	0.75	5,000
Dundee Bank of Canada – Investment Savings Account	0.70	0
HSBC Bank of Canada – Direct Savings Account	0.80	0
ICICI Bank Canada – Savings Account	1.20	0
ING Direct – Investment Savings Account	1.20	0
Laurentian Bank of Canada – Investment Excellence (2)	0.20	5,000
Laurentian Bank of Canada – Investment Excellence (6)	1.20	100,000
MAXA Financial – Regular Savings	1.85	0
Manulife Bank – Advantage account	1.00	0
National Bank – The Strategist	0.10	5,000
PACE Savings & Credit Union – Virtual (5)	1.20	25,001
Parama Credit Union – Regular Savings	1.20	0
Peoples Trust – Savings	2.10	0
President’s Choice Financial – Interest Plus Savings Account (2)	1.00	1,000
Royal Bank of Canada - RBC High Interest eSavings	0.75	0
State Bank of India – Super Saver	1.20	1,000
Steinbach Credit Union – Regular Savings	1.75	0
Sun Life Financial – Floating Interest Fund	0.25	0
TD Canada Trust – Guaranteed Investment Account	0.75	5,000

Source: Cannex.com. Rates effective Jan. 27, 2010.

APPENDIX 3

Top 10 Canadian Money Market Funds, by Assets

Fund name	Assets (Billions)	MER	30 day	3 mth	6 mth	1 yr	3 yr	Yield
RBC Premium	10.5	0.34	0.02	0.06	0.14	0.89	2.92	0.13
TD Premium	4.9	0.32	0.00	0.03	0.12	0.61	2.72	0.08
RBC Canadian	4.8	0.89	0.01	0.02	0.06	0.58	2.41	0.09
TD Canadian	3.9	0.76	0.00	0.01	0.05	0.32	2.21	0.05
CIBC	3.1	0.54	0.02	0.04	0.09	0.36	2.12	0.16
Scotia	2.7	0.75	0.01	0.03	0.06	0.39	2.15	0.10
Maclean Budden	2.6	0.55	0.05	0.13	0.25	0.78	3.02	0.44
CI	1.4	0.74	0.02	0.06	0.08	0.19	1.93	0.07
RBC C$ T-Bill	1.2	0.89	0.01	0.02	0.06	0.28	2.00	0.11
BMO Premium	1.0	0.41	0.06	0.17	0.35	1.05	2.76	0.63
Benchmark: 91Day T-Bill	**n/a**	**n/a**	**0.02**	**0.06**	**0.13**	**0.49**	**2.64**	**0.18**

Top 10 Canadian Money Market Funds, by 3 Month Performance

Fund name	Assets (Millions)	MER	30 day	3 mth	6 mth	1 yr	3 yr
United Cash Mgmt W	65.8	0.01	0.00	0.31	0.52	0.87	3.04
Manulife GIF SelAdv	228.5	0.00	0.08	0.25	0.52	1.32	2.78
SEI Series O	180.0	0.14	0.08	0.18	0.35	1.09	2.98
AIC Corp Class	50.9	0.89	0.21	0.18	0.07	0.70	2.15
Mavrix Multi ST Inc	3.6	0.53	0.00	0.18	0.63	0.82	1.74
BMO Premium	1025.6	0.41	0.06	0.17	0.35	1.05	2.76
Dynamic	43.3	0.80	-0.17	0.17	0.17	0.34	1.92
Highstreet	39.3	0.25	0.04	0.16	0.38	1.24	3.09
Manulife ML Elite	3.3	0.11	0.05	0.15	0.36	1.20	3.15
National Bank Treasury	448.5	0.28	0.05	0.14	0.30	0.91	2.82
Maclean Budden	2642.9	0.55	0.05	0.13	0.25	0.78	3.02

(continued on next page)

Bottom 10 Canadian Money Market Funds, by 3 Month Performance

Fund name	Assets (Millions)	MER	30 day	3 mth	6 mth	1 yr	3 yr	Yield
Empire Life Class C	2.3	1.51	-0.08	-0.17	-0.13	-0.03	1.86	0.02
Standard Life Ideal NL	16.0	1.21	-0.06	-0.18	-0.30	-0.16	1.87	0.15
IA Clarington Class B	0.2	1.40	-0.07	-0.19	-0.45	-0.67	n/a	0.15
DFS GIF 5	48.5	1.25	-0.15	-0.21	-0.30	-0.26	n/a	0.11
Cooperators VP	1.6	2.15	-0.12	-0.26	-0.43	0.21	1.70	0.54
DFS GIF 3	9.0	1.55	0.00	-0.28	-0.45	-0.58	1.40	
Imperial Life Growth	2.8	1.50	-0.05	-0.28	-0.41	-0.33	1.56	0.01
Co-operators VPNL	1.6	2.31	-0.14	-0.30	-0.50	0.05	1.54	0.33
Manulife GIF CAP A	20.8	2.10	-0.12	-0.35	-0.65	-1.1	0.97	
Acuity ST Income	0.6	1.95	-0.13	-0.39	-0.75	-1.3	n/a	

Source: Globefund.com. All figures in percentage terms, except for Assets. Performance figures as of December 31, 2009. Yields (last column) are as reported by companies on Globefund.com, and are current at January 19/10.