FAIR
Canadian Foundation for Advancement of Investor Rights
Fondation canadienne pour l'avancement des droits des investisseurs

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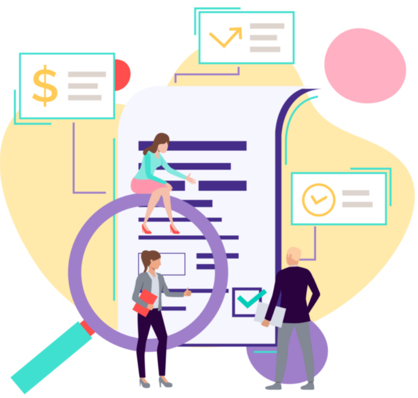
The Total Costs of Your Investments

Understanding the costs associated with your investments is key to helping you make the right decisions to reach your financial goals.



This is not always an easy task. For example, in the case of mutual funds or exchange-traded funds (ETFs), there are many kinds of fees that apply, depending on the type of fund you buy.

These can include:

Sales Charges: Fees that may be charged when you buy or sell a mutual fund or ETF.

Fund Expenses (aka the "Management Expense Ratio" or MER): These include a management fee, operating expenses, trailing commissions, and taxes charged to the fund you hold. The MER is expressed as a percentage of a fund's value.

Other Fees: These include fees that may be charged when you switch from one fund to another, or when you sell a fund within a short time (*e.g.,* 90 days)

See **Types of Fees** for more information about the fees you may pay

Some of these costs come directly out of your pocket, while others are deducted from your investments and affect your returns over time. For example, the MER is deducted from your investment and lowers your rate of return.

To illustrate how the MER impacts your investment, assume you invest $10,000 in a mutual fund with a MER of 2.5%.

• In very simple terms, the impact of a 2.5% MER would be the equivalent of you paying an additional $250 in charges ($10,000 x 2.5%) every year. The impact gets larger the longer you own the fund because of compounding.

• Another way of looking at it is to see how the MER affects the mutual fund's performance. For example, say that your mutual fund went up in value by 7% this year. After you deduct the MER of 2.5%, your rate of return will only be 4.5% for the year (7% - 2.5%).

Some, but not all, of these costs are listed in your annual account statements that your advisor sends you.

Why Aren't All Your Costs Listed on Your Statements?

One reason is that Canada's securities rules only require your advisor to tell you about the fees they receive. Since the MER is a fee paid to the mutual fund manager, it does not have to be disclosed in the annual charges and compensation report prepared by your advisor.

There are similar issues when you buy a segregated fund, which is a type of mutual fund that includes life insurance and is sold by life insurance brokers.

Financial services regulators across Canada are working together to find ways to address this problem and ensure you get a complete picture of all the costs associated with your investments.

As a first step, these regulators met recently with industry associations and investor advocates (including FAIR Canada) for input. A **press release** issued by Canada's securities regulators indicated that this project, dubbed the "total cost reporting initiative," is working to propose a regulatory framework on this issue. That framework will be as "harmonized as possible" considering the differences between mutual funds and insurance products.

Understanding Your Statements

The total cost reporting initiative is still in its early stages. In the meantime, you can check out these helpful resources to better understand your annual charges and compensation reports, which require some, but not all, costs to be reported to you:

• FAIR Canada produced a video explaining the "Annual Report on Charges and Other Compensation" when it was first required beginning in 2016. You can watch the video **here**.

• The Mutual Fund Dealers Association of Canada (MFDA), among others, produced helpful guidance to understanding the report your advisor must provide to you each year. See **MFDA Investor Guide: Compensation and Performance Reports**

Putting Your Interest First, Not Your Advisor's Interest

On June 30, 2021, new rules kicked in that require your advisor to resolve “material conflicts of interest” in your favour when giving you advice on how to invest your money. The rules (called the Client-Focused Reforms) also require your advisor to identify and tell you about these conflicts in a timely manner and avoid these conflicts if they cannot be addressed in your favour.

Some Examples of “Material Conflicts of Interest”

Paid Referrals: Your advisor may receive a fee or other benefit for referring you to someone else for other products or services. Under the new rules your advisor has to make sure the referral is in your best interest. If it would result in paying higher fees for the same products or services, the referral would be against the rules.

Recommending in-house/proprietary products: Your advisor may recommend investing in a financial instrument created by the firm they work for. For example, an advisor working at a bank may suggest you buy one of the bank’s mutual fund products. These are considered in-house or “proprietary products” that create a conflict of interest. In this example, under the new rules, the bank has to be able to demonstrate that it is addressing this conflict in the best interest of its clients. One way the bank can do this is to not pay any incentives to its advisors for selling proprietary funds versus other funds.

Internal incentives: Your advisor might receive incentives for recommending/selling specific products or services. This could lead to recommendations that are not in your best interest. Firms can address this by not paying such incentives to their employees.

Third party compensation: Your firm or advisor might receive compensation from a third party for recommending specific products to you over others. The new rules consider this to be a conflict. Firms must be able to demonstrate that recommendations are made without being influenced by any third-party compensation tied to the product being recommended.

When dealing with an advisor, you have the right to be told about these types of situations that may put your advisor’s interest ahead of yours.

Be sure to ask the right questions, such as how they resolved any conflicts in your favour. That can go a long way in helping to protect you and your investments.

There’s one last thing you need to know. The new rules on conflict of interests will not apply to mutual funds with deferred sales charges (DSCs), at least for now. As explained in our **May Newsletter**, the sale of mutual funds with DSCs is being banned in Canada on June 1, 2022 because these charges are unfair and create a potential conflict of interest.

Even though advisors can continue to sell you DSC funds for another year, you should speak to your own advisor about avoiding these types of products or switching out of them. Don’t wait for the ban to come into effect in 2022. You can start today by discussing any DSC funds in your portfolio.

Don’t Be Fooled by Gimmicks

In our last newsletter, we discussed the recent increase in the number of “do-it-yourself” (DIY) investors and the pros and cons in taking this approach to investing.

One of the benefits of DIY investing is that you can use an app on your smart phone to buy and sell shares and other securities. However, some apps are raising concerns with regulators because of the way they make investing seem like a game.

Known as “gamification,” the apps build in different gimmicks to encourage you to trade more often or make decisions that may not be in your best interest. For example, the apps may award prizes, such as free stocks or token badges. They may also include your name on leaderboards based on the number of trades you make.

Make no mistake – these features are deliberately designed to influence your investment decisions and trading behaviour through different prompts and psychological nudges. They may be amplified on different social media platforms that target less experienced investors and try to hype certain stocks or baseless investment strategies.

The problem, of course, is that investing is not a game. Your investment decisions have real life consequences and can impact your financial well-being now and into the future.

The issue of gamification has become such a problem that regulators are beginning to raise concerns. In the U.S., for example, the Securities and Exchange Commission (SEC) has announced that it is studying gamification and behavioural prompts on apps and is reviewing how these apps make trade recommendations.

In addition, the Financial Industry Regulatory Authority (FINRA), also based in the U.S., is seeking public comment on gamification practices used by trading platforms to attract investors. FINRA aims to develop new rules/guidance based on the input they receive.

This issue has also caught the eye of regulators in Canada. For example, Ontario Securities Commission Chair and CEO Grant Vingoe recently warned about this trend in a **broadcast interview**. "I believe the industry as well as the regulators have a responsibility to temper impulse trading and the tendency towards what’s being referred to as ‘gamification,’ where people are jumping on trades without much reflection,” he said.

It will take time for regulators to catch up to the firms that use these techniques. Until then, you should be aware of, and protect yourself against, the game-like gimmicks designed to make you trade more, as opposed to making smart investment decisions.

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FAIR Canada

36 Toronto Street, Suite 850
Toronto, Ontario M5C 2C5
647-256-6690

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