

Canadian Securities Administrators
CSA Discussion Paper and Request for Comment
81-407 *Mutual Fund Fees*

April 12, 2013

Dear Administrators,

Your December, 2012, paper sets out the complexity of the mutual fund fee issue quite well. The downward trend in investment costs is positive, but much lower costs are necessary. Your discussion of the harmful side effects of embedded advisor compensation fees is refreshing. (I would have inserted the word grotesque here and there to make your points more forceful.) It is obvious, however, that you do not have a bold plan for proceeding from here. You have essentially transferred your institutional responsibility to the pipedream of consensus. Nor do the regulatory responses in other jurisdictions present Canada with any more than a few minimal steps: See the list compiled by the far more eloquent, diplomatic and informed commentator, Keith Ambachtsheer.

As Mr. Ambachtsheer has done, I would encourage you to step back and look at some fundamental issues. Consider which policies would lead to a more satisfactory outcome for the Canadian public and economy over time. Look beyond your mandate as securities regulators, and work with other arms of government. Together you might have the legislative capacity to throw down a challenge to the private sector: Come up with a satisfactory solution that would meet these minimum standards for performance and consumer protection, and do it within a set time period. Take your cue from the public response to the scourge of tobacco smoking, not the approach of the Roman Catholic Church to priestly pedophilia.

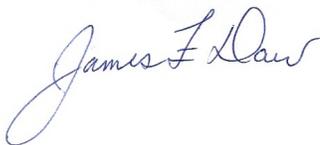
I suspect that not much will be accomplished by requiring disclosure of fund facts in a simpler, more prominent fashion, or by providing consumers with a choice of payment options for advisory services. These measures may be somewhat helpful, however, and they are surely minimal first steps. It is more likely that the most likeable and efficient of advisers will continue to attract the most client assets, earn the highest income for their marketing skills and continue dealing with products and a compensation model that will deprive consumers of the best-possible outcome.

The over-riding challenge is to address the high cost retail investment funds, the lack of scale and endless diversification of investment vehicles within a puny Canadian market. The least disruptive way to do so, I think, would be to encourage a competitive alternative to retail mutual funds, either within the public sector or the private sector. This is where other arms of government could have a role in encouraging the development of institutions that could manage retirement savings and income provision on a sufficiently large and professional basis. This may have to spring from certain provinces, as long as the federal government and other provinces turn their backs on this vital issue. Meanwhile, we need to all recognize and warn the public:

- Each percentage point of annual management (and marketing) expense will -- over time -- subtract about 20 per cent from the potential of a person's ultimate retirement income. (See Ambachtsheer's calculations.)
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- Most actively managed mutual funds will -- over long periods -- under-perform broad market indices, roughly in proportion to their management expense ratio. (See Ambachtsheer's citation of academic research.)
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- The mandatory disclosure in fund advertising -- that 'historical returns are no predictor of future returns' -- should be matched by a comparable warning that advisers are simply not equipped to direct investors to future performance leaders within the mutual fund sector.

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- The most useful advice for investors would address the importance of staying invested, the perils of market timing, the components of an investment portfolio appropriate to age, income and purpose, and suitable saving rates to achieve various targets. The public might then be more receptive to more economical investment choices, such as index-traded funds.
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- Public education would help more, at less cost, if it were furnished to advisors, along with the tools to help them personalize general principles for clients in a cost-effective and consistent manner. The time that financial advisers spend sorting through the massive selection of fund products, and compensation provisions, adds little, if anything, to client portfolios. A shakedown in the selection of funds would occur if there were competition from new, large-scale, balanced-portfolio alternatives. This would free advisers to concentrate on financial planning advice and education, instead of product marketing and portfolio balancing. Portfolio balancing should be left to teams of expert analysts, economists and managers, with a fiduciary responsibility to investors, and an objective of low costs.

Thank you for the opportunity to comment.



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