INVESTOR ADVISORY PANEL

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By Email

Ken Woodard
Director, Membership Services & Communications
Mutual Fund Dealers Association of Canada
121 King St. West, Suite 1000
Toronto, ON M5H 3T9
kwoodard@mfda.ca

Re: IAP Response to MFDA Discussion Paper on Expanding Cost Reporting

The members of the Investor Advisory Panel (IAP) welcome the opportunity to provide comments on the Mutual Fund Dealers Association of Canada (MFDA) *Discussion Paper on Expanding Cost Reporting*. The IAP is an initiative by the Ontario Securities Commission (OSC) to enable investor concerns and voices to be represented in its rule and policy making process. We are pleased to see the Mutual Fund Dealers Association of Canada (MFDA) focusing on this important issue and have consistently called for greater transparency around cost reporting – retail investors must know what they are paying for their investments and the impact those costs have on their returns over time.

Background

The MFDA's recent discussion paper follows on its 2015 *Consultation Regarding Cost Reporting for Investment Funds* which sought input on expanding cost reporting to include management fees, fund operating costs, redemption fees and short-term trading fees. At that time, the IAP expressed its support for the initiative, indicating that:

- *"Full disclosure of costs should be just that – a full list of all costs. Otherwise, what is the point of having rules for charges and compensation reporting?"*
- *"Full disclosure of costs should extend to all investment products and services, not just a select few. There is no reason for excluding any product or service from cost disclosure – this is a fundamentally important piece of information for investors."*

In light of the introduction of CRM2, the MFDA is revisiting the feedback it received in that initial consultation "*to advance the discussion to ensure mutual fund investors in Canada have a complete and accurate understanding of costs associated with their investments in order to make informed choices*." As noted in the paper, costs associated with owning mutual funds that are not currently required to be disclosed include the ongoing costs of owning investment funds, transactional costs, and costs related to other investment products. The discussion paper also includes examples of how this reporting is currently being done by some in the industry and seeks comments on their effectiveness.

Our general comments

The IAP is pleased to see the MFDA continue to push for better cost disclosure for investors in consultation with a wide range of stakeholders. Fundamental to any economic decision is a cost/benefit analysis – but without adequate information on costs, it's virtually impossible for the average investor to make such an assessment. If investors are to make informed judgments regarding mutual funds, they must be able to understand the full amount and ultimate impact of costs.

In order to better enable investors to make more informed decisions regarding purchasing investment products, the IAP recommends that the long-term compounded impact of fees should be made very clear as part of the cost disclosure. Since the potentially significant effect of compounding is not intuitive, limiting disclosure to annual fees and other costs is not sufficiently transparent for most retail investors. Understanding annual costs simply doesn't translate into understanding ultimate costs. Few investors realize that 1% or 2% annual fees can, over the long term, consume 25-50% of their total investment returns.

In recognition of this pervasive investor blind spot, other regulatory jurisdictions have taken remedial action. In the United Kingdom (UK), the Department of Work and Pensions recently introduced regulations requiring defined contribution (DC) pension fund providers to clearly demonstrate the cumulative, compounded impact of costs and charges over time. As the UK government has noted:

> *"The regulations require trustees and scheme managers of certain occupational pension schemes offering money purchase benefits to…provide an illustrative example of the cumulative effect of the pension scheme fund charge and transaction costs incurred by the member."*

These new disclosure rules will apply to roughly 10 million UK retirement savers. To support trustees and managers, the government has also provided guidance including the following illustration of the type and format of reporting required, which includes before and after calculations that take into account the impact of cost over time, from one year to 40 years:

Projected pension pot in today's money								
	Fund choice							
	Default fund		Fund A		Fund B		Fund C	
Years	Before charges	After all charges + costs deducted	Before charges	After all charges + costs deducted	Before charges	After all charges + costs deducted	Before charges	After all charges + costs deducted
1								
3								
5								
10								
15								
20								
25								
30								
35								
40								

Canadian regulators have also recognized this issue. Mutual funds are required to provide disclosure of the impact of costs over time. However, this disclosure is limited and, most problematic, it is often difficult to find within the dense legalese of the prospectus. Few, if any, investors ever see it. This is an example of a well-intended regulatory requirement that misses the mark.

We believe that the long-term impact of fund costs over a range of time frames (making clear the gap between pre-cost and post-cost returns) must be presented in a manner designed to reach, and be understood by, investors (including prominent display in the Fund Facts document).

The following is an example of the type of disclosure which we believe would be effective:

Fund Expenses Impact on Portfolio Returns

Assuming a 6% annual return before expenses, the illustrative table shows (i) the total return before costs; (ii) the amount consumed by costs; and (iii) the net return to the investor after costs on a $1,000 investment in a mutual fund with a 2% MER:

Impact of Fund Costs Indirectly Borne by Investors (assuming 2% annual MER)

Investment Holding Period (Years)	1	5	10	20	30	40
Total Fund Return Before Costs	$60	$338	$791	$2207	$4743	$9286
Fund Return Consumed by Costs	$20	$121	$311	$1016	$2500	$5485
Net Fund Return After Costs	$40	$217	$480	$1191	$2243	$3801

Responses to discussion questions:

Based on the specific questions posed in the consultation document, the IAP offers the following responses:

Expanding Cost Reporting

1. *Should regulators consider expanding cost reporting for Investment Funds?*

   For the reasons discussed above, yes.

2. *Should regulators consider expanding cost reporting for other investment products?*

   For the reasons discussed above, yes.

Costs Considered for Expansion

3. *Do you agree that the costs considered in this Discussion Paper (i.e. MER, short-term trading fees, redemption fees and client costs paid directly to third parties) should be disclosed to clients?*

   For the reasons discussed above, yes.

4. *Are there any other costs that should be reported to clients?*

   All costs (or cost estimates) should be reported.

Cost Reporting

5. *What are your views on the reporting examples provided in this Discussion Paper?*

   The proposed reporting would be more helpful to investors if complemented by reporting of the long-term impact of ongoing costs

6. *Are there better ways to report the costs of investing to clients?*

   For the reasons discussed above, yes.

7. *What challenges or issues do you foresee in obtaining and reporting expanded cost information to clients?*

   Dealers will inevitably complain about the difficulties and costs associated with collecting and reporting individualized costs of ownership. However, as witnessed with CRM2, similar issues were raised by dealers, but once the new requirements were put in place all dealers managed to meet them without obvious strains or difficulties.

8. *Are there different challenges or issues to expanding cost reporting for investment dealers or other securities registrants?*

   Notwithstanding the specific business model, any registrant permitted and prepared to sell securities to retail investors must be required to meet a single standard of full investment cost disclosure to clients.

Implementation

9. *Based on the cost reporting approaches detailed in this Discussion Paper, what would be a realistic timeframe for implementing expanded cost reports to clients?*

   As soon as is feasible and no later than January 1, 2020.

Conclusion

We support the MFDA's desire to "*ensure mutual fund investors in Canada have a complete and accurate understanding of costs associated with their investments in order to make informed choices*." The IAP believes this can only be achieved by full cost disclosure supplemented by a clear and prominent illustration of potential investment results over time, both before and after costs.

Sincerely,

"***Letty Dewar"***

Letty Dewar
Chair, Investor Advisory Panel