TORONTO STAR
www.thestar.com

Activist raises tough questions on fund fees

Sep. 7, 2006. 10:09 AM

JAMES DAW

Business Columnists
James Daw
David Olive
Ellen Roseman
Tyler Hamilton
David Crane
Bill Carrigan
Jennifer Wells

A debate over high mutual fund fees continues to rage, with analysts and investor advocates demanding more information.

Three American and British researchers set off a controversy when they calculated Canadians pay the highest average fees in the world, and far more than the average among developed countries.

Their precise figures have come under attack, and are under review. But the issue of fee levels is vitally important, particularly if we are entering a world of low investment returns.

Many pension plans are forecasting returns in the range of only 5 per cent to 7 per cent, notes independent analyst Diane Urquhart. If so, a 2 per cent annual fee would deprive investors of about 30 per cent to 40 per cent of their gains. And 2 per cent is less than what many Canadian mutual funds charge per year.

Researchers Ajay Khorana, Henri Servaes and Peter Tufano report in a draft research paper that Canadian mutual funds charged an average management expense fee of 2.68 per cent a year, compared with 1.42 per cent in the U.S. at the end of 2002. Sales charges lifted the effective annual costs even higher.

Windsor analyst Dan Hallett is critical of the authors' figures. But he is prepared to accept earlier estimates that average fund fees were 2.44 per cent in Canada, versus 1.61 per cent in the United States.

Those fees may help explain why few mutual funds do as well as stock market indices, or funds that charge lower fees and merely track a major stock market index.

Standard & Poor's Corp. reports that fewer than 19 per cent of Canadian equity funds beat the S&P/TSX composite index during the first half of 2006, and fewer than 14 per cent over the previous five years. In the United States, 38.6 per cent of U.S. equity funds beat the S&P 500 index early this year, and 25 per cent over the past five years.

Other factors may help to explain the lagging performance of funds in Canada, such as a reluctance by managers to bet as heavily on energy and resource stocks as does our value-weighted market index. But investor advocate Ken Kivenko argues the fee differential should be a matter of public concern.

An industry association for mutual fund companies has promised to respond to the controversy over fund fees by the end of the month. So Kivenko has jumped on the opportunity to ask some pointed questions.

Kivenko's questions will give other investors something to think about, even if the Investment Funds Institute of Canada chooses not to respond:

- Why can't do-it-yourself investors buy F-class funds, which are cheaper because managers don't pay annual trailer fees to salespersons?

- Why do firms that charge penalties to investors, who redeem early from funds with deferred sales charges, not return the fees to the fund's assets?

- Why, in most cases, are the same management and sales charges deducted from investors whether they pay sales charges at the time they buy, or only when they redeem within six years or so?

- Why are the trailer fees so high, at 1 per cent to 1.25 per cent of assets in many Canadian funds compared with 0.25 per cent in the United States?

- Why are management expenses not reduced by a prescribed formula as assets rise in value within a fund? Are there no economies of scale as funds grow?

- Why aren't sales distribution costs broken out on financial statements, the way the so-called 12b-1 fees are broken out in the United States?

- Why is there no independent board monitoring fund expenses, supplier selection and manager performance?

- Why do managers of index-tracking funds charge such high management and sales charges compared with U.S. funds and exchange-traded index funds?

- Why can't Canadians have access to low-cost American funds, considering the North American free-trade agreement?

- Why do more funds not use fee schedules that rise or fall depending on the performance of the fund?

"Many more factors could help to bring down total fund expenses," says Kivenko. "Hopefully, (the institute) will provide some good answers supported with facts, research and numbers."

***James Daw**, CFP, appears Tuesday, Thursday and Saturday. He can be reached at Business, 1 Yonge St., Toronto M5E 1E6; at 416-945-8633; 416-865-3630 by fax; or by email at jdaw@thestar.ca.*

Additional articles by James Daw

Click here for copyright permissions

Get great home delivery subscription deals here!

FAQs | Site Map | Privacy Policy | Webmaster | Subscribe | My Subscription | RSS Feeds | Webmaking Blog

Home | GTA | Business | Waymoresports | A&E | Life