INVESTING

Understanding Mutual Fund Fees

Mutual Funds – Canada's Most Popular Form of Investment

Over the last two decades Canadians have overwhelmingly embraced mutual funds as their investment of choice. Today, it is estimated that approximately 35% of all households own mutual funds,[1] and the $1 trillion currently held in some 3,000 different funds represents more than 30% of all the financial assets in Canada.[2] Why are mutual funds so popular? Simply because the many features and benefits they deliver make mutual funds an ideal vehicle – either as a single "do it all" investment or as one component of a well-structured portfolio.

Like any other investment, of course there are costs associated with mutual funds. Since advised, well-informed investors tend to make better decisions, stick with their plans and, ultimately, have better experiences, we think it's important for you to understand not only how – and how much – you are paying for your mutual fund, but also what exactly what the amount you pay is buying in terms of services.

Mutual Funds – Many Benefits!

- Professional asset management – some of the world's leading asset managers work for you on a daily basis, deciding what stocks and bonds to buy and sell
- Instant diversification – a single transaction gives you a well-diversified portfolio of securities
- Flexibility – you can invest as little as $100…or much more. Systematic plans allow you to make automatic regular monthly purchases to accumulate capital, or dispositions of fixed amounts every month to generate an income from your savings
- Versatility – you can find a fund that's appropriate for just about any investment objective;
- Liquidity – most funds can be purchased or resold daily
- Automatic reinvestment of dividends – this produces a powerful compounding effect that grows your savings more quickly

The Management Expense Ratio Explained

The management expense ratio (MER) represents the amount charged to your fund to cover the costs of running the fund and distributing it. The MER is expressed as a percentage and calculated by dividing the fund's annual management, operational and distribution expenses by the total assets in the fund. For instance, a $100 million fund with expenses of $2 million would have a MER of 2%. If you had $10,000 invested in this fund, the share of the expenses you bear would be $200. Broadly speaking, the MER includes:

- compensation for the asset manager
- the cost of investment research
- amounts to cover the administrative costs associated with running a fund company
- shareholder record-keeping and reporting costs
- marketing expenses
- legal fees associated with filing the original prospectus and its annual renewal
- compensation for the investment dealers and advisors who distribute the fund
- GST, and HST where applicable

MERs are debited directly from the fund's assets on a regular basis, so the net asset value per unit and fund performance data you see published in various places is stated on a net basis after subtraction of the MER. Looking for the MER of a fund you own? You can find it in Fund Facts, a document that all fund companies are required by law to produce for each of their funds and send to all unit-holders immediately after the initial investment in the fund is made. Fund Facts is also available directly from the fund company upon request, from your advisor, or online from the Canadian Securities Regulator's System for Electronic Document Analysis and Retrieval website (www.sedar.com).

MERs, TERs and Management Fees?

MER stands for Management Expense Ratio. TER is the abbreviation for Trading Expense Ratio, which measures the execution cost for the fund's portfolio transactions. The management fee is merely a subset of a fund's total costs, to which taxes and administrative fees are added to arrive at the MER. Note that the MER does not include the fund's trading costs so, technically, the total cost borne by the fund is the sum of the MER and the TER (both of which are detailed in the Fund Facts document). Confusing? Definitely! To simplify things, we suggest that you focus on the MER since it shows a more complete picture of total cost than the management fee, and given that for most mutual funds the TER is a negligibly small amount.

Other fees you may be charged

This document has focused exclusively on what is charged directly to the mutual fund. Depending on your choice of financial institution, the nature of your relationship with this financial institution and the series of fund you invest in, certain fees and expenses may be charged to you directly. Examples would include:

- Registered plan fees – if you purchase the fund in an RRSP, RRIF, RESP or TFSA account
- Sales commissions – often referred to as a load, and charged either upon purchase or when you redeem, but not both
- Transaction fees – certain financial institutions charge a fee for executing your purchase or redemption transaction

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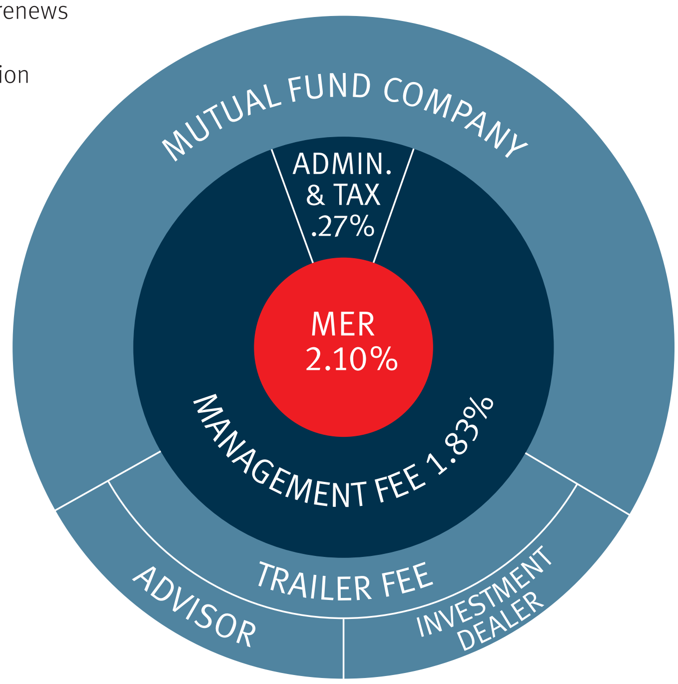
Investing in Mutual Funds – Three Partners Playing Three Different Roles

Of course the fund company is paid for the products they bring to market, but there are other parties that play an important – if not essential role in your mutual fund investment. In most cases you will be working with an advisor who helps you set your goals, define your investor profile, choose the appropriate fund or funds and monitors your portfolio on an ongoing basis. The investment dealer for whom your advisor works is also an important part of the picture, since the dealer is responsible for opening and maintaining your account, as well as a myriad of associated activities described in the diagram below. With most funds, a portion of the management fee, often referred to as a "trailer fee", is remitted to the investment dealer as compensation for the work the dealer and the advisors do. Hereafter you will find, as an example, this partnership displayed.

Three Partners – Three Different Roles

The Mutual Fund Company

- "Manufactures" the fund (creation, registration with securities commissions, etc.)
- Manages the fund's assets – either internally or sub-contracting to external portfolio managers
- Maintains unit-holder record-keeping
- Files annual information forms, renews fund prospectus annually
- Produces tax reporting information for the unit-holders



Your Investment Advisor

- Works with you to create a financial framework for your investment decisions
- Helps you clarify your time horizon and risk tolerance
- Recommends the mutual funds and other securities which best suit your investor profile
- Monitors your portfolio on an ongoing basis, recommending rebalancing transactions as appropriate

Your Investment Dealer

- Opens and maintains your account that will hold the mutual funds and other investments you purchase
- Processes the transactions
- Sends ongoing reporting in the form of account statements and other documents to you
- Underwrites Canadian Investor Protection Fund coverage on your account
- Provides the infrastructure required by your Investment Advisor (physical location, systems, regulatory, etc.)

Different Needs? Different Series

As the Canadian mutual fund industry matures, it is constantly introducing new products to better serve its customers. One of the innovations we have seen over the last decade is the launch of new series of funds with the same underlying investment characteristics, but with different cost structures. For example, a fund company might offer its Canadian equity fund in three different series: a "plain vanilla" series for most investors, a second series for High Net Worth investors requiring a substantial initial purchase with an accompanying lower management fee, and a third designed to be held in a fee-based account with the investment dealer and advisor component of the fund's cost structure stripped out. Each of these series, typically identified by a single letter (e.g. the "A" series versus the "B" or "C" series) will have a different MER. Your Investment Advisor will recommend the series that is best for you in light of your personal situation.

Sources:
1) Investment Funds Institute of Canada
2) Investor Economics

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