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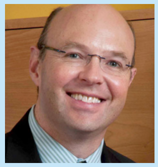

Nigel Roberts, MBA, CFA **is the president of Bluenose Investment Management Inc.** Bluenose provides comprehensive investment counselling and portfolio management services to individuals and institutions. For other articles visit **www.bimi.ca**
To contact Nigel, call 250-548-3232 or email: nroberts@bimi.ca

On Track with Investor and Advisor Interests

Employee behaviour is influenced by how they are compensated. Similarly, by considering how investment advisors are compensated, investors can evaluate if their advisor is being rewarded in a way that is aligned with their interests and investment goals.

Financial advisors are compensated on either a transaction commission or an asset based fee arrangement. A transaction-based commission is the most common. Mutual funds are often a combination of the two with advisors receiving both a transaction commission and on-going fees.

TRANSACTION-BASED COMMISSIONS — In a transaction-based arrangement a commission is taken every time a security is traded. For example, a buy order for 100 shares of a $10 stock costs $1000 plus a commission. Bonds and coupons work the same way except that the commission is built into the price and is essentially a mark up from a wholesale to a retail price. The commission rates at discount brokers are lower compared with full-service brokers because the advisor portion of the commission is removed. In a transaction-based arrangement, compensation is proportional to the value and number of transactions.

ASSET BASED FEES — In an asset-based fee arrangement, an annual fee is paid based on the value of the assets managed. Many large investment brokers offer 'wrap' or managed accounts with the annual fee typically starting at 4% including trading costs.

Investment Counsellors and Portfolio Managers annual management fees are typically 1.25% or less. Trade execution costs are at institutional rates and bonds and coupons are bought at the wholesale price.

Institutions and private investors with large portfolios often choose this type of fee arrangement because the advisor is motivated to increase the portfolio value. A cost advantage of the fee-based approach is that the fees are tax deductible if paid from a non-registered account.

MUTUAL FUNDS — A mutual fund holds securities that are managed by a portfolio manager. Many mutual fund unit holders are surprised to learn that there is an annual cost for the management of these securities.

Just like any business, there are costs to operate a mutual fund such as management expenses and sales commissions. A mutual fund pays a management fee to the portfolio manager to manage the fund's assets. The fund also pays other operating costs such as accounting, legal and marketing. The management expense ratio or MER is the total of these costs divided by the total value of the mutual fund.

The MER of most Canadian equity funds is between 2% and 4% with the average being 2.7%. For example, an investor with $100,000 invested in a fund with a MER of 2.7% is paying $2,700 annually to the fund company. The MER does not usually include trading costs that add an average of 0.4% per year. Mutual fund unit holders don't receive a bill for either of these services as these costs are paid directly from the mutual fund's assets. MERs are reported to unit holders in the fund's financial statements and the monthly mutual fund feature in our national newspapers.

SALES COMMISSIONS — Sales commissions compensate financial advisors who sell funds on behalf of a mutual fund company. They are usually charged in one of two ways. In a front-end load, the unit holder pays an amount to buy the fund and can sell it at anytime at no commission. In a deferred sales charge (DSC) arrangement there is no up-front commission paid but there is a selling commission if the fund is sold within a time period, typically 7 years. In either case, the mutual fund company pays the investment advisor a commission for selling the fund. The fund company also pays the advisor an annual 'trailer fee', which is intended to compensate the advisor for providing on-going service to the investor while holding the fund. The trailer fee is usually included in the MER but check each fund to be sure.

No-load funds have a similar MER, but have no sales commissions although there may be a transaction cost if the fund is not purchased directly from the fund company. No-load funds are typically sold directly by mutual fund companies or discount brokers. Transaction-based advisors are unlikely to select mutual funds that do not pay commissions or trailer fees. Whom do you serve?

In summary, the mutual fund costs paid by a unit holder are an annual amount for the management and operation of the fund (MER plus the funds trading costs) plus a sales commission. Mutual fund companies are dependant on attracting advisors to recommend their products. Advisors have financial incentives biased towards selling and keeping mutual funds with higher sales commissions and trailer fees. Transaction based advisors are also unlikely to recommend 'no-load' funds with no financial incentives.

By being aware of the compensation structures for financial advisors, you can select the one that is best suited to your circumstances and needs. Recognize that there are often inherent conflicts of interest. Ask your advisor how they are compensated and discuss any potential conflicts of interest and how they deal with them—after all it is your money.