Shareholders Win as Bank of Nova Scotia Cuts Fees

Description

Bank of Nova Scotia (TSX:BNS)(NYSE:BNS) announced January 10 that its ScotiaFunds subsidiary was implementing a new pricing model effective immediately that lowers 51 of its mutual funds' annual management fees.

In addition to lower fees, ScotiaFunds is simplifying its pricing model, so clients can more readily understand their fees. In an age of greater transparency, this should come as a welcome surprise for ScotiaFunds's clients.

BNS shareholders might be tempted to conclude this move is only going to reduce the annual revenue generated by ScotiaFunds, but that would be off the mark.

Yes, in the short term, there will be some financial pain, but in a world where asset management has become a commodity, lower fees are a new reality.

"The two major [investment] trends are commoditization and transparency," Charles Schwab CEO Walt Bettinger said on December 31, 2016, in a Q&A with *Investor's Business Daily*. "Commoditization has arrived for commissions (with discount brokers), is occurring right now in asset management (as seen in the shift to passive investing), is underway in asset allocation and is beginning in financial and investment planning."

Although Bettinger is talking about the U.S. experience, the same thing is happening here in Canada, as witnessed by CRM2, the industry-wide regulatory changes implemented over the past three years requiring investment firms and their financial advisors to be more transparent about the fees clients pay as well as the true performance of assets under their management.

A bigger concern for BNS shareholders is the fact it doesn't have a suite of ETFs like **Bank of Montreal**, **Royal Bank of Canada** or **Toronto-Dominion Bank**.

Add to this the fact that Vanguard Canada now has four actively managed global ETFs that charge 0.35% annually, a fraction of the MERs charged by ScotiaFunds's mutual funds, even after this latest fee reduction, and the business case for its 51 funds definitely becomes questionable over the long haul.

Vanguard’s presence in Canada is the most disturbing of the points mentioned in the two previous paragraphs.

BNS, like **Canadian Imperial Bank of Commerce**, will ultimately end up creating their own suite of ETFs or doing what **CI Financial Corp.** did in 2015 by acquiring one of the approximately 10 ETF providers that might be available for sale.

However, the fact that Vanguard isn’t bothering to create mutual fund versions of their ETFs in Canada suggests the shelf life of most mutual funds — active or passive — is shorter than any of us realize.

At the end of the day, there is no way that BNS is not going to come up with a solution to this problem given that the $139.2 billion in mutual fund assets under administration (AUA) at the end of October generated fiscal 2016 revenues of $1.6 billion or 50% of its global wealth management business.

Back to the Vanguard problem.

The $1.6 billion in revenue generated by mutual funds is 1.2% of the $139.2 billion in AUA. Let’s assume that’s cut to 0.35% (Vanguard’s fee); BNS revenues would decline by 71% to $471 million. That’s a material change if there ever was one.

So, why do I believe shareholders win?

Because this is the first in a series of preemptive moves by BNS to position its wealth management business for a future in which mutual funds play a smaller role. You can bet there will be more to come.

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