New Mutual Fund Advice Guidelines Underwhelm Advocates for Consumer Investors

Description

Consumer advocates for Canada's beleaguered mutual fund investors fear the industry will never put clients ahead of advisor interests, following Thursday's recommendations by securities regulators to retain embedded compensation (a.k.a. trailer fees or trailer commissions).

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Canada still suffers the stigma of being the country with arguably the world's highest mutual fund fees, but consumer advocates had high hopes that the Canadian Securities Administrators (CSA) would choose an outright ban of embedded compensation. After all, embedded compensation has already been prohibited in places like Australia and the United Kingdom.

True, the CSA did go halfway by recommending the end of DSC (Deferred Sales Charge) mutual funds—funds that charge consumers a redemption fee in the first six or seven years of owning them, albeit declining with time.

Thursday's CSA announcement, which has been widely reported in the country's daily newspapers and trade press, went only half as far as most would like. Embedded commissions will be prohibited only for online brokerage firms that sell mutual funds. This has long been a sore point with do-it-yourself investors, who argue that since discount brokerages offer no advice, it hasn't been fair for them to charge commissions.

More disappointing is that the Ontario Securities Commission opted to drop a plan to introduce a so-called "Best Interest" standard that would have upped the ante in requiring financial advisors to act in the best interest of their clients. This prompted fee-only financial planner Sandi Martin to tweet, "The CSA has decided that it's perfectly fine for financial salespeople to continue pretending like they're giving you good advice 'for you' instead of 'for how much they'll make off you.'"

Indeed, the investment industry's newspaper, *Investment Executive*, headlined its coverage as a "big win for the industry." The article said, "Dealers and advisors can breathe a sigh of relief that there is no blanket ban on trailer commissions and no statutory best interest standard."

The article prompted investor advocate Ken Kivenko to say it was “hard to disagree with this assessment.” There are “lots of battles still ahead. The lobbyists have proven their worth.”

Investment advisor and author John De Goey said in an email, “This is shameful on the part of the CSA. It has been almost 15 years since Julia Dublin’s Fair Dealing Model drew attention to the concern of bias caused by embedded commissions.” Advisor bias is caused by embedded compensation, De Goey said, “and there’s nothing here to address that.”

Nor did the CSA allow for what he terms “product meritocracy,” or for the fact trailer commissions on equities are double what they are on fixed income. Clearly, this fact alone would tend to make advisors more likely to recommend more aggressive asset allocation for clients. And finally, De Goey said the CSA did nothing to address the discrepancy between mutual funds and exchange-traded funds (ETFs). With a few rare exceptions, the latter rarely carry trailer fees, which makes low-cost tax-efficient ETFs a non-starter for advisors who have more regard for their own retirement than that of their clients.

Even so, the CSA appears to be paying at least some lip service to the need to lower such possible conflicts of interest, saying they are proposing a set of “targeted” reforms and policy changes that would prohibit some trailer commissions for dealers who don’t make a “suitability” determination for mutual fund investments. It says these changes would “provide greater clarity on the services provided to investors and their associated costs.”

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OSC chair Maureen Jensen told the *Financial Post* she is “pleased that all CSA jurisdictions have agreed on reforms that put clients’ interests first. This has been our objective all along.” It means that from the time an investor opens an account, their interests must come first. Jensen said, “This is a significant shift from the current system.”

While embedded compensation is still with us, Vanguard Investments Canada Inc. managing director Atul Tiwari said Vanguard believes “the Canadian market, like other regions around the world, will organically evolve away from it.” Tiwari added he is “encouraged by some of the proposals from the CSA … The CSA has made clear that suitability determinations will need to be in the best interests of clients. This will likely accelerate the move that we are already seeing in advisors going from commission-based to fee-based models.” Vanguard supports that trend as “providing superior fee transparency and enhancing the use of low-cost products to give clients better long-term returns.”

Australia has adopted a fiduciary standard for advisors, but some in that country feel this also created reduced competition and an “advice gap” that leaves some smaller investors with no investment advice at all. Here in Canada, the industry argues that small mutual fund investors are at least getting some advice, possibly more than the fees generated by modest portfolios might justify. Evidently, that view held some sway with the CSA.

So, what’s my personal take on all this? To paraphrase our prime minister, it’s 2018. That means that by now, only the most naïve investor would fail to take a commission-paid advisor’s recommendations with a grain of salt. Most do-it-yourself investor—aided, perhaps, by publications like this one—have long since decided that no one cares more about their money than they do themselves. They havelong since embraced discount brokerages and buying their own securities, perhaps in combination with buying ETFs. Or some of the more well heeled will have turned to private investment counsel that charge no more than 1% for asset-based advice.

Those still invested in mutual funds are evidently continuing to demonstrate the triumph of hope over experience. There’s certainly no lack of evidence on the web and in the nation’s press that the odds are against them. In fact, I continue to marvel at the fact that every week in the *Globe & Mail* (Dianne Maley’s “Financial Facelift” column) and the *Financial Post* (Andrew Allentuck’s “Family Finance” column), plus frequent articles at MoneySense.ca, the arguably more objective advice depicted is remarkably consistent.

And what is that advice? Almost invariably, the experts cited by these columnists conclude that the profiled couples could save a bundle by jettisoning their high-fee mutual funds and replacing them with low-cost portfolios of ETFs or individual securities.

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Investors don’t need the CSA and the bank-dominated investment industry to defend their interests. They just need to wake up and smell the coffee. Or, as they say, you can lead a horse to water, but you can’t make it drink.

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