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Karen McGuinness, CPA, CA
Senior Vice-President, Member Regulation – Compliance
Mutual Fund Dealers Association of Canada
121 King Street West, Suite 1000
Toronto ON M5H 3T9

Re: Measurement and Disclosure of Total Investor Costs

Dear Karen,

It is my pleasure to have this opportunity to offer thoughts on – and potential solutions to – such an important issue. In my view, true and full cost disclosure is at the heart of putting clients' interests first; and key to a transparent reporting regime.

HighView Financial Group is the brand under which we operate our business. HighView Asset Management Ltd. is registered in Ontario, Alberta, British Columbia and Saskatchewan in the category of Portfolio Manager. We design portfolios for affluent families and institutions. I started my career licensed to sell mutual funds but have spent the majority of my 21 years in the industry licensed as an Advising Representative or Advising Officer for firms registered in the category of Portfolio Manager.

Accordingly, we are in a fiduciary relationship with each of our clients. As part of this duty we provide detailed but meaningful reporting to each client – which includes full cost disclosure broken down by the source of each cost component (i.e. custody, advisory, manager/product, trading, etc.). Accordingly, our current reporting is unlikely to be affected by phase II of the Customer Relationship Model (CRM2) cost disclosures – and additional measures the MFDA is considering. But I am providing this comment because it's an issue about which I feel very strongly.

The need for mandated full cost disclosure

CRM2 proposes a level of disclosure that the dealer community has never before provided on any scale. This is a great step for the industry's end clients. But as I first highlighted in an article in Investment Executive's mid-October 2014 issue¹ CRM2's cost and commission report omits embedded product costs that are not paid to dealers in some form.

I wholeheartedly support the MDFA's desire for full cost transparency. CRM2 cost and commission disclosure, as it stands, will make comparisons across firms very challenging where embedded product fees are present. True and full cost disclosure facilitates a more even comparison between firms with different business models and across registration categories.

CRM2's shortcoming

The CSA requires CRM2's cost report to provide a precise accounting of fees, charges and commissions paid to the dealer with respect to each client's account(s) over the previous year. The "precise accounting" component is the key reason why some or all of the embedded products costs will not be included. Since the portion of embedded product fees kept by product sponsors does not flow through dealers' back office systems, it cannot be reported with precision.

Past fee disclosure efforts

My HighView partners and I have provided total cost disclosure in the past for individuals invested in mutual funds, insurance products (e.g., GMWB products), offshore structures and/or other products. For investors holding mutual funds we simply calculated a weighted average of the management expense ratios (MERs) of an individual's mutual fund portfolio. I have been involved in providing this kind of disclosure **since 1997**.

The result was never a precise accounting of actual fees paid in the past. But it was always an excellent forward-looking estimate of costs that would be paid in the year ahead. And this was provided to investors in both dollar and percentage terms.

¹ See <http://www.investmentexecutive.com/-/a-nasty-eye-opener>

HighView continues to provide this kind of disclosure to prospective clients who come to us with a portfolio of products with embedded fees (mutual funds and otherwise). And in virtually every case, investors are surprised at the level of costs (particularly in dollars) they are currently paying – and frustrated that they've never been provided with this simple disclosure.

Potential Solutions

I would tend to agree that it's likely to be problematic for product manufacturers to provide – by account – an accounting of fees charged net of commissions paid to each dealer for each client account. The solution, then, to achieving a truly complete cost disclosure may lie in the ability to blend the CSA's precision with our forward-looking approximation.

The simplest and most feasible solution may simply be for product sponsors to feed dealers the MER percentage for each fund. The trailer commission rate is already embedded in dealer back office systems. So too will the dollar amount of trailers paid thanks to CRM2; fund-by-fund and account-by-account. Total costs can then be provided to clients using these three data points – i.e. trailer commission percentage, trailer commissions in dollars and MER percentage. See the example below for a sample fund calculation.

Input Factor	Input	Status of Data Point
Trailer Commissions Paid (TC\$)	\$1,000.00	Already required by CRM2
Trailer Commission Rate (TC%)	1.00%	Already in back office systems
MER Percentage (MER)	2.25%	Additional data point required
Use above inputs to solve for fund management & admin costs		
Fund Management & Operating Costs = $(\text{MER} - \text{TC}\%) \div \text{TC}\% \times \text{TC\$}$ = $(2.25\% - 1.00\%) \div 1.00\% \times \$1,000$ = \$1,250		
Calculation and disclosure can be simple		
Trailing Commissions Paid to Dealer = \$1,000		
Fund Management & Operating Costs = \$1,250		
TOTAL = \$2,250		

MER data is only updated once annually. There is definitely additional work required of dealers to handle the MER input and add this calculation to their systems and reporting. But it strikes us as a reasonable requirement that seems feasible given the CRM2 requirements.

I hope that this input is helpful. I would be pleased to further discuss this issue with you as you review all comments received and move through the decision-making process.

Sincerely,

Dan

Dan Hallett, CFA, CFP
Vice-President & Principal
HighView Financial Group