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Dear Sirs / Madame,

We are grateful for the opportunity to comment on the Canadian Securities Administrators (CSA) discussion paper and request for comment 81-407 Mutual Fund fees dated December 13, 2012.

Background:

As way of background we have investments as follows: mutual funds (65 %), stocks with dividends (15 %),
bonds (15 %) and money market/cash (5 %). Of our total investment portfolio the 14 mutual funds shown in Annex 1 make up the lion share at 65 %. Our access to the mutual fund industry is 100 % via a financial advisor of a large financial services company.

Perspective:

Any critique of the subject industries must be measured against our investment objectives.

In the 1980s we owned shares in a software company that did well for over 15 years but it eventually went bankrupt. This was our first investment venture which produced a loss of $30,000.

This negative experience burned into our mindset that we would never again invest all our money into a single company regardless of how attractive the opportunity appeared.

Following that investment loss we withdrew from high risk investments for several years holding our money in GICs and cash. During the dot com investment boom and bust period we sat on the sidelines. As GICs barely yield enough interest to offset inflation we sought the counsel of a financial advisor.

Our objective was to hold a variety of financial vehicles to produce growth and income for our retirement years.
In order to diversify our holdings and reduce risk exposure we asked our financial advisor to recommend mutual funds, bonds and stocks with dividends - hence over a period of 14 years we have built a balanced investment portfolio.

Mutual funds allow us to hold stocks in Canadian, US and off-shore companies. This strategy gives us international exposure and opportunities where we would not venture on our own. Our 14 mutual funds include over 150 companies.

Our investment mix provides some protection against wild market swings in any given week. If the stock markets (TSX, Dow Jones) increase by 4% our total investment only increases by 2% or 50% of the market movement - same on the down side. Hence the investment mix functions as a tidal breaker or buffer.

Our mutual funds have low-load fees i.e. each has a 3 year declining fee formula for the sell commission (year 1 - 3%, year 2 - 2%, year 3 - 1%). In year 4 the sell commission is zero. When we purchased our mutual funds we accepted the concept that it takes at least 3 years of market performance to determine if a fund should be held or culled.

The major downside of holding mutual funds in Canada are the excessively high management fees (MERs). As shown in Annex 1 the MERs of our 14 mutual funds average around 2.4 % - some lower and some higher.

As set out in the CSA paper there is a lot more competition in the US mutual fund industry as compared to Canada so MERs tend to be lower in the USA. As I dialogue closely with a US colleague he informs me that his 12 mutual funds have an average MER of 0.56%. This means that Canadian mutual fund management fees are about 4 times the level of US fees.

A second key point is that although MERS are known in percentage terms the actual cost of management fees in dollars are embedded in the mutual fund structure and are not fully transparent. As shown in Annex 2 one can estimate the dollar value of management fees for each mutual fund using the MER level and the fund market value.

A third key point is that management fees of 2.4% absorb 25-50% of the earnings depending on the mutual fund. At this level the mutual fund industry moves from a service industry to being an "investment partner "who contributes zero investment capital and has zero risk in the business venture. Fees are drawn from the funds monthly - year after year - regardless of fund management activity or market performance.

How does one pull the management cost (MERs) out into the light to make it fully transparent and competitive?

One option would be to mandate by law a maximum mutual fund industry wide MER of 2.0%. In our view this would simply backfire on investors resulting in a reduced level and quality of service. To secure on-going profits the mutual fund companies would most likely pay fund managers lower salaries which would impact the quality of management of the funds. High quality managers would move to more lucrative aspects of the financial world. This is clearly not in our long-term interest - we want top quality fund managers looking after our investments.

We are aware that Exchange Trading Funds (ETFs) offer significantly lower management fees and track market indexes - we continue to study the pros and cons of this investment vehicle.

Recommendation:

In order to increase transparency of how the mutual fund industry operates we propose that mutual fund companies be mandated by law to provide their clients with annual reports showing the dollar value of management fees for each fund by January 20th for the previous 12 month period (i.e. January - end of December).

A standardized format for these annual reports should be mandated to allow investors to easily compare mutual fund management fees and performance.

Once investors see the actual level of management fees in dollar terms there will be pressure on the mutual fund industry to lower the MERs. When investors see in a report that they pay $3,500 to $40,000 per year in way of management fees there will be a desire to trim this investment cost.

Investors will focus on management fees moving money to funds which offer more competitive fees.

Kind Regards

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