The Value of Advice : An Investor Viewpoint

Kenmar Associates **August , 2010**

“ Mutual funds are sold not bought” - old industry adage

1. Introduction

Canadian retail investors are exposed to financial markets that are among the most developed yet poorly regulated in the world. They enjoy an overwhelming supply of products and services to address their financial and investment needs. Advice is a component of this unduly complex marketplace. Canadians historically have chosen to invest and manage their financial decisions with the help of advisors. But things are changing . According to J. D. Power and Associates, one third of full service brokerage clients also do some investing online, and 26% of bank mutual fund investors are also using the online channel.

Whether its investment dealer shenanigans, incompetent advisers, high mutual fund fees, the non-bank ABCP fiasco, poor fund performance , the Earl Jones Ponzi debacle, or advisor fraud, retail investors are looking at alternatives to the commission-driven advisor channel. Too many `advisors` are basically salespersons interested in collecting trailer commissions on mutual funds and other expensive packaged products. A recent Nanos Research poll [http://www.nanosresearch.com/library/polls/POLNAT-S09-T388.pdf and http://www.advisor.ca/advisors/news/industrynews/article.jsp?content=20090922_160729_656] found that 77 % of respondents rated medical doctors as "high" or "very high" when it comes to honesty and ethics in their profession; business executives 25% , bankers 31%. and Stockbrokers **rated just 18%.**

The Canadian public policy debate about retirement savings has created an awareness of the impact embedded commission advice has had on small investors. Advisors also work to what is known as a commission grid , a scale that is designed to increase commission payouts as higher sales volumes are reached. Visit http://wheredoesallmymoneygo.com/the-grid/ for more details on this potentially abusive sales incentive approach.

Some of the reference works supporting stakeholder positions in this debate have systematically overvalued the advice component of private sector solutions for improving retirement savings in Canada. The cost of most mutual funds contains the opaquely disclosed cost of financial advice (i.e. Embedded trailer commissions paid to persons identified as financial advisors).These industry participants have claimed that public sector plans won't do the job and therefore compare unfavourably to private sector plans, with the implication that individualized service and advice, largely absent in the public plans, is of superior value.

A comprehensive study by Canadian pension fund expert Keith Ambachsheer has found that Defined Benefit pension plans in Canada achieved annual average returns at least 3.8% higher than mutual funds with comparable investments. Defined benefit pension funds outperformed the market by 1.23% per year, while mutual funds had average returns that were 2.6% below the market during the 1996 to 2004 period. Returns for most mutual fund investors were even less than this, as a result of sales fees and consistently poor selection of mutual funds by misinformed investors: buying high and selling low. This means that those with savings in mutual funds lost a total of about $25 billion a year from the higher management fees and lower returns compared to workplace pension funds. Higher management fees are responsible for about $15 billion of this. If these trends continue, those depending on private mutual funds will have retirement pensions that are about 40% lower than defined benefit pensions plans for the same amount invested. In the example used by the study of a $45,000 annual pension, this means $20,000 less per year for retirees. Mr. Ambachsheer concludes that most of the difference in returns is because of much higher management fees charged by the mutual fund industry [*The $25 billion annual mutual fund ripoff*]] http://cupe.ca/pensions/The_25_billion_annua

This Report attempts to set the record straight for this and other public policy issues where financial advice plays a role. Throughout the Report, the concerns we have with respect to embedded commission derived advice are supported by fact-based, independent, third-party research available from credible, published sources. The aim is to provide a clear, unbiased view of what real advice means to the financial well-being of Canadians and their confidence in the future. In so doing, it is hoped that this work will enable public policy-makers to better assess the impact the advice market has had on investor's savings.

2. Advisors – What They Do

Advisors are employed in the provision of a variety of financial and investment advisory services including: distributing products like mutual funds , the setting of planning targets; choosing suitable vehicles to reach those targets; and hopefully developing cost-effective portfolios matched to client needs.

Each client is unique in terms of his/her own financial situation, life cycle needs, risk/loss tolerance and investment / savings goals. And there is a confusing array of products and services proposed to meet those needs. A majority of Canadians find that they lack the financial knowledge, or the time required, to research all the options available to them and to make the important financial decisions they need to make at critical points in their lifetimes. Those without professional financial and investment advice may find themselves ill-prepared for some of the most important financial decisions they will encounter in their lifetimes.

So what exactly is meant by “advice” ? Financial advice is advice provided to an individual or family to assist them to grow, manage and protect their wealth. It includes strategic advice, recommendations about suitable investment classes, appropriate products (investments, RRSP and insurance) as well as explanation of the impact of legislation, taxation and other external factors on their financial position.

A professional advisor helps people make the right decisions , decisions that are not blurred by dual loyalties. The range of decisions range from budgeting, debt management, and financial planning to investing for retirement, insurance and estate planning. A professional advisor is well educated in the field (s) he/she is registered in. Depending on issue complexity, specialists in such areas a taxation,r life insurance or estate planning may be needed. Professional advisors have a fiduciary duty to clients . Traditional embedded commission advisors paid by mutual fund companies need only provide products that are suitable for investors. Such advisors may have taken no more than a correspondence course and passed a multiple choice exam to be licensed.

Under the new National Instrument 31-103 as of September 28, 2009, mutual fund representatives, formerly called “salespersons”, are now called mutual fund “dealing representatives” and individuals who were an advisor under a portfolio manager are now called an advising representative. See this link for full details: http://www.bcsc.bc.ca/uploadedFiles/securitieslaw/policy3/31-103%20Registration%20Requirements%20and%20Exemptions%20%5BNI%5D.pdf Many feel that the previous title was more descriptive of their behaviour. To be sure, the title *salesperson* wasn’t normally on their business cards. No matter what the title, these folks are paid lucrative sales commissions for selling you mutual funds and keeping you invested. That's how they make their living.

This was visibly apparent when , back in 2004, online broker E*Trade Canada attempted to sell low cost F Class funds to retail investors. AIM Trimark and Elliott & Page had agreed to such an arrangement . But after advisors started howling , both firms backed out. Bruce Seago, then COO at E*Trade Canada remarked “ It seems the fund companies are not open to offering these lower cost funds outside fee-based advice accounts”.

The advice industry suffers from a proliferation of designations. There are no central regulators to keep tabs on the designations . Some can be obtained with minimal effort, most have restrictions on what they can competently advise on. You can find a good explanation of the alphabet soup of designations at http://www.advocis.ca/content/consumers/designations.html

Unless they’re dual-licensed to also sell securities and ETFs, or triply licensed to include insurance recommendations, options or commodities, take with a grain of salt industry declarations that most embedded commission mutual fund “advisors” do much more than distribute mutual funds. Paraphrasing Henry Ford, ,*” You can have any product you want as long as it's a mutual fund”*.

3. Wide Range of Valuable Services

Professional advisors provide a range of valuable services to their clients, including the planning and maintenance of targets, helping them choose the right vehicles and designing low-cost portfolios to achieve those targets.

A. Setting and achieving planning targets: There exists a significant body of expert research, supplied by academia, showing the potential and realized benefits of advisor-supplied financial or investment planning.

A survey sponsored by the Financial Planners Standards Council (FPSC) showed that only 40% of Certified Financial Planners did financial plans for "most" of their clients in 2006, down from 53% in 2002 . Overall, 70% of those surveyed said they have used a financial planner and a majority were aware of the services beyond investments that a planner can provide, including tax planning, estate planning and risk management. But, importantly, fewer than 10% claimed to have actually used these other services-including mortgage, insurance or money management advice The survey showed that while 44% said they are working with an advisor, only 18% are (knowingly) working with a Certified Financial Planner (CFP) and 27% of those with an advisor don't know what credential's that person has, if any.

According to the 2009 CSA Investor Index Report (Oct. 5, 2009) fewer than half of Canadians have worked with their advisor or someone in a financial institution to create a formal assessment of their willingness to take risk. Among those who have, only half have reviewed their risk profile within the past year. Only 25 % of Canadians has a formal written financial plan that includes clear investment goals, despite the fact that 46 % say they have an advisor. Among those who do have savings or investments set aside for the future, over half (53%) hold mutual funds, 37 % hold term deposits or GICs, 27 % hold stocks, 16 % hold corporate or government bonds, 9% hold income trusts and just 6 %t hold low-cost exchange traded funds (ETFs).The Report also found that Canadians express confidence and believe that they are knowledgeable and responsible about investing , yet their behaviour may indicate otherwise. http://www.msc.gov.mb.ca/about_msc/2009_csa_invest_exec.pdf

B. Choosing the right vehicles and plans: Advisors can , in principle, help individuals choose the right vehicles and plans to optimize outcomes for their unique circumstances. But this ideal can easily be sabotaged by sales commissions, trailer commissions , sales quotas and the relentless driving force of commission grids. The underlying assumption is that the "vehicle" is likely to be a mutual fund or wrap account with enough embedded compensation to justify the effort. It's unclear what the average fund salesperson will say about alternative "vehicles" such as paying off all your non-deductible debts, , setting aside emergency funds, investing in GICs , Real Return Bonds, inflation-linked annuities or low fee ETF's .

What can be said of the mutual fund "vehicle" recommended by so many advisors is best expressed by S&P Index Versus Active management Scorecard ("SPIVA") : *Standard & Poor's continues to observe passive indices outperforming* [pre-tax] *the majority of domestic funds. In the three- and five-year periods ending Q1 2010, only 10.9% and 3.3% of actively-managed Canadian Equity funds have outperformed the S&P/TSX Composite Index. Looking at the performance of actively managed foreign equity funds, over the last five years, only 9.8% of active funds in the International Equity category, 11.3% in the Global Equity category and 9.7% in the U.S. Equity category have outpaced the S&P EPAC BMI LargeMidCap, S&P Developed BMI LargeMidCap and S&P 500 indices respectively.*

http://www.cnw.ca/en/releases/archive/June2010/09/c3323.html Over time , investors pay a heavy price for this chronic underperformance. Attractive sales commissions put these expensive products at the top of the advisor's recommended buy list.

One weeps for those Canadians who follow undifferentiated advice to save in RRSP’s. Apparently, only tax experts and bureaucrats know that the effort will be of almost no value Too many clients are not told the very important tax and estate issues associated with RRSP's /RRIF’s when withdrawal time comes around. The GIS clawback will hurt people with less than $100,000 in retirement assets hard. A CD Howe Institute Backgrounder No. 65 *New Poverty Traps: Means-Testing and Modest-Income Seniors* available at www.cdhowe.org/pdf/backgrounder_65.pdf) demonstrated that many RRSP's were dead end trips, satisfying the need for sales commissions rather than the best interests of clients.

Another example: An HRSDC REPORT on RESP’s http://www.hrsdc.gc.ca/eng/publications_resources/evaluation/2008/industry_practices/page08.shtml remarked **:** *"In all, there is a significant risk that participants in group plans end up in a worse financial situation as a result of their participation”* Group scholarship plans are characterized by a complex prospectus- the CST prospectus is 124 pages. The referenced report notes that in 2006, some 20% of gross contributions went towards fees.) , complex Terms and Conditions and unexpected consequences. According to the referenced HRSDC report, a shocking **3.2**% of group RESP plans were canceled or terminated **i**n 2006. Additionally, 1.9% of group scholarship plans were closed by the group RESP vendors and subscribers paid the price: “When the group scholarship provider closes a group plan, the subscriber can reclaim the contributions, and these are then returned net of fees and without the investment income. Closing also means the grant and bond are repaid to the government, and these cannot be earned back later if new contributions are made for the same beneficiary.”

Typically, fee/penalty plan disclosure is hard to understand, risks are not adequately articulated or understood, the true cost of ownership is poorly revealed, embedded sales commissions are masked and constraints inadequately explained. The enrolment fee is not part of the investment base. It therefore is a cost of the investment even if 100 % returned at contract maturity. It does not earn any money and is returned after many years in deflated dollars. This does not occur with self-directed RESPs. See also http://www.canadiancapitalist.com/the-mer-on-group-scholarship-plans/ .So-called advisors may not be acting in their client's best interests by flogging these products.

A 21- page FAIR Canada Report http://faircanada.ca/top-news/fair-canada-issues-report-on-money-market-funds-canadians-losing-out-on-300-500-million/ found that Canadians hold $56 billion in money market funds (MMF) earning almost nothing. In the six months to year end 2009, the average Canadian MMF earned just 0.02% after costs, before the impact of inflation and taxes. The average return for the most recent 30 and 60 day periods was 0%. Even worse, fully one quarter of all Canadian money market funds (mostly smaller segregated funds) lost money in the three or six months to December 31, 2009, and continue to lose money. Again, we find evidence that advisors aren't paying attention to the needs of clients .

Do advisors improve investor performance?: Over the years, Morningstar has examined investor behavior patterns in a number of ways. An investor's emotional response to the market's gyrations may be one of his/ her biggest costs as an investor. The return lost to poor timing can even trump the cost of expense ratios. The average asset-weighted expense ratio across Morningstar's database of mutual funds is 1.23%. During the last decade, the gap between asset-weighted investor returns and total returns is 1.64%.You can think of this gap as the returns that were sacrificed because investors bought and sold funds at the wrong time. The pattern is clear: Investors tend to buy funds and asset classes following rallies and sell at low points, leaving a lot of money on the table in the process. Some of their most conclusive findings show that investors have the hardest time using volatile funds well. But Morningstar dug deeper – their data simply doesn't prove or disprove the premise that financial advisors are any more or less fickle than individual investors. To read more,visit http://www.morningstar.com/go/?uidm=TMQH5FV3QPYQ&murl=ETC0AGGT *Whose more fickle: Advisors, Institutions, or Individuals? A close look at true investor returns yields some surprises. ,* Karen Dolan, CFA

According to Do financial advisors improve portfolio performance?, a recently released study of German investors at Vox by university professors Andreas Hackethal, Michalis Haliassos and Tullio Jappelli. says they don't. The reason is the old bugaboo - costs and fees.

Advisors add value but ... "*Even if advisors add value to the account, they collect more in fees and commissions than they contribute.*" Apparently the authors found that richer, older people tend to use advisors more which accounts for a preliminary gross conclusion that "*Investors who delegate portfolio management to a financial advisor achieve on average greater returns, lower risk, lower probabilities of losses and of substantial losses, and greater diversification through investments in mutual funds.*" They note that the financial industry would love to grab that statement for publicity. However, the net truth is completely opposite: "*Once we control for different characteristics of investors using financial advisors, we discover that* ***advisors actually tend to lower returns, raise portfolio risk, increase the probabilities of losses****, and increase trading frequency and portfolio turnover relative to what account owners of given characteristics tend to achieve on their own.*"

Of course, all this research does not mean that all advisors are bad for your financial health. It does mean choosing carefully, however. Attention must be paid to professional qualifications, experience , fit and fees . A comprehensive Checklist for choosing the right advisor can be found at http://www.canadianfundwatch.com/modules.php?name=News&file=article&sid=100

C. Setting the right investment mix: Professional advisors help choose the right asset mix for an individual client's circumstances, objectives, and risk/loss tolerance. The value of this for individual investors is that, with advice, their portfolios will be weighted according to their specific needs, loss tolerance and time horizons. Investors are often coaxed by widespread media commentary that they can do better on their own through low or no advice embedded products, such as exchange-traded funds . The fund industry claims the reality is that the investment decisions of investors, without advice, are very often driven by short-term biases. They chase past performance. Investors often cycle between being over-cautious and under-cautious, and very often at precisely the wrong times. Of course, some of negative actions are caused by fund company marketing machines hyping new mutual funds near market highs such as the e-commerce and internet funds in 2000.

So do advisors really help reduce the buy high, sell low trap or do they contribute to it? In their study, "Assessing the Costs and Benefits of Brokers in the Mutual Fund Industry," Daniel Bergstresser (Harvard Business School), John Chalmers (University of Oregon), and Peter Tufano (Harvard Business School) analyze a database of U.S. mutual funds from 1996 to 2004. Their objective was to compare the performance of investors who bought funds through broker-dealers to investors who purchased funds directly. They found that investors with broker-sold mutual funds experienced "lower risk-adjusted returns, even before subtracting distribution costs." They also found that investors purchasing broker-sold funds were directed into funds with "substantially higher fees" and failed to show superior asset allocation. And as for helping investors avoid behavioral biases, "regrettably, the advisers generally demonstrated all the same biases that the rest of us have." Even without this study, one only had to look at how advisors overemphasized technology funds in the late 1990s and how many advisors are overemphasizing energy, gold, and foreign funds today.

In any event, it's generally accepted that asset mix is a far greater influence on portfolio performance than securities selection. This would suggest that cost would reign supreme. But since MFDA licensed "advisors" can't sell low-cost ETF's or won't sell cheaper funds lacking a trailer commission, they don't recommend ETF's. In fact , cost is the most important driver of returns . According to a new study by Morningstar Inc. , low fees are likely to be the best predictor of a mutual fund's future success. The study shows that using low fees as a guide would give investors better results than even Morningstar's own star-rating system, which looks at past risk- and load-adjusted returns. While the stars system has typically guided investors to better results, it isn't as effective in predicting future returns at times of big market swings. Morningstar found that in aggregate, low-cost funds had better returns than high-cost funds across all asset classes, during various periods from 2005 through March 2010. Fees "have proven to be the strongest predictor out there." says Russel Kinnel, director of fund research and author of the study. "The stars system, as a measure of past risk-adjusted performance, is going to be a little more limited." http://news.morningstar.com/articlenet/article.aspx?id=347327 Fees Count!

Based on this and similar research , if advisors are to have a net positive economic impact to justify their costs it will have to involve some intangible benefits. Some of the key intangible benefits that professional advice could provide include:

(a) peace of mind

(b) greater control of finances

(c) the prospect of a more comfortable retirement

(d) avoiding bad investments following a budget and

(e) the ability to save tax-effectively .

While a professional advisor may bring piece of mind , incompetent or unscrupulous advisors can ruin your life. Here's some Advisor Red Flags to be on the lookout for:

- Lives flamboyant lifestyle
- Unwilling to provide written information, including provincial securities registrations and verifiable references
- Ignores or evades your questions.
- Fails to provide personal rates of return and proper client statements
- Asks you to sign blank forms or cheques
- Asks you to sign any documents you haven't fully read or don't fully understand
- Offers yields -returns that are too good to be true
- Suggests offshore investments
- Borrows money from you
- Asks you to name him as executor of your will
- Indications that a signature has been forged. or a form adulterated
- Account statements that don't originate from the firm
- Insists that an uninsured investment has little or no risk
- Offers a guaranteed investment or one with 'no risk'
- Advises you to put all of your money in one investment
- Recommends investments you don't recognize, and doesn't try to explain them clearly, or says they're too complicated to understand
- Argues with you or ignores your instructions
- Makes unauthorized trades
- Makes claims on performance guarantees that make no sense.
- Is vague about the amount of commission or fees he or she will earn
- Uses High pressure sales tactics with an insistence on an immediate decision;
- Requires you to keep the deal secret
- Unwilling to let you discuss the deal with another advisor or to get a second opinion;
- Suggests that you invest on the basis of trust or faith.

On his website http://www.macgold.ca/advisorfault , dispute resolution consultant Robert Goldin lists 156 ways that an advisor can be responsible for your investment losses. These include such items as:

1. the lack of suitability of your investments.
2. failure to ensure that an investment, originally suitable remained suitable.

3. your financial advisors failure to construct an investment portfolio that mirrors your investment objectives and risk tolerance levels.
4. failure to learn the essential facts about you.
5. inserting incorrect information into your account opening application form that is filled out when you open up an account with your brokerage house (This is known as the Know Your Client Form or the KYC Form). The KYC is the **contract** between you and your brokerage house.
6. failure to conduct periodical or more ideally, annual reviews of your KYC form.
7. failure to update your KYC Form with new information such as changes in your personal, social, family or business circumstances resulting in possible new investment objectives and risk tolerance levels. These include marriage, divorce, retirement, disability, additional children, supporting elderly parents etc.
8. over-concentration in single investments or in single industry sectors.
9. lack of diversification of your investments, over a number of different market sectors so as to limit your overall risk.
10. failure to monitor the performance of your portfolio and warn you of any possible dangers such as a potential market turndown, your investments about to tank and doing nothing to stop the slide, or letting you know of any changes both positive and negative in any of your securities i.e. giving you the bad news along with the good.

One of the worst cases of advisor abuse involved Mutual Fund Dealers Association (MFDA) registered "advisor" Ian Thow. The case is "one of the most callous and audacious frauds this province has ever seen," said the BCSC when it imposed the $6-million fine in 2007. An entire webpage is dedicated to his story of investor devastation.
http://www.investorvoice.ca/Scandals/Thow/Thow_Index.htm

For an exposee of the Canadian financial services industry, view Larry Elford's fantastic movie *Breach of Trust* …see links at his website Breach of Trust Intro and then Chapters 1-8 http://web.me.com/lelford/breachoftrust.ca/Welcome.html It's a MUST SEE for every Canadian.

4. Confidence in the Future

Advisors are supposed to encourage their clients to adopt good savings and investment behaviours early in life and to maintain those practices through their lifetimes. It is alarming that despite the best intentions and a clear understanding of the risks of not being adequately prepared, too many pre-retired Canadians have yet to take action to protect themselves financially for the future.

Canadians nearing retirement worry about their standard of living, depleting their savings and being unable to pay for health care - but few are doing much about it, a survey released June 14, 2010 for the Canadian Institute of Actuaries suggests. The survey was done to gauge the attitudes and actions of individuals approaching retirement age, or who have recently retired. Actuaries are specialists in risk management and work with pension plans, insurance companies, government regulators and individuals. The survey found that 74 % of those over 45 but not retired were concerned about maintaining a reasonable standard of living for the rest of their lives. Sixty-two per cent worry about having enough money for health care or depleting all their savings. One in five said they would never fully retire, while only 8 % said they are very prepared for retirement. The macro-impact of the advice business seems to have had little success as the survey demonstrates.

The poll was conducted Feb. 4 - 10 for the actuaries by Ipsos Reid. It involved 1,064 Canadian adults over 45 who are not retired and 1,073 who consider themselves retired. The error margin for each of the two sections of the poll is plus or minus three percentage points, 19 times out of 20.

5. Financial Literacy

Governments have noted the importance of improving the financial literacy of Canadians. The Government of Canada has established the Task Force on Financial Literacy to develop a national strategy. Provincial governments in British Columbia, Manitoba, Ontario and Prince Edward Island have begun to target early age learning through financial education initiatives in their school systems. After the last stock market crash, the federal government realized that people needed help with spending, saving, investing and – of course – borrowing.

Although individuals must assume more responsibility for their financial affairs, the financial services industry must be accountable for products that harm consumers . An important element of financial literacy is to teach people how to avoid outright scams, toxic financial products and commission driven "advisors" .The annual losses are staggering.

People need to be taught to be less trusting and more inquisitive about financial products and services. For example, we have the highest mutual fund fees in the world because Canadians are too trusting and don't realize all the annual commissions built in and the impact these expenses have on returns over the long term. This is taking a very heavy toll on retiree and pensioner nest eggs. There is a danger that the literacy initiative will result in a retardation in regulatory reform. That would be a big mistake. Regulators must become more proactive in their efforts to protect consumers and to punish fraud, misleading advertising and other violations of the public trust. Today's financial products are increasing in complexity so financial consumer protection is paramount. No amount of financial literacy will be able to keep pace with the creativity of the financial services industry .

Indeed , a paper by Professor Lauren Willis *Against Financial Literacy Education* argues against too much emphasis on education. The professor believes the day of the informed investor is implausible, given the velocity of change in the financial marketplace, the gulf between current consumer skills and those needed to understand today's complex non-standardized financial products, the persistence of biases in financial decision making, and the disparity between educators and financial services firms in resources with which to reach consumers. The search for effective financial literacy education should be replaced, the author states, by a search for policies more conducive to good consumer financial outcomes.

http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1105384 The Small Investor Protection Association (www.sipa.ca) agrees. In its submission to the Task Force on Financial Literacy , President Stan Buell remarked:

" ..The financial services industry is also important to Canadians. They are led to believe that they can trust the financial industry. The media advertising suggests that early retirement is possible by placing trust in the industry. Slogans like "Freedom 55" encourage this belief. Products with names like "Income Trusts" or "Principal Protected Notes" sound secure, although many Canadians have lost their savings when they were concentrated in these products. Canadians are told that the financial services industry is well regulated, and that investors are protected. In 2004 the Senate Committee held that belief, as do most Canadians, however their hearings revealed a much different story.."
https://www.financialliteracyincanada.com/documents/consultation/Small%20Investor%20Protection%20Association%20(SIPA)_Buell_Stan_29%20April.pdf

6. Advantages of a Regulated Market?

There are potential advantages to dealing with an individual licensed to sell a financial product, and who, in turn, is dealing with a regulated entity. This is the case for most retail buyers of mutual funds and securities in Canada. But consider the following facts:

- An advisor licensed to sell mutual funds cannot sell you ETF`s ; as a result these low-cost products aren`t included in mutual fund portfolios
- The regulation of these dealer representatives is by two self-regulating Organizations (the MFDA and IIROC) , not provincial securities commissions . Neither of the SRO's owes a duty of care to individual investors.
- Canada`s regulatory system of 13 provincial regulators is regarded by many observers, including the Federal Government , as fragmented and dysfunctional
- These SRO's do not have the power to collect on fines levied on advisors once they leave the industry

If your driver's licence is pulled, that means right across Canada. Arrest warrants are valid right across Canada as well. And as for the national revenue folks . . .But all a provincial securities commission can do is tell scam artists not to try it again within their province of jurisdiction. So if Alberta scammers set up shop in Moose Jaw , who's to stop them? The infamous Earl Jones case in Quebec exposed many weaknesses in the system. Investor advocates have been pleading for years for tougher, uniform enforcement .

Regulatory exemptions have not been kind to small investors. For example , the inappropriate granting of an exemption on mutual fund DSC early redemption penalty reimbursements so that investors could be sold expensive proprietary funds harmed investors. Recently , the Canadian Securities Administrators (CSA) has proposed a Point of Sale disclosure regime that may suit the wishes of the fund industry but certainly puts retail investors in a worse position. Despite firm recommendations to modify the regulations from the investor advocacy community and Morningstar Canada, a respected fund rating firm, the proposals seem ready to be unleashed on small investors. The new Fund Facts document is written for those with Grade 6 literacy and as a result many key points, like risks, are greatly abbreviated and dumbed down. Under the new plan, retail investors would now have to request a copy of the full prospectus.

The industry-sponsored and funded Ombudsman for Banking Services and Investments (OBSI) has had to deal with a record number of complaints . Its 2009 Annual Report highlights include .

- Opening of 990 case files, a 48% increase from 2008.
- Over 200% increase in total case files opened over the last three years.
- A 73% increase in investment case files opened over 2008.
- Unsuitable investments is the #1 cause of investor complaints .
- 21% increase in banking case files opened over 2008.

Just 35 % of OBSI's recommendations support complainants. Can there be any question that the advisory community needs to introduce reforms?

Canada continues to lag behind other countries in investor protection During the non-bank ABCP fiasco no regulator came forward to assist distressed retail investors. Were it not for the determined efforts of several investor advocates , these folks would have been left high and dry. Canada's complaint handling system is notorious for wearing down even the most determined of complainants.

FAIR Canada (www.faircanada.ca) has released an expert report with options for improving the management of conflicts of interest at the Toronto Stock Exchange (the TSX), in connection with the TSX's regulation of listed companies. FAIR Canada has expressed concerns since its establishment about the inherent conflict at the TSX between the TSX's listings business and listing regulation functions, and has pushed for regulators to address this conflict-of -interest in a way that is consistent with international standards.

Earlier this year the United Kingdom moved to outlaw by 2012 the sales commissions that are embedded in fees for investment products. Australian regulators proposed something similar. Then, late in July, the U.S. Securities and Exchange Commission (SEC) voted to cap such fees for mutual funds at a quarter the 1 per cent fee included in some funds in Canada. Meanwhile , Canada's Quebec and Alberta provincial regulators attempt to patch a broken regulatory system and block attempts to establish a national regulator.

Securities Regulation in Canada may be second rate but industry lobbyists are world class. The Investment Funds Institute of Canada (IFIC; www.ific.ca) is the well financed and influential lobbyist for the Investment fund industry. They have been enormously successful in blunting or delaying industry reforms to protect investors. Most recently they displayed a burst of chutzpa in attempting to prevent the publication by Morningstar Canada of Stewardship grades for a number of Canadian fund companies . The grades are designed to help investors better understand the funds recommended by advisors and help determine the difference between a great investment and one to avoid. IFIC contacted the U.S. Parent who refused to censor the report. Details of the grades at http://corporate.morningstar.com/ca/asp/subject.aspx?filter=PR4512&xmlfile=2430.xml

There are many more examples demonstrating Canada's weak regulation of securities markets and low level of investor protection. Foreign investors continue to see Canada as the "Wild West;' to use the words of former Bank of Canada governor David Dodge..

7. Broad Local Access

The financial advice industry comprises approximately 289,000 Canadians, working locally and contributing to their communities in all regions of Canada . Of these individuals, advisors make up a large workforce, including the 114,116 IIROC, MFDA and AMF registrants licensed to sell securities and mutual funds, the 131,900 insurance representatives licensed to sell life and health insurance products, and the more than 17,000 financial planners holding the CFP designation.

Geographic coverage is excellent but the fees are also world class**.** The 2007 “Tufano” report *Mutual Fund Fees Around the World* concluded that Canada’s mutual fund fees were among the highest in the world suggesting that Canadians should be receiving truly superior performance for the outsized fees. Or, it could suggest an uninformed investor base paying an excessive price. Approximately 85 % of funds are purchased through an “advisory” (sales) channel .
Source: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=901023]

Client complaints are not geographically uniform. In its 2009 Annual Report OBSI disclosed that Ontario accounted for 57.8 of complaints with 38.8 % of the population . Quebec on the other hand accounting for just 12.5 % of complaints with 23.4 % of the population.

According to a August 12th article by the Toronto Star's James Daw *, Industry defends mutual fund trailer fees* , a lot of money is at stake. He quotes Carlos Cardone, senior consultant with research house Investor Economics who says about $2 billion was deducted from Canadians’ mutual fund assets in 2009 to pay advisers what are called trailer commissions. That compares with about $9.5 billion in the U.S., with ten times the population. The Canadian figure excludes what banks embed in their funds to pay sales and advisory staff. Bank funds hold roughly 30 % of total mutual fund assets in Canada. And things aren't getting better. As of July 1, Ottawa and Queen’s Park want to collect revenues at a rate of 13 % on mutual fund fees paid by Ontario investors. That’s up from just 5 %, when the fees were subject only to GST, and there was no provincial tax bite.

Mutual fund annual fees-which include management fees, administrative costs, trailer commissions and taxes—can really make a dent in your overall return. You may be surprised by how much. Say two people invest $10,000 in two different stock funds, which both gain an average of 8 % per year over 10 years. Fund A charges 0.5 % in annual fees, and Fund B charges 1.5 %. A decade later, Fund A will deliver a return of roughly $20,530 while Fund B will return $18,560. The longer the time period, the greater the impact on returns. To compare funds yourself, taking into account expenses, the Ontario Securities Commission's Investor Education Fund offers a mutual fund fee impact calculator on its website, http://www.getsmarteraboutmoney.ca/tools-and-calculators/mutual-funds/default.aspx .

8. Canadian Choose Advice

Advice, because it is relationship-based, tends to provide outcomes that are of more durable value than services that are purely transactions-based. Embedded commission based advisors however do have serious conflicts- of interest .

Do advisors help clients find funds that are lower cost (excluding distribution costs)? After analyzing several trillion dollars worth of transactions, the answer appears to be no. A U.S. study released in November, 2006 by the Zero Alpha Group (ZAG) and Fund Democracy [***The Costs of Using a Broker to Select Mutual Funds*** **]** could not find evidence that advisers find low cost solutions. Their study showed investors who buy index funds through brokers pay half a percentage point more in management fees than do independent investors who go through no-load channels - for essentially the same fund. The use of a broker to advise mutual fund investment decisions thus causes investors to pay twice – once to the broker for his bad advice and then again in the form higher ongoing annual fund expenses.

Error! Filename not specified. In "Investor Timing and Fund Distribution Channels," Mercer Bullard (University of Mississippi), Geoff Friesen (University of Nebraska-Lincoln) and Travis Sapp (Iowa State University) also compared the performance of U.S. mutual-fund investors by distribution channel. They found that brokers did not prevent clients from buying high and selling low — i.e. from exhibiting poor investment timing. Comparing asset-weighted and unweighted returns, investors in funds with front/rear loads and/or annual fee (sold by brokers) were found to have purchased and sold their funds more than investors of no-load index funds. Investors in load/annual fee funds consequently underperformed a buy-and-hold approach whereas investors in no-load index funds closely approximated the buy-and-hold approach. The study's conclusion leaves little doubt about the authors' opinion of the utility of financial advisers. *"We find that investors who transact through investment professionals using conventional distribution arrangements experience substantially poorer timing performance than investors who purchase pure no-load funds,"* they say.

In "Conflicts of Interest and Competition in the Mutual Fund Industry," Ajay Khorana (Georgia Institute of Technology) and Henri Servaes (London Business School) examine how conflicts of interest in the U.S. mutual-fund industry affect competition and investor behaviour (their database covered the period 1979-1998). Overall, their paper "highlights a number of conflicts between fund families and investors," say the authors. For example, they found "no evidence that investors derive any benefit" from annual fees for marketing and distribution (12b-1 fees in the

U.S). Furthermore, “fund families generally want to maximize assets under management … and the resulting management fees,” an objective at odds with investors’ “desire for high risk-adjusted performance at low cost.”

Here's how to set the bar for a professional advisor:

1. Find out how mutual fund portfolios did vs. benchmarks for the last 5, 10 years

2. Ask if he/she provides personal rates of return and prepares an Investment Policy Statement

3. Make the advisor show you the analytics and logic behind their portfolio designs

4. Ask for the MER and TER for the funds they want to sell you and the impact after 10, 15, 20 years

5. Make them demonstrate how they measure and manage portfolio risk.

6. Ask to see a copy of a typical client statement

Advisor- refugees are growing in numbers and so are ETF`s. Today, ETFs are available on all types of indexes and sectors, together with bonds, currencies, commodities and commodity futures. Sensing the trend, BMO has recently entered the field. With interest rates low and muted forecasts for future returns, fees count as never before. Online Do-It-Yourself investing allows you to take charge of your investments. It`s worth spending the time to seize control over your money .A fair number of online investors retain an account with a mutual fund dealer to maintain access to some advice. On-line investing is a different experience, so take it slow and maybe try a practice account. If you need help along the way you can obtain it from a professional fee-only advisor, an accountant or a second opinion service such as www.secondopinions.ca By looking after your own portfolio you'll save on commissions and fees, manage your taxes better and develop a better understanding of the world of finance as you build your nest egg.

9. Conclusions

In this Report we have examined the financial and investment advice business in Canada, articulated what professional advisors should do for their clients, highlighted a number of client-advisor issues and identified some of the principal results that investors should expect to derive from the relationships they have with their financial professionals.

Professionals can help individuals in setting and maintaining planning targets, and assisting in their choices of the right vehicles and the right portfolio for reaching their goals. In the crash of 2008 we discovered that diversification may fail us when we need it the most. If your “advisor” looks at investment risk only through the mutual fund prism, he or she may not be able to help you truly insure your portfolio with sophisticated hedging strategies and alternative investments outside the mutual fund “vehicle.”

Advisors can contribute to the financial literacy of Canadians but the sheer number of issues and client complaints suggest that all is not well in advice land. Advisors operate within a deficient regulatory framework and controversial distribution system that has proven incapable of protecting the Canadian retail investor. As our demographics show that seniors, retirees and pensioners are a growing portion of the population , if the necessary industry and regulatory reforms don't occur ,there could be a heavy social cost to pay.

Thankfully, taking control of your investments has never been easier, thanks to the proliferation of information on the Internet, the growing assortment of free research tools made available by discount brokers and independents and some excellent choices for low-cost ETF’s , even some that are actively- managed. The Horizons AlphaPro Funds are actively- managed Exchange Traded Funds ("ETFs"), which are similar to traditional mutual funds, but are listed on the TSX exchange. As a result, active ETFs combine active management with the traditional structural advantages of ETFs: lower fees, intra-day liquidity, and superior tax efficiency.

You can open US $ accounts, RRSP`s, RESP`s, RRIF`s, TFSA`s and the like. Accounts can also be set up to permit option transactions and margin buying. Instead of working with the same stock broker, you will do most of your trading online, or if you decide to call in your order, with the first available broker (order taker). Commissions typically run about $9.95 per online trade but can vary widely. You can invest in stocks, bonds, GIC`s, options, mutual funds and ETF`s. Advisor-refugees often migrate to ETF`s when moving away from mutual funds. The case for ETFs:

1. Lower MER`s and expenses since most replicate an underlying index

2. Index ETFs have often beaten active managers over the long term

3. Can be traded throughout the day (mutual funds must be redeemed at the end of the trading day)

4. Are more transparent because they disclose all holdings daily

5. Low portfolio turnover helps make for greater tax efficiency

You can stick with actively- managed mutual funds without paying for advice you don`t want. RBC Direct Investing offers a wide selection of its funds in the low- cost D Series. TD offers its lower cost eFunds and of course there`s always the low- cost fund providers. Discount firms offer research that is on par with those offered at the traditional brokerage firms. .

When you do need advice , consider a fee-only advisor to avoid conflicts-of-interest . Financial advisors can be important contributors to your financial success – if they are experienced, competent and have your best interests at heart. Unfortunately, most investors have no means to assess the service and advice they receive from their advisors. Check out this rating system at http://www.weighhouse.com/resources/rate_advisor.aspx

Given growing competitive forces, the possibility on a national voluntary pension plan and increasing investor awareness of client-advisor issues , the $600 billion Canadian mutual fund industry will need to demonstrate that the advice it dispenses adds value for investors , not by declarative assertions, but by hard facts and results.

Kenmar Associates