ADVISOR INSIGHTS

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Modest Investors: Easy Access and the Freedom to Choose are Keys to Successful Long-term Investing

Canada's securities regulators are exploring measures to ensure that investors understand the costs of investing and are receiving value for their money. The industry supports these goals and believes they can be achieved in a manner that supports investors' abilities to save for retirement by protecting their access to advice and the freedom to make informed choices.

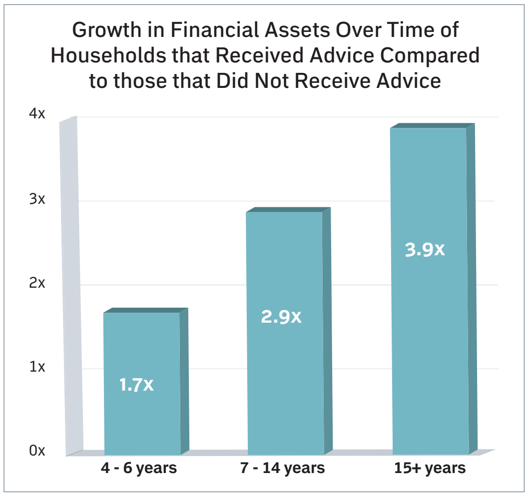
At present, Canadian investors have access to financial advice through various purchase options; however, potential changes to the rules governing how investors are allowed to pay for their dealer's and advisor's services could disproportionately impact some segments of consumers – in particular, more modest investors and those just starting on their savings path.

This issue of *Advisor Insights* contains data on the household assets of Canadian investors and provides insights on the difference that access to advice can make in their long-term savings. You might want to share these research findings with your clients.

How do investors benefit from financial advice?

Canadians enjoy many benefits from financial advice: the growth of their investment wealth, higher levels of confidence in their ability to make financial decisions, and the development of sound long-term savings habits.

Investors who receive advice build more savings over time. Research tells us that advised investors have on average 3.9 times more assets after 15 years than similar investors without advice.[1] This highlights the significant benefit of having access to advice for investors.



In addition to helping investors choose the right products to meet their goals, advisors serve as financial coaches, helping investors to develop disciplined savings habits and avoid common investor behavioural pitfalls.

88% of mutual fund investors agree they get better returns because of advice.[2]

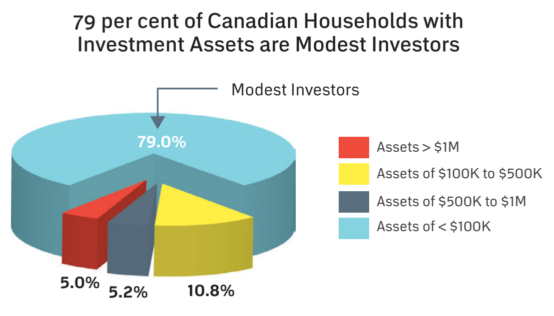
[1] Montmarquette, C., & Viennot-Briot, N. (2016). *The Gamma Factor and the Value of Financial Advice.* CIRANO.
[2] Pollara, *Canadian Mutual Fund Investors' Perceptions of Mutual Funds and the Mutual Fund Industry,* 2017.

Who is a 'modest investor' in Canada?

Modest investors:

- Are in households with financial assets – excluding real estate – of less than $100,000.[3]
- Started investing with less than $25,000.[4]
- In most cases (about 8 out of 10) purchased mutual funds through an advisor.[5]

79% of Canadian households that had financial assets are modest investors.[6]



Source: *Investor Economics, Household Balance Sheet, 2017. (2016 data)*

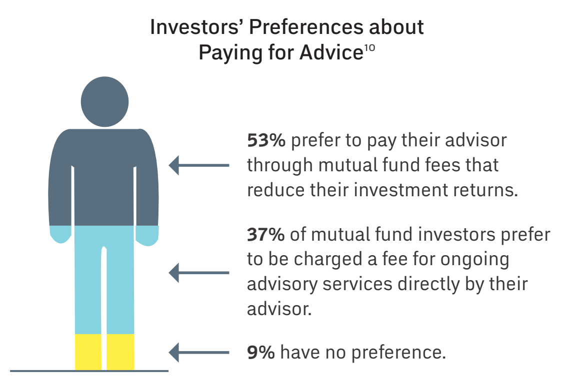
The importance of choice for modest investors

Significant research has been done in several countries to understand investors' views about fee payment options:

- In the U.K., research found that many investors would rather not pay financial advisors directly for advice – particularly investors with smaller amounts to invest;
- In the U.S., about 80% of advisor-sold funds use a model where **investors pay separately** for advice. Under this model, investors with assets of $100,000 are usually charged advice fees in the range of 1.25 – 1.75% of the assets, compared to an **embedded cost** in Canada of about only 0.78% for distribution of long-term funds regardless of the size of the investor's assets[7], and
- The Financial Advice Market Review in the U.K. found that access to advice has decreased since 2012, when embedded compensation models were eliminated. Many consumers who said they would be willing to pay for advice were discouraged by higher prices.[8]

Research in Canada also highlights the importance of having choice in payment options:

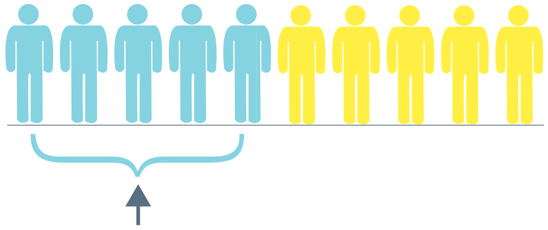
- A total of 53% of mutual fund investors prefer to pay their advisor though the fund's fees, compared to only 37% that would rather be charged a fee for ongoing advisory services directly by their advisor and 9% who are undecided;[9]



[3] This definition is comprised of short term assets including savings deposits, short-term paper, GICs, and short-term investment funds; and long term assets including fixed term, fixed income, funds, equities, and other discretionary financial assets. Investor Economics, *Household Balance Sheet*, 2017. (data to end of 2016).
[4] Pollara, *Canadian Mutual Fund Investors' Perceptions of Mutual Funds and the Mutual Fund Industry*, 2016.
[5] Pollara, *Canadian Mutual Fund Investors' Perceptions of Mutual Funds and the Mutual Fund Industry*, 2017.
[6] Households with $0 in financial wealth are not included in the Investor Economics database. Households with between $0 and $50K make up 73.6% of the sample. Investor Economics, *Household Balance Sheet*, 2017.
[7] Mutual Fund MERs and Cost to Customer in Canada: *Measurement, Trends and Changing Perspectives,* Investor Economics, September 2012, p.5.
[8] *Financial Advice Market Review Final Report*. https://www.fca.org.uk/static/fca/documents/famr-final-report.pdf
[9] Pollara, *Canadian Mutual Fund Investors' Perceptions of Mutual Funds and the Mutual Fund Industry*, 2017.
[10] 1% did not provide an answer, explaining why the total response equals 99%.

- Individuals who have lower incomes are less inclined to pay for fees directly than those who have higher incomes[11], and
- If consumers were required to pay a fee that is higher than the current embedded fee in their mutual fund, only 50% of those people that are currently using an advisor would continue to use one.[12]

It is Important to ensure that Investors Receive the Benefits that Advice Provides



Only **50%** of consumers who currently use an advisor would continue to do so if they were required to pay a higher, separate fee.

In general, it is important that Canadians, especially modest investors, continue to have access to the affordable payment options for financial advice that currently exist, so that they can continue to take advantage of all the benefits that advice has to offer. Investors who receive financial advice will be able to make more informed financial decisions as they work towards achieving their investment goals in the future.

Key points to discuss with clients

- Canadians benefit from financial advice through the growth of their investment wealth, an increase in their confidence to make financial decisions, and the development of sound long-term savings habits.
- Research in Canada emphasizes the importance of choice in payment options for advice – a total of 53% of mutual fund investors prefer to pay their advisor though the fund's fees[13], and individuals who have lower incomes are less inclined to pay for fees directly than those who have higher incomes.[14]
- It is crucial that Canadian investors continue to have access to payment options for advice that are affordable.

[11] Pollara, *Canadian Mutual Fund Investors' Perceptions of Mutual Funds and the Mutual Fund Industry*, 2017.
[12] Pollara, *Canadian Mutual Fund Investors' Perceptions of Mutual Funds and the Mutual Fund Industry*, 2017.
[13] Pollara, *Canadian Mutual Fund Investors' Perceptions of Mutual Funds and the Mutual Fund Industry*, 2017.
[14] Pollara, *Canadian Mutual Fund Investors' Perceptions of Mutual Funds and the Mutual Fund Industry*, 2017.

Describing Payment Options to Clients

When purchasing Canadian mutual funds, the most common way to pay for advice is to pay over the years that you own the funds, based on a percentage of the assets that you own. There are two ways to pay with this method:

1. **Separate asset-based fee accounts:** in this case, the investor directly pays the advisor's dealer for the advisor's services – usually a percentage of the total amount they have invested with the firm.
2. **Embedded fee accounts:** in this case, a percentage of the fund's assets come out of the fund to pay for the advisor and dealer services.

The other payment method offered by some advisors is Fee-for-Service. For example, financial plans covering a broad range of financial products and services are generally only available on an up-front flat fee basis.

This issue of *Advisor Insights* provides information to help investors understand the importance of advice and the availability of multiple payment options for fees. *Advisor Insights* issues are written in plain language and advisors are welcome to share them with their clients.

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