Investor Insights

Understanding Fees

Many people invest because they believe it's a good way to achieve their financial goals. They also know that getting professional financial advice can help them invest better.

If you're working with a financial advisor (or considering it), you should understand how advisors are compensated. The topic of fees can be complicated, but we'll stick to the basics.

There are three main forms of advisor compensation: a commission-based model, a fee-based model or by salary.

Commission-based. Advisors working in this structure receive compensation when their clients buy or sell an investment (e.g., mutual funds, exchange-traded funds or stocks). The commission they earn may depend on the investment type, the dollar value of a trade or other variables. Advisors may also receive ongoing compensation from fund companies in relation to the funds their clients hold (more on that later).

Fee-based. Advisors working in this structure earn a fee based on the value of assets they manage on a client's behalf. Even if a client makes many trades and frequently uses certain advisory services, the fee charged remains a prearranged percentage (e.g., 1%) of the value of assets being managed. Sometimes the fee percentage declines as a client's assets increase.

Salary. An advisor working for a bank or credit union will often earn an annual salary plus a performance-based bonus. Salaried advisors provide value to clients but may not hold the same industry licencing as commission- or fee-based advisors, which may narrow the range of services they can offer.

Some advisors are compensated through a mixed structure. For example, they may charge a flat fee for creating a financial plan and earn commission on trades they execute for your account.

Management expense ratio (MER)

If you invest in mutual funds, segregated funds or ETFs, you've likely heard about MERs. They're calculated as a percentage (e.g., 2%) of fund assets and deducted from the value of your investment. MERs are used to compensate fund managers and dealers, and to pay related taxes.

Fund manager. This is the firm that operates the fund you invest in. They set the fund's strategy and objectives, and employ portfolio managers who decide what (and when) to buy and sell, in order to help enhance fund returns and manage risk. They also provide administrative duties like recordkeeping, as well as legal, accounting, audit and custodial services. For these important duties, fund managers earn a portion of the MER.

Dealer. This is the firm where your advisor is registered. Dealers maintain account records, produce and deliver account statements, and provide the technology for online account access. Dealers also ensure their investment advisors meet all regulatory requirements. Part of a dealer's MER allocation (also called a "trailer fee") typically goes to the advisors responsible for client-oriented tasks like planning, portfolio construction and monitoring, and trade execution.

Taxes. A portion of the MER is used to cover federal and provincial taxes charged on fees and services related to the fund manager and dealer.

Client Relationship Model 2 (CRM2)

Implemented in 2017, an industrywide initiative known as CRM2 obliged dealers to provide clients with a personalized annual report that summarizes charges and compensation related to a client's account. This report is designed to be transparent and is written in straightforward language. For a better understanding of fees (e.g., what you pay and where the fees go), check your personalized annual report.

To learn more about the costs of investing, speak with me today.