From: larry elford (lelford@shaw.ca)
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Cc:
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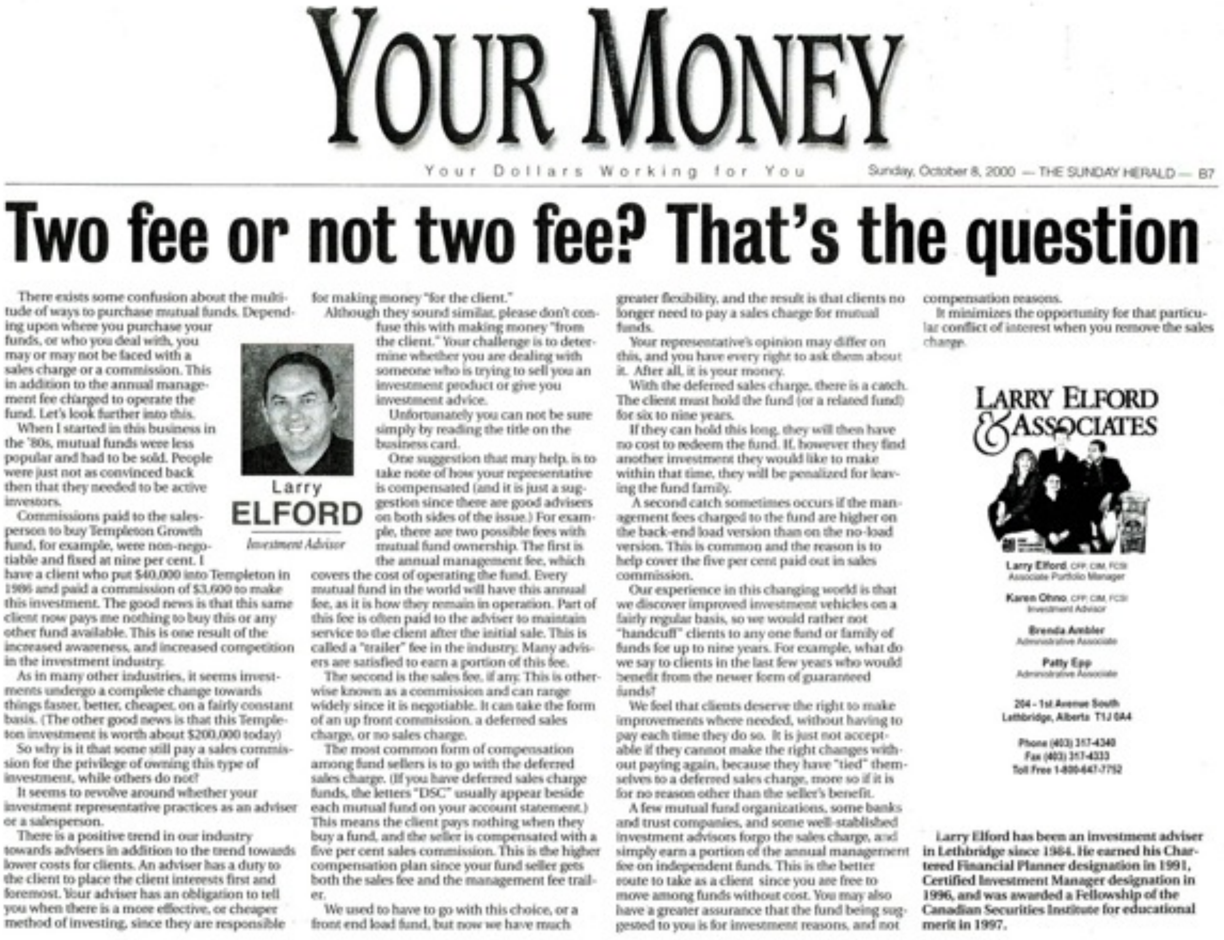

YOUR MONEY
Your Dollars Working for You
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Two fee or not two fee? That's the question

Larry
ELFORD
Investment Advisor

There exists some confusion about the multitude of ways to purchase mutual funds. Depending upon where you purchase your funds, or who you deal with, you may or may not be faced with a sales charge or a commission. This in addition to the annual management fee charged to operate the fund. Let's look further into this.

When I started in this business in the '80s, mutual funds were less popular and had to be sold. People were just not as convinced back then that they needed to be active investors.

Commissions paid to the salesperson to buy Templeton Growth fund, for example, were non-negotiable and fixed at nine per cent. I have a client who put $40,000 into Templeton in 1986 and paid a commission of $3,600 to make this investment. The good news is that this same client now pays me nothing to buy this or any other fund available. This is one result of the increased awareness, and increased competition in the investment industry.

As in many other industries, it seems investments undergo a complete change towards things faster, better, cheaper, on a fairly constant basis. (The other good news is that this Templeton investment is worth about $200,000 today)

So why is it that some still pay a sales commission for the privilege of owning this type of investment, while others do not?

It seems to revolve around whether your investment representative practices as an adviser or a salesperson.

There is a positive trend in our industry towards advisers in addition to the trend towards lower costs for clients. An adviser has a duty to the client to place the client interests first and foremost. Your adviser has an obligation to tell you when there is a more effective, or cheaper method of investing, since they are responsible for making money "for the client."

Although they sound similar, please don't confuse this with making money "from the client." Your challenge is to determine whether you are dealing with someone who is trying to sell you an investment product or give you investment advice.

Unfortunately you can not be sure simply by reading the title on the business card.

One suggestion that may help, is to take note of how your representative is compensated (and it is just a suggestion since there are good advisers on both sides of the issue.) For example, there are two possible fees with mutual fund ownership. The first is the annual management fee, which covers the cost of operating the fund. Every mutual fund in the world will have this annual fee, as it is how they remain in operation. Part of this fee is often paid to the adviser to maintain service to the client after the initial sale. This is called a "trailer" fee in the industry. Many advisers are satisfied to earn a portion of this fee.

The second is the sales fee, if any. This is otherwise known as a commission and can range widely since it is negotiable. It can take the form of an up front commission, a deferred sales charge, or no sales charge.

The most common form of compensation among fund sellers is to go with the deferred sales charge. (If you have deferred sales charge funds, the letters "DSC" usually appear beside each mutual fund on your account statement.) This means the client pays nothing when they buy a fund, and the seller is compensated with a five per cent sales commission. This is the higher compensation plan since your fund seller gets both the sales fee and the management fee trailer.

We used to have to go with this choice, or a front end load fund, but now we have much greater flexibility, and the result is that clients no longer need to pay a sales charge for mutual funds.

Your representative's opinion may differ on this, and you have every right to ask them about it. After all, it is your money.

With the deferred sales charge, there is a catch. The client must hold the fund (or a related fund) for six to nine years.

If they can hold this long, they will then have no cost to redeem the fund. If, however they find another investment they would like to make within that time, they will be penalized for leaving the fund family.

A second catch sometimes occurs if the management fees charged to the fund are higher on the back-end load version than on the no-load version. This is common and the reason is to help cover the five per cent paid out in sales commission.

Our experience in this changing world is that we discover improved investment vehicles on a fairly regular basis, so we would rather not "handcuff" clients to any one fund or family of funds for up to nine years. For example, what do we say to clients in the last few years who would benefit from the newer form of guaranteed funds?

We feel that clients deserve the right to make improvements where needed, without having to pay each time they do so. It is just not acceptable if they cannot make the right changes without paying again, because they have "tied" themselves to a deferred sales charge, more so if it is for no reason other than the seller's benefit.

A few mutual fund organizations, some banks and trust companies, and some well-stablished investment advisors forgo the sales charge, and simply earn a portion of the annual management fee on independent funds. This is the better route to take as a client since you are free to move among funds without cost. You may also have a greater assurance that the fund being suggested to you is for investment reasons, and not compensation reasons.

It minimizes the opportunity for that particular conflict of interest when you remove the sales charge.

LARRY ELFORD
& ASSOCIATES

Larry Elford, CFP, CIM, FCSI
Associate Portfolio Manager

Karen Ohno, CFP, CIM, FCSI
Investment Advisor

Brenda Ambler
Administrative Associate

Patty Epp
Administrative Associate

204 - 1st Avenue South
Lethbridge, Alberta T1J 0A4

Phone (403) 317-4340
Fax (403) 317-4333
Toll Free 1-800-647-7752

Larry Elford has been an investment adviser in Lethbridge since 1984. He earned his Chartered Financial Planner designation in 1991, Certified Investment Manager designation in 1996, and was awarded a Fellowship of the Canadian Securities Institute for educational merit in 1997.

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