A Breakdown of Investment Management Fees

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The purpose of this paper is to outline the various fee structures charged within our industry, and to clearly explain the following:

1) How are fees charged?
2) How are advisors paid?

At TD Wealth Private Investment Advice, you will receive an annual report entitled "Annual Performance & Fee and Charges Report" each January. Mandated by industry regulator IIROC[1], these fee reports are designed to provide greater transparency about the cost and performance of client accounts.

The Breakdown

Generally, investment fees can be divided into three major categories:

1) Operating charges
2) Transaction costs
3) Compensation received from third parties.

Operating Charges

Operating charges generally include administration fees, account fees, and RSP fees. These fees enable TD to run your accounts, which includes setup, reporting, and supporting the technology to enable us to buy and sell securities.

For fee based accounts (see below), this is also where you will see your investment management fees.

Transaction Fees

Transaction fees include items such as commissions, transfer fees, and interest charges. They are related to the buying and selling of investments.

Compensation Received from Third Parties

Compensation from third parties primarily consists of trailing commissions, which are embedded costs within commission-based mutual funds.

[1] http://www.iiroc.ca/about/Pages/default.aspx

Mutual Fund Expenses

Total mutual fund expenses (also known as the 'management expense ratio (MER)') can cover three different kinds of costs:

- The cost to manage the investments in the fund.
- The compensation received by the advisor.
- The costs of day-to-day administration and taxes.

Your annual fee report will only list the compensation paid to advisors, and not the total management fee charged by the fund. Moreover, third party compensation to advisors is usually only used by commission-based advisors.

Fee Based Accounts vs. Commission Based Accounts

Fee-Based

The investment industry is increasingly trending towards a fee-based model that imposes an 'all-in' annual fee based on a percentage of client investment assets. The percentage fee is reduced at various asset levels ranging from $500,000 to $5+ million. At TD Wealth Private Investment Advice, a fee-based account eliminates essentially all other costs such as account fees, commissions, and compensation received from third parties.

Additionally, in most circumstances, the investment fee charged within a corporate and non-registered investment account can be tax deductible*, whereas compensation from third parties (i.e. mutual fund expenses) is not tax deductible. Implementing a fee-based account also allows the advisor to choose lower cost fee-based mutual funds, which strip out the compensation received from third parties.

* Fees charged to non-registered investment accounts may be tax-deductible. Please consult your tax advisor to see how this relates to your personal situation.

<u>Commission-Based</u>

A commission-based advisor's income is earned entirely on the products they sell, or the accounts they open. Fees by commission-based advisors included financial instruments such as commission-based mutual funds, debt and equity transactions, and account fees.

In contrast to fee-based mutual funds, commission-based mutual funds will have higher MER expenses, where the difference in cost is the compensation provided to the financial institution/advisor. As stated above, unlike fee-based accounts, these fees are not tax deductible.

How are advisors compensated?

With both fee-based and commission-based structures, the financial institution (i.e. TD) receives the fees directly, and a portion of these fees are used to compensate the advisor. At TD Wealth Private Investment Advice, an Investment Advisor will usually have additional expenses associated with direct support staff costs, client costs, and business/marketing supplies.

Fee-Based Example

Suppose you have $1 million invested as follows:

1) $500,000 in a non-registered account.
2) $450,000 in an RSP.
3) $50,000 in a TFSA.

<u>Assumptions</u>

- Investment management fee is 1%.
- The weighted average management expense ratio is .4%
- The non-registered account management fees are tax deductible with a marginal tax rate of 40%.

Your total all in costs would be the following:

- $3,000 in management fees for the non-registered portfolio (after deduction).
- $5,000 in management fees for the RRSP/TFSA.
- $1,300 for HST.
- $4,000 for the mutual fund MER.

Overall, the total all-in costs would be 1.33%. However, the weighted average management expense ratio is excluded from your fee report. *In contrast, the fee report would show a cost of 1.13%.*

Commission-Based Example

Using the above information, a commission-based advisor will typically use a commission based mutual fund with an average MER between 2-2.5%. For each individual stock transaction, there would also be a commission charge ranging from .35% for extremely large transactions and 2.75% for small transactions.

<u>Assumptions</u>

- Average commission-based MER is 2%.
  - Half of that expense (1%) is paid as compensation to TD and the advisor.
- Total commission charges of $10,000.
- Account fees of $125 for the RRSP, and $50 for the TFSA (plus HST).

Your total all in costs would be the following:

- $10,000 for the mutual fund MER.
  - Of which, $5,000 is paid as compensation to TD.
- $7,200 in commission fees (after deduction).
- $175 in account fees.
- $1,300 for HST.

Overall, the total all-in cost would be 1.87%, although the actual amount reported on your fee statement would not include the entire mutual fund MER (only the compensation to TD), and the commission fees would show the pre-deduction amount ($10,000). *However, your fee report would show a cost of 1.65%.*

Our Preferred Fee Schedule

<u>Our preference is to implement a fee-based compensation model since we believe it best aligns with your best interests</u>. Under the fee-based model, the advisor's primary incentive is to ensure your portfolio is protected and grows over the long-term.

Additionally, a fee-based schedule helps eliminate a possible conflict of interest associated with portfolio recommendations. Given there are no transaction costs under the fee-based model, the incentive to trade excessively to generate commissions (also known as 'churning') can be eliminated.

To clarify, I am not suggesting a commission-based advisor will not act in your best interest, we just feel that minimizing possible conflicts of interests is always a good thing. We will always proactively communicate any commissions associated with your investments.

Our Core Services

As a reminder, here is a summary of the primary services we offer:

- Professional Investment Management.
  - Our team consists of advisors with decades of investment experience.
  - As a Chartered Financial Analyst (CFA), my role is to create a customized portfolio built to match your investment time horizon and willingness for risk.
  - We are committed to our strict investment discipline to ensure we maintain an objective and rational view of markets.
  - The most recognized paper on the value of financial advice was a study developed by Vanguard[2] in 2016. **The paper concludes the overall net impact of good advice is about 3% (see below chart), with the main contributions being:**

(1) Build a customized investment plan aimed at achieving goals and meeting constraints for risk tolerance and risk capacity	
> 0%	suitable asset allocation with broadly diversified investments
0.45%	focus on low-cost investments (low expense ratios)
0 - 0.75%	locating assets properly in taxable and tax-advantaged accounts
0.45%	focusing on total returns investment instead of income investing
(2) Minimize risks and tax impacts	
0.35%	rebalancing to the strategic asset allocation
0 - 0.70%	deciding where to draw assets from (tax-deferred or taxable) to meet spending
(3) Behavioral coaching	
> 1.5%	providing support to stay the course in times of market stress

[3]

[2] https://www.vanguard.com/pdf/ISGQVAA.pdf
[3] https://retirementresearcher.com/the-value-of-financial-advice/

- Comprehensive financial planning.
  - The objective of a financial plan is to provide a roadmap to help guide us to achieve your financial goals.
  - Our discovery process covers a variety of financial planning topics such as retirement planning, business succession, insurance and estate planning, charitable giving, and tax considerations*.
  - The financial plan also provides us the opportunity to collaborate with your other professional advisors such as your accounting and legal team.
  - Our financial planning offering includes a team of TD specialists with professional expertise in areas of accounting, law, estate and trust management, philanthropy, and insurance.

  *Some services are provided in collaboration with TD specialists.

- Tax Efficient Wealth Solutions
  - Our focus is to implement the necessary strategies to **maximize your rate of return after taxes and inflation**.
  - Examples of tax efficient strategies include proper asset allocation between taxable and tax-sheltered accounts, use of tax efficient investment vehicles, corporate investment planning, and foreign withholding tax considerations.

Services we do not Offer

Two common requests we receive regarding our services is whether we can prepare your tax returns, or draft a Will. Both of these services are outside the scope of our expertise; however we are always happy to refer you to our preferred professionals when needed.

We will collaborate with your professional team to ensure your financial plan is efficiently implemented. Our input also includes our thoughts on preferred strategies.

Summary

To conclude, a good Investment Advisor can consistently add excessive value over cost, even when markets are volatile. We are deeply committed to protecting and growing your wealth, as well as minimizing costs over the long-term.

Aside from investment advice, a qualified advisor can also consistently add value by offering other essential services such as comprehensive financial planning, risk minimization strategies, tax efficient wealth solutions, and behavioral coaching/education.

The information contained herein has been provided by Matthew Karam, Investment Advisor, and is for information purposes only. The information has been drawn from sources believed to be reliable. Graphs and charts are used for illustrative purposes only and do not reflect future values or future performance of any investment. The information does not provide financial, legal, tax or investment advice. Particular investment, tax, or trading strategies should be evaluated relative to each individual's objectives and risk tolerance.

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Commissions, trailing commissions, management fees, and expenses all may be associated with mutual fund investments. Please read the fund facts and prospectus, which contain detailed investment information, before investing. Mutual funds are not guaranteed or insured, their values change frequently and past performance may not be repeated.

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ETF units are bought and sold at market price on a stock exchange and brokerage commissions will reduce returns. Index returns do not represent ETF returns. The indicated rates of return are the historical total returns for the periods including changes in unit value and reinvestment of all distributions and do not take into account redemption, commission charges or income taxes payable by any unitholder that would have reduced returns. Past performance may not be repeated.

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