Investment/Retirement Plan
Client: Mr. and Mrs. Smith
Date: October 22, 2017

By: Joe the Investor

Investment Plan for Mr and Mrs. Smith
October 22, 2017

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Please note that this is a sample report which will be customized to your situation. There will also be calculations provided for portfolio investments, retirement projections, tax simulations or any customized calculations as needed to make the plan complete. These calculations would be presented via charts or tables in this document or would be delivered via a spreadsheet which would be a second document related to this summary. Any names or descriptions used are for demonstration purposes and do not reflect actual names or values. Any information that appears to be factual is by coincidence only.

Objectives:

The main objective is to generate enough return to have enough money in retirement – the target date is June of 2015. The target retirement income ideally would be $100,000 per year after taxes. Using an approximate average tax rate of 30%, this would mean generating income of $144,000 before taxes if all of the income generated is from interest. Secondary objectives would be to preserve capital, and keep risk, investment fees and taxes low.

Background:

Mrs. Smith is a teacher with the Toronto District School Board and wants to retire in June of 2015. She likes teaching, but she does not like the constraints of her current job. She is currently 62 years old, and she will be 65 years old in 2 years. She would currently receive $750 per month in pension income and $300 per month in CPP payments when she is retired. This would equate to approximately $12,000 in income before taxes. She and Mr. Smith worked out of Canada for many of their working years, so CPP and OAS would be significantly less than the maximum usually paid. Mrs. Smith has no children, so there are no concerns about passing on an estate or saving money for another generation. Mr. Smith used to work in Aerospace and they would work all over the world, and he now works on projects on his own. The $100,000 per year after taxes to live on in retirement is the initial target, but it can be revised when Mrs. Smith begins to incur actual expenses if necessary. Mrs. Smith currently lives on rent; she is considering buying a place, but prefers rent as it has fewer headaches. They also like travelling, which is much easier to do if you are renting. Living in an apartment in Europe for 1 or 2 months at a time, or doing multiple trips per year are also possibilities.

Current Investments

The current investments in Canada consist of $53,000 worth of RRSP investments, $33,000 worth of TFSA investments, and approximately $525,000 worth of non-registered investments. Most of the non-registered investments are in cash with some equities. Part of the RRSP has $35,000 worth of Canada Life annuities which are expected to be sold. The rest of the RRSP has $5000 in equities and $13,000 in cash. Of the $525,000 in non-registered holdings, $73,000 of this is in equities and $450,000 in cash. The TFSA account has $13,000 in equities and $20,000 in cash.

RRSP room is maximized as well as TFSA room. There is likely not a use for capital losses at this time, but if there are any capital losses, they can be used to cancel future capital gains for tax purposes.

Emergency Fund

This was not discussed but could be built into the cash component of the investments. The amount needed is assumed to be $90,000 per year after taxes divided by 2 to equal 6 months. Since the likelihood of both incomes halting at the same time is very small, $45,000 would likely be enough for a 1 year disruption in income. This $45,000 amount is assumed to be part of the cash investments in the non-registered accounts. It is labelled as Cash and Emergency Fund in the spreadsheet.

Risk Tolerance

Risk tolerance is very low as capital preservation is a key element in the retirement strategy. Monitoring the markets and dealing with volatility are not preferred, so the portfolio will have to be constructed with little maintenance and few headaches. Most of the portfolio will be in cash accounts and cash generating securities. There is also a need to have cash being generated consistently for income. Locking in money for years at a time before receiving any income is not considered favourable.

Strategy

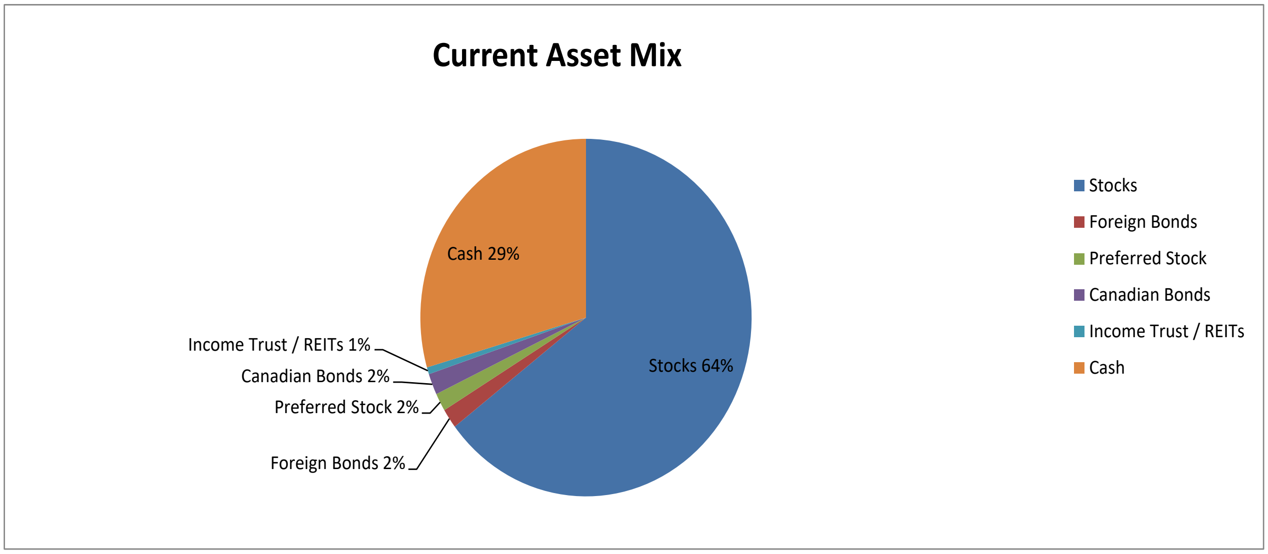
Since the investments funds are largely needed for security and not for day to day spending needs, the main focus will be to preserve capital. There will be income from interest and dividends, but risk is kept intentionally low, as well as fees and tax effects. The suggested portfolio mixture would be about 25% in equities (dividend stocks) primarily in Canada and the European equities, and the rest of the money in GICs and high interest accounts.

Portfolio Cost

The average MER once the portfolio is constructed would be 0.07% per year, and the average yield would be 2.46% including all of the cash investments. The income generated alone would be about $133,000 net of MER expenses per year: this does not include capital gains or losses on the equities or trading fees. The income after taxes generated would be around $100,000 per year. Trading fees are expected to be under $100 to set up the whole portfolio and would likely be around $50 to rebalance each year. Please see the attached spreadsheet for the portfolio breakdown. The expected average rate of return including capital gains would be around 6% per year for the dividend investments only.

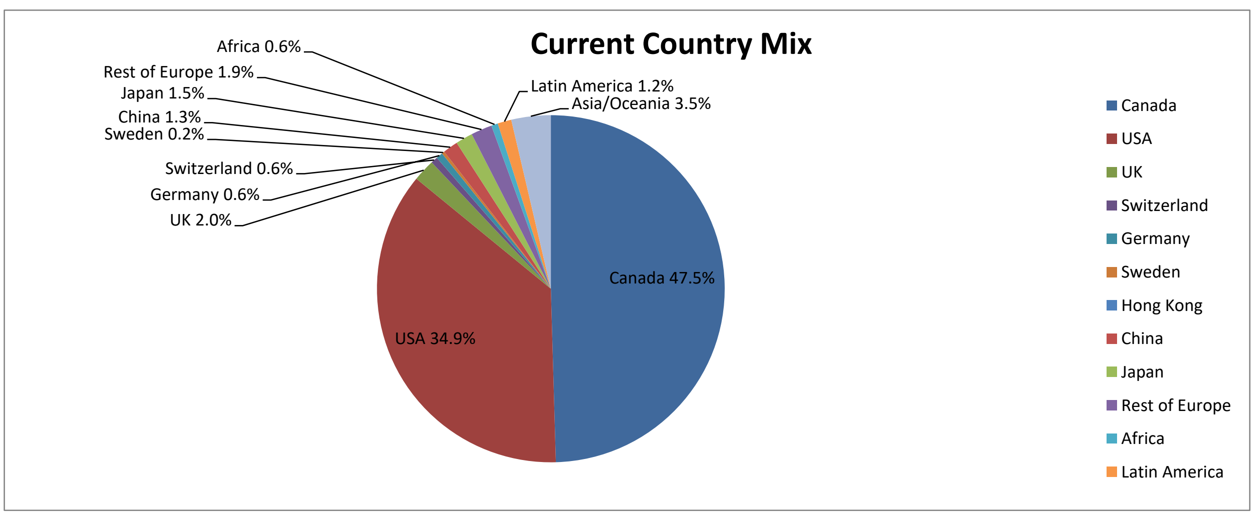
Asset Mix

The portfolio is concentrated in Canada with some European equities which are a legacy from the present portfolio. The strategy is based on achieving the target for gross income before taxes with the least amount of exposure to the equities market at this time. The suggested portfolio will be summarized in the charts below. There may be additional charts provided depending on what specific situation exists with respect to taxes, currencies, diversification or specific portfolio considerations.



Country Mix chart

The country mix charts show the exposures in the portfolio by the country of domicile. There will be a separate chart for currency exposure which may be different due to hedging and what currency the security is being traded in. A Canadian security can trade in U.S. dollars is an example. The Canadian component will have equities, preferred shares, REITs and fixed income, whereas the other country exposures typically have equities.   It is suggested that U.S. and international exposures be raised by about 6% in the proposed portfolio versus the current portfolio.



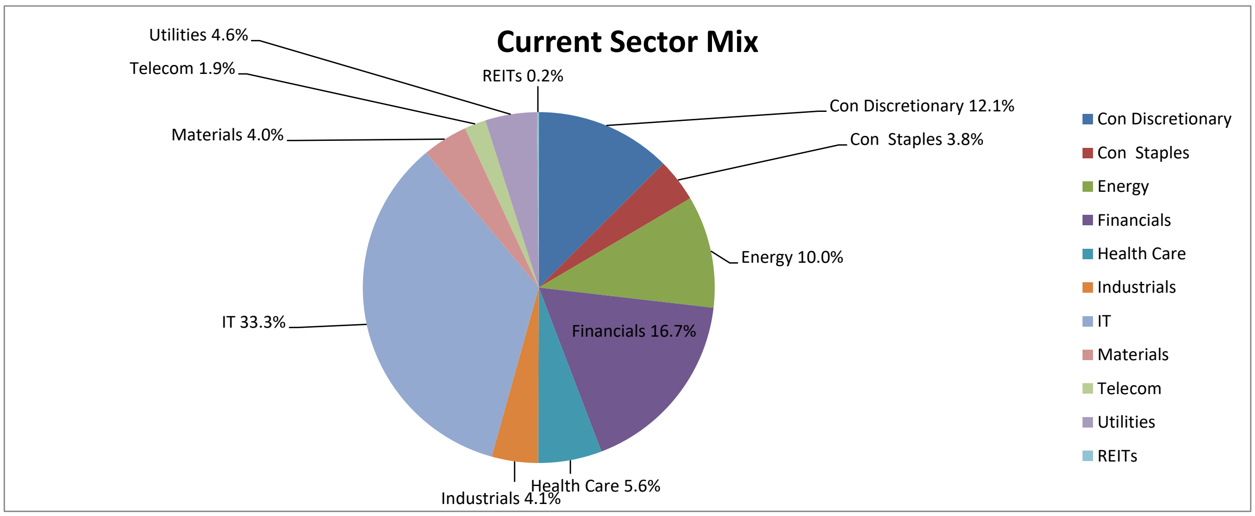
Sector Mix Chart

Canadian Investments

Canada has a high concentration of financial companies (banks and insurance companies) and energy companies (oil and gas). There are also materials companies (mining for metals and precious metals) as well as utilities companies and industrial companies.

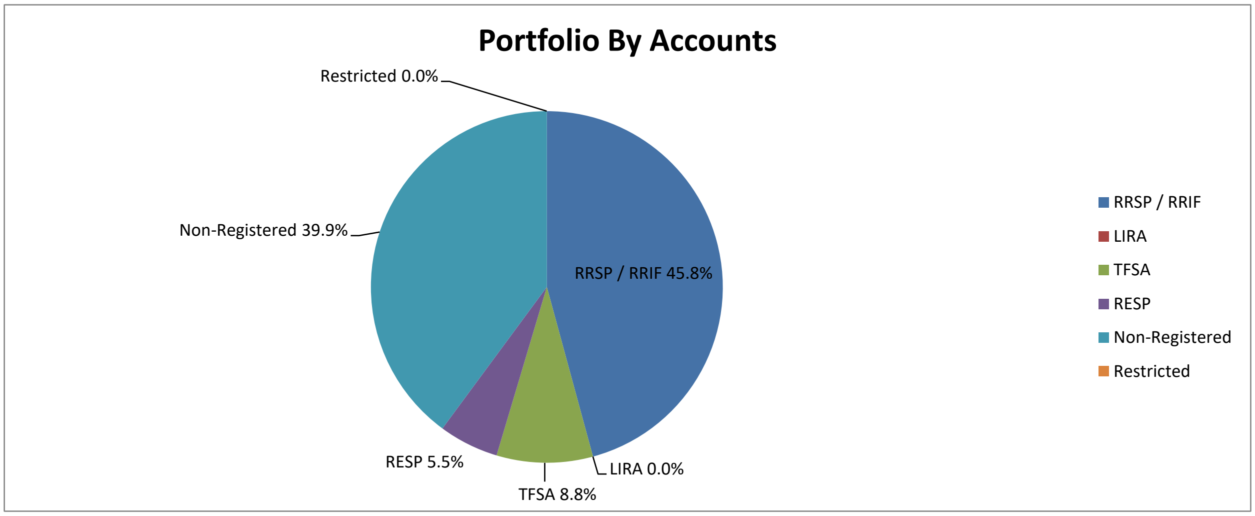
Sector Diversification

There are 10 Global Industry Classification Standard (GICS) sectors in every country. If you include real estate, there are 11 sectors. Having investments in all of the sectors is a way of diversifying across different industries. In Canada, the market is well represented in energy, materials and financials, and to some extent utilities. The other sectors should be emphasized in the US or internationally because there is much more to choose from in the other sectors – the industrials, consumer discretionary, consumer staples, health care, telecommunications and information technology. There are some Canadian companies in these sectors, but not that many compared to the rest of the world. There is an allocation to U.S. dividends and international ETFs that have dividend income to diversify among sectors as well as among countries and currencies.



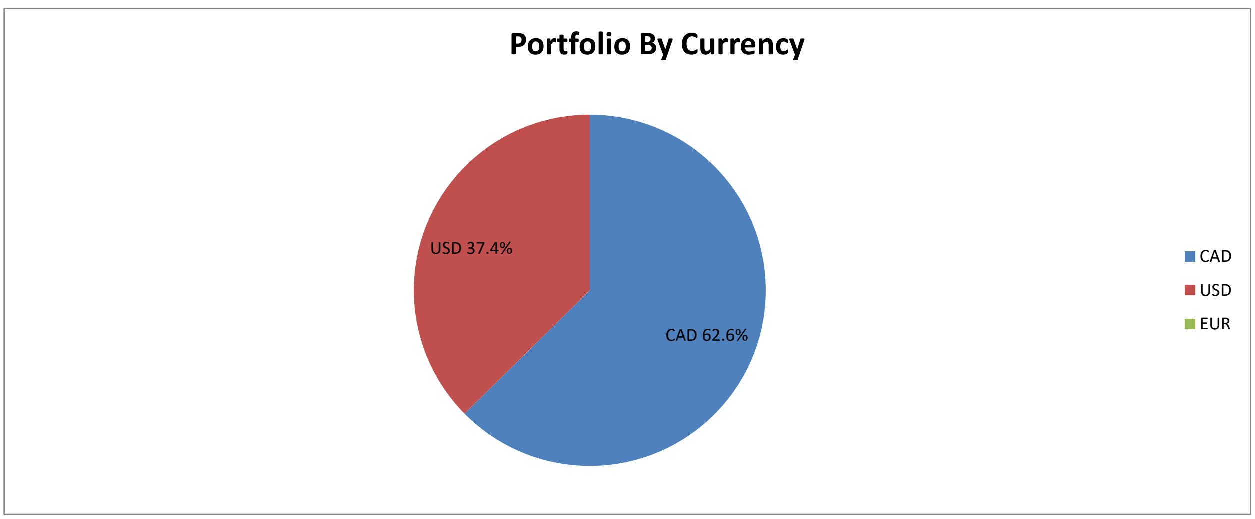
Portfolio By Account

The portfolio by account charts how the portfolio is broken down by account type. There are no proposed changes to the account breakdown.



Portfolio By Currency held in the account (after any conversions)

These charts show the exposure to various currencies. This chart should not be confused with the country mix chart. The country mix shows the securities by domicile, and the currency chart shows the currency in which the security is traded. You can have differences such as a Canadian stock trading in U.S. funds.



Interest Rates on Cash Deposits

The interest paid on high interest savings accounts is about 1.0% at most financial institutions. Rates as high as 2.0% are also available from credit unions, Tangerine, PC Financial and virtual banks (banks without physical branches). The trading accounts like TD Waterhouse, BMO Investorline etc. also tend to have higher rates on cash and deposits versus the bank branches.

Retirement Projections and Tax Scenario

The target income for retirement is $144,000 per year before taxes in Canadian dollars assuming all of the income is from interest. The employer pension plan and the CPP payments will amount to $750 plus $300 per month respectively, which is $12,600 per year. The income generated from the portfolio comes from 2 sources: interest on cash and dividends. The income from European equities is included with interest income as it would be taxed this way in Canada. The income from European equities is net of withholding taxes and converted to Canadian dollars at $1.30 Canadian to 1 Euro. The dividend income produced is $32,920 per year if you subtract the fees from the ETFs which generate the dividends. The interest income generated is $95,910 from all of the cash, GICs and European equities. The pension income of $12,600 per year is also added to the tax scenario. The interest and dividend income held in the registered accounts is included in income, but not included for the tax calculations. Note that the actual income generated is less than $144,000 because the $144,000 target income assumed all of the money is coming from interest. In the tax scenario, the income appears larger than $144,000 due to the Canadian dividends being grossed up and then reduced by a tax credit. Since there are some dividends generated as well and they are taxed less than interest for Canadian dividends, the after tax money will still amount to just over $100,000 per year.

Table F
Assumptions Table For Asset Return Calculations

Assets	Dollar Amount	Expected Return	Allocation	Comments
House and Real Estate		2.00%	100.00%	
Equity		6.00%	100.00%	
REITs / Preferred Shares		6.00%	100.00%	
Long Term Inflation Rate (10 years or longer)		2.00%	100.00%	
Fixed Income		2.00%	100.00%	
Cash		1.00%	100.00%	
Average Return				

There are 2 tables shown below: One for 15 years into the future and another for 20 years into the future. The top part of the table is showing the current assets being invested at the assumed rate of return gross of taxes and calculating a future asset value. The bottom part of the table takes the asset value and converts into an annual income stream (excluding the house). There is a provision for taxes and the current expenses are assumed to be the retirement expenses.

Table G Retirement Projection and Assumptions				
Retirement in 15 Years (Year 2033)	Dollar Amount	Expected Return	Future Value	Comments
Years Until Retirement	15			
House	$3,000,000	2.00%	$4,037,605	
Rental Properties	$600,000	2.00%	$807,521	
Margin Account	$2,256,244	4.00%	$4,063,368	Assumed 50% Equities and fixed income
Margin Account	$711	4.00%	$1,280	Assumed 50% Equities and fixed income
TFSA	$480	4.00%	$864	Assumed 50% Equities and fixed income
TFSA	$50,538	4.00%	$91,016	Assumed 50% Equities and fixed income
RRSP	$341,434	4.00%	$614,903	Assumed 50% Equities and fixed income
RRSP	$49,200	4.00%	$88,606	Assumed 50% Equities and fixed income
RESP	$20,678	0.00%	$0	Assumed Spent on Education
Mortgages are assumed to be paid off by this time.				
Total Retirement Assets			$5,667,559	
Income Generated In Retirement Before Taxes		4.00%	$226,702	
Provision For Taxes (35% Rate)			$79,346	
Income After Taxes			$147,357	
Current Expenses			$192,000	
Difference			-$44,643	

Table H Retirement Projection and Assumptions				
Retirement in 20 Years (Year 2038)	Dollar Amount	Expected Return	Future Value	Comments
Years Until Retirement	20			
House	$3,000,000	2.00%	$4,457,842	
Rental Properties	$600,000	2.00%	$891,568	
Margin Account	$2,256,244	4.00%	$4,943,708	
Margin Account	$711	4.00%	$1,558	
TFSA	$480	4.00%	$1,052	
TFSA	$50,538	4.00%	$110,735	
RRSP	$341,434	4.00%	$748,124	
RRSP	$49,200	4.00%	$107,803	
RESP	$20,678	0.00%	$0	
Mortgages are assumed to be paid off by this time.				
Total Retirement Assets			$11,262,390	
Income Generated In Retirement Before Taxes		4.00%	$450,496	
Provision For Taxes (45% Rate)			$202,723	
Income After Taxes			$247,773	
Current Expenses			$192,000	
Difference			$55,773	

Future Considerations:

Option to buy individual securities versus ETFs

For the Canadian dividend portfolios, you can purchase individual financial sector stocks (3 to 5 names), energy sector stocks (5 names or so) and the utilities sector stocks (5 names) instead of buying ETFs. This strategy can also be effective in terms of diversification. The advantage of doing this is that trading fees are cheaper than the MER on the ETFs, especially if you want to hold onto the stocks for many years. Rebalancing can be more expensive versus one ETF trade, but generally rebalancing would not mean trimming every stock at one time. The disadvantage of buying individual stocks is more portfolio monitoring and less diversification. This method would also produce dividends which are taxable. The preference is to use the ETFs rather than securities, but either option would be effective.

Inflation Protection

There are also concerns of inflation eroding the value of the inheritance. This could be alleviated by buying a house, precious metals or stocks based on physical goods. This will add risk and complexity to managing the money, so this has to be weighed with the risk tolerance and the income generated. Real estate investment trusts can also be used as part of the equation, but these securities have a lot of debt and are sensitive to interest rates rising, so these should be purchased when interest rates are falling. There is no assumed inflation protection except for the equity holdings that have claims on physical assets. The best sectors for this purpose are metals and mining, energy, utilities and industrials as they have physical assets and can charge more for products easily if inflation causes their costs to go up. Canada has a high exposure to materials and energy, with some utilities, so the proposed portfolio as it stands partially protects against inflation.

Inflation Considerations

Inflation is not included in the portfolio allocation and projections. The best way to incorporate inflation is to find out what you would be spending in retirement, which would happen when you are close to that time. This is in effect calculating your personal inflation number, which is more accurate than the CPI or other average that can be used as an estimate. The other indirect way to hedge against inflation concerns is to have physical goods or investments. The house would qualify as this type of investment, as well as shares in physical based sectors like real estate, energy, materials or utilities. Since the investments will have exposure to all of these sectors, inflation is covered through your investments.

The Sleep Factor

If the portfolio is being constructed and is not going the way you would like, consider the sleep factor. If you are losing sleep over the portfolio, it may be too risky. If this happens, the equity portion should be reduced and the cash portion should be increased until you can sleep again. Since money for the house, the reserve fund and market corrections have been accounted for, the risks are minimal to the lifestyle and paying the bills. This portfolio is fairly conservative due to a high cash allocation. For registered accounts, there is a lot of time to recover losses, but it may take up to 10 years if there is a severe market pullback. In this case, using the contributions to buy more would shorten that time span considerably. In spite of all this, if it does not feel good, it is time for a change in the portfolio. This is hard to know in advance until you are in the middle of a live situation.

Taking CPP Early or Delaying Taking the CPP and OAS

Taking CPP early is defined as taking your CPP before the age of 65 years old. The maximums given by CPP calculators assume this age when providing the monthly payments. If you elect to receive CPP early, the amount would be reduced by 0.6% per month for each month you take CPP early. If you receive CPP at age 64, it would be reduced by 0.6% x 12 months or 7.2%. Taking CPP at age 60 would reduce the amount by 36%.

If you delay taking the CPP and OAS both to save taxes and to increase the amount of the payout per year in future years. The CPP monthly payments would increase by 0.7% each month or 8.4% each year the longer you wait to take the CPP. The downside is that more of the investment proceeds will have to be spent on expenses before the CPP kicks in. The investment return from these funds being spent sooner would also not be recovered. The same concept can apply to the OAS payments except that they increase by 0.6% per month for each month that it is delayed. OAS payments can be delayed until age 70 and higher payments would be received when they do start.

Capital Losses

From a tax perspective, capital gains and losses are generally the best way to invest as the tax rates are the lowest. There is also no discrimination if you have gains on Canadian or foreign investments held in a Canadian account, which is not the case with dividends. Any capital gains or losses generated in a registered account would not be taxed. Any benefit of capital losses would not be realized in registered accounts. The ideal scenario is to have all of your losses in a non-registered account, all of your gains to offset those losses in a non-registered account, and all of the interest income, dividends and some gains in a registered account to make them tax free.

Bonds

Generally, bonds should be avoided as an investment at this time in any account because interest rates are very low, and will likely only rise. This would mean either a loss of principle, or a breakeven return on principle if the bonds are held to maturity and bought at par, which is an unlikely scenario. Short bonds (maturing in 2 years or less) could be considered, but high interest savings accounts and GICs would yield just as much interest without the trading fees and restrictions. Bond funds should also be avoided due to the high fees and mixing of long bonds with short bonds, which generate losses on rising longer term interest rates. Should interest rates rise by 3% or more in the future, bonds should be reconsidered as an investment as they are safer than dividends and interest income is more predictable.

Preferred Shares and Real Estate Investment Trusts

These are good alternatives to buying dividend stocks because they pay a higher percentage of the dividends as income. The companies tend to be the same as the large companies that pay common dividends. The one major difference is that because more money is paid in income rather than capital gains, preferred shares tend to be more interest rate sensitive. This means that if interest rates rise, these stocks act like a bond and will go down in price. These could be purchased in the short term to create income, but preferred shares should be monitored closely for interest rate environment changes. Real Estate Investment Trusts are also driven by interest rate movements but they make their money from rent and real estate price gains. Interest rate hikes or a correction in real estate are two main reasons to sell these securities. Buying these securities is not recommended at this time because interest rates are expected to rise, but this is an investment for future consideration.

Estate Planning

This section has been added for things to keep in mind and revisited in the future. It is assumed that wills and powers of attorney for health and property have been drawn up. These documents can be changed when there is a significant change in what is contained in the documents. Minor changes can be done by a lawyer for a reduced fee – but what is minor or major should be discussed with the lawyer. In terms of the investments, make sure that beneficiaries are up to date for all of the accounts and non-registered accounts can be made joint for easier access. Taxation for items like RRSPs can be discussed in the future as transfers can be done between spouses with minimum tax effects for RRSP and RRIF accounts as well as the house. The non-registered accounts would be taxed each year for income and dividends so there would not be additional expense for the estate.

Estimated Tax Bill Should Both Spouses Pass Away

For the retirement accounts, should one spouse pass away, the other person would get the assets without any tax implications for registered accounts. When the second spouse passes on, the beneficiaries would pay taxes as if they received the entire amount in one lump sum. Assuming that an RRSP account is worth $700,000 at the time of death, this would be considered income and taxed at the various tax brackets which would be close to 50% at the maximum. This would equate to a $350,000 tax bill.

The TFSA accounts are tax free up until the day of death. Income earned after that date would be taxed, but this amount would be minimum. Principle residences would not be taxed until the day of death and there is a capital gain between the time of death and the time of distributing the proceeds. For non-registered accounts, the income is taxed on an annual basis. The assets would however be deemed sold at the time of death and these would be considered capital gains or losses.

One possible solution would be to have an amount in the non-registered accounts that can be sold and pay the tax bill which would save on insurance premiums. This strategy would pay off if one of the spouses lives for a very long time. Life insurance policies should therefore focus on the value of the registered accounts and minimizing the tax liability in the event of liquidation.

What Parts of the Portfolio Are Subject to Tax on Death?

The general rule is that all assets are deemed to be disposed of on the day of death. There are many exceptions to this rule however. For a principle residence, the house would be deemed sold on death but it is tax free until that day. Any income earned after that day would be taxable. If the principle residence is inhabited by the surviving spouse, this rule would not come into play until the surviving spouse passes on.

The non-registered accounts would be taxed each year for income and dividends so there would not be additional expense for the estate. The assets themselves however would be deemed disposed of and any capital gains or losses would be taxable. There may be a net gain or loss so this type of account will vary as to the tax consequences.

For corporations and trusts, these do not pass through the estate because they have their own rules for dispositions. When a corporation is wound up or it sells its assets, a tax event would get triggered. The same idea would happen with the trusts, as they dispose of assets on a different schedule than when the settlor passes on. The corporations also have the advantage of being eligible for the lifetime capital gains exemption upon selling of corporation shares.

TFSA accounts are tax exempt until the day of death and any income after the day of death would be taxable to the estate. This will likely not be a large amount so there is not much tax risk with these accounts.

For the registered accounts (RRSP and RRIF), the assets would get transferred to the surviving spouse upon death with no tax consequences. When the surviving spouse passes on, the assets would then be deemed withdrawn and a tax bill would then ensue.

For pension plans, they typically have a survivor provision where if the spouse contributing to the plan passes on, the other spouse would receive a survivor payment. It would be worth to find out the rules regarding this since each plan has its own provisions. The rules may also depend on who is assigned as a beneficiary in the pension plan.

Ontario Estate Planning Laws and Estate Administration Tax (EAT) or Probate Fees

Ontario has introduced a new Estate Administration Tax (EAT) starting in 2015. The gist of the new tax is that reporting requirements will be much more stringent and will have to be done more quickly than in the past. The reporting is also more complicated and the penalties more onerous.

The Estate Administration Tax rate ranges from 1% to 1.5%, topping out at 1.5% in the $5 million range or higher for the estate value. This fee will apply to most assets – real estate, bank accounts, vehicles and registered accounts that have no named beneficiary. Any asset that does not pass through the estate would not be subject to this tax – TFSAs, RRSPs, RRIFs, Life Insurance policies with a person as a named beneficiary, real estate outside of Ontario and CPP death benefits. This tax is generally payable at the time of application with a refund for adjustments to the valuation given later on in the process.

The main way to prepare for the probate fee is to have your estate documents organized in a known location. These documents include the will, powers of attorney, funeral arrangements, list of assets, account numbers and locations, passwords and other access information. The idea is to make it easy for the executor to carry out the instructions and pay the fees by knowing where everything is located.
Life insurance funds will be available to pay these fees but information will allow for better preparation. A list of income sources would also be helpful, like pension incomes, CPP, OAS payments, dividends and carry forward of net losses. Past tax returns would be helpful in looking at past trends.

If any clarification is needed, or if there are any questions or concerns, feel free to contact me.

Sincerely,

Joe Barbieri

Joe the Investor

Appendix

Active Versus Passive Investing

A Primer on Investment Fees

Active Versus Passive Investing

Before getting into which of the products are suitable for you, there are some aspects that need to be considered so that you understand what the variations are among the products.

Active investing is when someone (a portfolio manager) picks the stocks that are in the fund and decides how much of each one to hold (the ***weighting***). This portfolio manager would also monitor the portfolio and decide when a security should be sold off, added to or have its weighting decreased. Since there is ongoing research, meetings and analysis that must be done to build and monitor this portfolio, this fund manager would have research analysts and administrative personnel to help run the fund.

Passive investing has the same setup as active investing, but rather than someone deciding what securities to buy or how much of each one to buy, the portfolio manager would copy a benchmark. A ***benchmark*** is a collection of securities which the fund is compared against to see how well it is doing. Since everything in investing is about how much money you can make and how much risk it takes to make that money, every fund out there is trying to compare to all of the other funds of the same type to see who can make the most money. The basis for the comparisons is the benchmark, which can also become comparing between peers or funds managed the same way. Comparisons are general and done only for returns. The risk aspect of the equation is handled by looking at what type of securities the fund holds or how specialized the fund is.

How Do I Know By the Fund Name If it is Active or Passive?

The short answer is that you have to get to know how the fund manager operates the fund. Some clues to know more quickly if the fund is active or passive are given next. If they are intentionally trying to pick securities according to some beliefs that they have about the market, this is active management. If the fund description talks about "beating the benchmark" or "manager skill" then it is actively managed. Looking at the return history, if the returns vary versus the index by different amounts each year, then the fund is actively managed. Lastly, the fees may be expensive and have sales loads.

If the name of the fund says "Index" or "Index fund" there is a good chance that the fund is passively managed. If the name of the fund says "ETF" or "Exchange Traded Fund" this could be a passive fund, but you need to make sure of this because some ETFs are actually active funds, but they are managed in a certain way. Most of the passively managed ETFs are provided by BMO, iShares, Claymore, Vanguard and Horizons in Canada and Powershares, Vanguard, iShares and SPDR (or Standard and Poors) and others if the holdings are from the U.S. Most of the other companies would have actively managed funds only. If the fund description states that the fund is trying to "imitate" the performance of an index or benchmark, then this implies that it is copying the index and this is passively managed. From the return perspective, passively managed funds will be very close to the index that they claim to imitate, but slightly less due to fees each year. The amount that the returns are under the index will be close to identical each year unless there are currency conversions or variances in cost which may come from currency fluctuations or hedging that the fund may do. Passive funds typically do not have sales loads as they are geared toward people who invest for themselves.

There are some funds that try to mix active and passive management. These products can be assumed to be actively managed, although their results will be closer to the benchmark than most of the other funds, so this is something to consider if the variation from the index is a factor.

A Primer on Investment Fees

The Management Expense Ratio (MER)

This is the largest cost for most funds and represents the cost of managing the fund. "Managing the fund" means running the investment company, researching the investments, advertising, overhead and the cost for the advisor or sales person when it applies. Administrative costs like GST / HST within the fund and accounting for trades and record keeping are also part of the expense. The MER covers all of these costs in an actively managed fund. The MER is given as a percentage, which is the percentage of the assets that the fund manages or invests over a year of time. If you have $100,000 invest in a fund, and the MER is 2% per year, you are paying $2000 per year to keep this fund. The cost is subtracted from the return and what you see in your investment statement is your return net of fees, or after fees. There are exceptions to this rule if you have a high net worth account or a special arrangement with the fund company, but for the typical investor, this would be true. The Management Expense Ratio is the management fee plus the administrative costs. The administrative costs are usually between 0.05% and 0.1% of the assets of the fund. If the information you obtain states a "Management Fee" instead of a "Management Expense Ratio" you would have to add on the administrative costs to get the true fee. Seek out the prospectus and look up fund operating costs to find exactly how much the number is. In some cases, an advisory fee is also added to the management fee and administrative fee which can be substantial. If your advisor does not disclose this, the prospectus is the next best place to find out what the costs are.

For American funds, the MER would be called the "Expense Ratio" or "ER" which is the same thing as the Canadian MER, but advisory fees are not included in the ER and would be included in Canada for the MER if the product is actively managed. If the product is passively managed in Canada or the U.S., the same names apply, but no advice would be part of the cost since these products are used by people who invest for themselves and would pay for advice separately if they retain it.

MER Will Depend on Class

There are products that have various classes of the same product, the same way there are different models of the same car or the same cell phone. For investment products, the classes indicate how you came across the product, or what restrictions you have on access to the product. For example, Class A is usually a retail class where anyone can buy the product with any amount of money. There is Class I, which can be obtained through an employer or another institution. An example might be buying this product through your company pension plan. There is a Class O which typically has no fees embedded in the return and is reserved for non-profit institutions of high net worth clients that buy direct from the company. There are also classes that are part of different portfolios that are set up by the issuer, like Class F which would be available depending on who your investment dealer is. There are also classes that vary depending on what type of advisor you have and what relationship they have with the fund company. The best thing to do here is ask what class you are being offered and get material form the issuer on how much it would cost. In some cases, you can get the same product in a different class and pay less in fees. Some companies may have "Series" instead of classes or some variation thereof. The key thing to note is that different versions of the same fund would different fees, and the differences can be substantial. Note that each company has different class names pertaining to different fees. This question should be asked for each different fund company whose funds you have in your account.

Sales Loads

Whenever you see the word “load” on a fund it refers to a sales load. This fee is paid to a sales person for advising you and recommending the product to you for the company. There are “front end loads” which are paid as a percentage of the amount you initially invest. If a front end load is 4% and you invest $100,000, you will pay $4,000 up front just to buy this fund. These funds may have the code “FE” in the fund name on your statement. Note that sales loads are not related to MER fees – they are separate fees. There is also a “back end load” or “Rear end load” which is a percentage charged to you when you sell the fund. These are marked with the code “DSC” or “Deferred Sales Charge”. If a back end load is 5%, and you sell $120,000 worth of this fund, you would pay $6,000 in fees to exit the fund. These funds tend to have a DSC redemption schedule which means the sales load will decrease the longer you stay in the fund. Most companies stop charging the rear end sales load after 6 years of holding the product. New regulations in 2018 may mean that the deferred sales charge may not be utilized any longer. Since each company varies, you should obtain the details of this schedule up front and understand how the numbers apply to your holdings. There are also “no load” funds which do not charge sales loads at any time. You may also come across “Low Load Funds” and “Level Load Funds”. Low load is similar to the fees discussed above, but they are discounted or lower than average. The level load idea means that the same percentage of sales load is charged over time.

Some companies charge an early redemption fee if you sell their fund within a short period of time. How short the period is will depend on the institution. In some cases, it is 30 days, but it can be 90 days, 6 months, 1 year or some other time period. This fee is designed to discourage quick redemptions or short term trading of the product.

The best thing to do to clarify which load you have is to ask up front and have it explained to you. If the information is not forthcoming, it may be time to find another place to invest your money or do the research on your own. Note that sales loads only apply to a fund that is sold through a sales person. You may be able to get the same fund without the sales person in some cases. Passive investing generally does not have sales loads – but the exception would be if an advisor recommends these funds and charges you some type of referral fee. This would be another question to ask if you are being advised to buy a passive fund and are not seeing any direct cost to buying the product.

ETF Fees double counting

Certain ETFs have other funds or ETFs within their holdings. This is not encouraged because there would be two layers of fees: one layer to run the ETF that you have plus additional MER fees for the funds on the holdings list. This scenario has been avoided by choosing ETFs that hold securities directly instead of funds. Generally, these fees would not be double counted, but it is hard to research.

Currency Hedging Costs

This type of fee will occur in funds that trade in non-Canadian currencies and hedge them so that the price you receive would be in Canadian dollars. The cost of transacting the hedge itself is the fee being described here, and it can range from 0.5% to 1% per year. If the fee is not disclosed, assuming 0.5% is the cheapest that it will likely be. If you are investing in emerging market currencies or non-developed market currencies, the hedges are much more expensive to put in place and go higher than 1% per year.

This is a cost embedded in the return of the fund, but should be examined to flesh out exactly what you are paying to have this hedged. Both active and passive funds pay the same fee for this type of activity.

The alternative would be to keep the securities in their home currencies and whatever changes happen to the foreign exchange rates would be reflected in the price of the product. The fact that currency exchange rates can change is a risk of your investment, but it is not considered a fee like the other fees discussed in this article. This fee does not apply if the fund price is in your home currency. You may have a U.S. dollar account, buy a fund that trades in U.S. dollars and then redeem this fund for U.S. dollars. Until you convert the money on your own to Canadian dollars, there is no currency charge. You would only have a conversion charge to change the final dollar amount to Canadian dollars.

Referral Fees or Trailer Charges

These can sometimes be called Service Fees. This type of charge is paid to a third party who sells the product to you on their behalf. It can be thought of as a referral fee or trailer fee. This fee tends to be captured by the MER, but this should be investigated with the company you are dealing with as this may vary. This type of fee tends to arise with active management as passive management products usually do not have any referrals attached to them.

Performance Fee

This fee is based on whether a fund achieves a return over a required benchmark – a reward for good performance. This type of fee is common with hedge funds or exotic types of products, but it is sometimes embedded in funds sold to retail investors. Like most of the fees, ask questions and do your research because this type of fee will be different for every institution and product. This fee is optional in that it usually will not apply if the return on the fund is negative or positive but not that high, but the question should still be asked to minimize surprises.