

Understanding the costs of mutual fund investing



There are many different investment options available to help you reach your financial goals. Regardless of which investment you choose, it is important to understand the costs involved and how they can affect your investment.

Mutual funds offer many benefits to you as an investor, including professional management, investment diversification, easy access to your money and convenience. For many investors, mutual funds can provide all of these benefits at a fraction of the cost of creating a portfolio of individual investments. However, not all mutual funds have the same fee structure and the costs of some funds will impact your return more than others.

The information that follows will help you better understand the costs involved with mutual fund investing so that you can make well-informed decisions and get the value you want out of your investment.

The costs involved in operating a mutual fund

Operating a mutual fund involves many responsibilities, from managing the investments to administration and investor reporting. Generally, there are three cost categories associated with these functions:

1. Management expense ratio
2. Trading expense ratio
3. Sales charges

1. Management expense ratio

The management expense ratio (MER) represents the combined total of the management fee, operating expenses and taxes charged to a fund during a given year expressed as a percentage of a fund's average net assets for that year. All mutual funds have a MER.

The returns you earn as an investor – whether reported on your statement, in newspapers or in other promotional materials – reflect performance data that is reported after the fund's MER is deducted. For example, if your fund's investments gained 9% last year and its MER is 2%, the reported return would be 7% for that time period.

WHAT ARE THE COMPONENTS OF A MER?

A MER is made up of several components. These components may be different across different series of the same fund.

Management Fee

The Management Fee (as shown in the diagram below) includes two components:

- **The fee paid to the investment manager:** Pays for professional investment management, supervision of the fund, administration of fund operations and service support.
 - **Team.** Access to the advanced skills and specialized education, experience and professional designations of the portfolio manager and their team of analysts (if there is a team to support).
 - **Tools.** The fund manager and analysts have access to research reports, company executives, competitor information, market data, specialized analysis tools, proprietary tools and other important data.
 - **Time.** Mutual fund managers and analysts dedicate their professional lives to researching and analyzing current and potential holdings for the mutual fund allowing investors to enjoy their time doing something else.
- **The trailing commission paid to an advisor*:** Fund companies pay ongoing fees (known as trailing commissions or trailers) to the firm for which your advisor works. A portion of the trailing commission is sometimes paid by the advisor's firm to its representatives.

The value-added activities that your advisor provides in exchange for the trailing commission can be summarized under three pillars:

- **Access** includes the infrastructure required of your advisor's firm to support the distribution, sales and servicing of mutual funds.
- **Advice** represents the expertise an advisor provides to clients. This expertise can include fund recommendations and portfolio construction; ongoing monitoring and portfolio rebalancing; and retirement, tax or goal-specific planning.
- **Service** encompasses a wide range of activities, including account openings/closings, reporting and issuance of quarterly account statements and client communications, and regulatory compliance activities.

Operating Expenses

Each fund also pays an administration fee that is used to pay for regulatory filing fees and other day-to-day expenses such as:

- Record-keeping fees
- Accounting and fund valuation costs
- Custody fees
- Audit and legal fees
- Costs of preparing and distributing annual and semi-annual reports and prospectuses

Taxes

Each fund is required to pay Harmonized Sales Tax (HST) on management fees and administration fees charged to the fund. In general, the HST rate depends on the residence of the fund's unitholders at a certain point in time.



* Please note depending on how you work with your advisor the dealer/ advisor compensation may not be included in the management fees ie. for fee-based accounts the dealer/ advisor compensation is not included in the management fee and is negotiated between the advisor and investor.

2. Trading expense ratio

The trading expense ratio (TER) is a measure of a fund's trading costs. Generally, the higher a fund's TER, the more actively the fund manager has traded in a given year. The TER is typically expressed as a percentage. For example, if a \$100 million fund incurs a total of \$1 million in trading commissions (expenses) for the year, the TER is 1%. When a portfolio manager buys and sells securities more often or invests in less liquid securities (such as small or micro caps), these funds tend to have higher TERs. Funds with low turnover rates that invest in more liquid securities will tend to have lower TERs. The TER is independent of a fund's MER. TERs typically only apply to funds that hold equities. Most fixed income funds do not have a TER because commissions for fixed income funds are already embedded in the price of a bond.

HOW DO TERS WORK?

The TER is determined by taking the fund's total trading commissions incurred over a reporting period divided by the fund's total assets. As this ratio will vary by fund, it is important to evaluate this cost in conjunction with a portfolio manager's investment style, track record, skill and strategy over time. Fund performance is reported after trading expenses have been deducted.

3. Sales charges

A load is a sales charge that an investor may incur when buying or redeeming units or shares in a mutual fund. It is separate from the MER and is not to be mistaken for the ongoing trailing commissions that make up part of the management fee.

Mutual funds are sold with one of three types of sales charge structures:

No-load

No sales charges are paid when a no-load fund is purchased or redeemed.

Front-end load

A front-end load is a sales charge paid upon purchase of a fund and is expressed as a percentage of the amount you invest (ranging from 0% to 5%). The sales charge, which is often negotiated with the advisor prior to investing, is deducted from your initial investment and paid to your advisor's firm.

While RBC Funds, PH&N Funds and BlueBay Funds are available under many of these options, the majority of our funds are sold on a no-load basis. Talk to your advisor about the best option for your needs.

Talking with your advisor

It is important to have an open dialogue with your advisor to better understand the various costs of investing in mutual funds. Here are answers to some of the more common questions posed by investors:

How do the fees I am paying compare to other investments?

When comparing the cost of investments, ensure you are comparing similar offerings to understand the value you will receive for the fees you pay. For example, in the case of exchange-traded funds and stocks, you have to remember to factor in associated transaction costs and brokerage commissions. When you consider an investment solution, it's important to evaluate its "collective value": professional management, diversification, the ability to automatically reinvest distributions and rebalance holdings, as well as the investment advice and service you receive from your advisor.

How do I pay mutual fund fees?

You pay the fees indirectly, as they are automatically deducted from the fund; meaning, the investment return that is reported on your account statement, on the RBC GAM website and in the newspaper is shown on an after-fee basis. For example: If the investments in a fund you own return 8% for the year and the MER is 2%, you would earn 6% after fees and the fund's rate of return would be reported as 6%.

Where can I find information on MERs?

A fund's simplified prospectus discloses the management fee, fixed administration fee, and trailing commissions paid by the fund company. Alternatively, information about MERs can be found on a mutual fund company's website or at many third-party research sites that provide mutual fund information. For MER information on RBC Funds, PH&N Funds and BlueBay Funds, please visit our website at rbcgam.com/funds.

For more information about the costs of investing in mutual funds, please speak with your advisor.

Please consult your advisor and read the prospectus or Fund Facts document before investing. There may be commissions, trailing commissions, management fees, and expenses associated with mutual fund investments. Mutual funds are not guaranteed, their values change frequently, and past performance may not be repeated. RBC Funds, PH&N Funds and BlueBay Funds are offered by RBC Global Asset Management Inc. and distributed through authorized dealers.

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