Pension Watch

May 2004

**The last edition** of Pension Watch provided "An Introduction to the Yield Curve". This edition looks at "No Load Versus Load Investment Funds".

# No Load versus Load Investment Funds

One topic that confuses investors is the term "No Load". Before purchasing units of an investment fund, an investor should be aware of any potential commissions or sales charges levied to the investor. Funds that administer charges are called load funds and those that do not are called no load funds. All of our Phillips, Hager & North and BGI investment funds are no load.

Loads can range from 1% to 9% of the investment, although they are usually 5% or less. There are a number of ways that the load can be charged. A front-end load is payable by the investor at the time of investment and is calculated as a percentage of the amount invested.

A back-end load, also known as a redemption charge or deferred sales charge, is paid when funds are redeemed and is calculated as a percentage of the funds invested or amounts redeemed. Such loads are usually based on a fee that declines annually and reaches zero in the fifth to seventh year. (This period when the charge can still be levied is called the redemption charge period.) Either way, a load represents a direct cost to the investor. For this reason, many investors prefer no load funds as they can be bought and sold without transaction costs.

Back-end load funds are often mistakenly thought of as 'no load' because no sales charge is applied if the fund is held longer than the redemption charge period. However, many investors find they wish to sell all or part of their holdings during this period for a variety of reasons, and discover, sometimes to their surprise, they must pay a charge. Although such charges are outlined in the prospectus, they may not have been appropriately reviewed with the investor.

An investor should also consider how reinvested dividends are treated within back-end load funds. In many such funds, units purchased by the dividend distribution are considered a new investment and are subject to the redemption charge period as they are a new initial investment. Therefore, should these units be redeemed during their redemption charge period, they would incur a back-end charge.

Another common misconception among investors is that fund management companies generate their revenue from commission fees. Commission fees are how most brokers, mutual fund dealers, and financial planners, generate revenues. Fund management company revenue is generated from a management fee that is charged to compensate for providing their expertise and services.

In fact, all investment funds, whether load or no load, charge a management fee, which is generally paid monthly or quarterly from within the fund's assets. This fee is paid indirectly; even though the investor does not 'pay out' any money, the cost results in a reduced rate of return for the fund.

Investors should be aware that many back-end load funds have a higher annual management fee compared to a similar fund in the same family that is front-end load. For example, a fund that charges a front-end load may charge an annual management fee of 1.25%. The same fund set-up as a back-end load fund may be identical in all respects, but have an annual management fee of 1.50%, or 1/4 of a percent more. In such a case, if an investor holds the fund past the redemption period, and therefore pays 'zero' load (neither front or back), the increase in cost would be the larger annual management fee paid over the period, and beyond.

Loads do not ensure better or worse performance. A fund's performance is the product of the ability of the manager and the objectives of the fund. Therefore, investors should consider these investment criteria first and always compare rates of return on a net, or after load, basis.

For example, with no load funds, 100% of your investment begins working immediately and remains working for the duration of the investment. Hence, over a number of years, the load fund must perform better than a no load fund to compensate for the load charges.

***Note:*** *The purpose of this information is to increase awareness regarding no load versus load issues.*

# PERFORMANCE COMPARISON

| For The Period: Ending March 31, 2004 | 3 Months % | 1 Year % | 3 Year % | 5 Year % | 10 Year % |
|---|---|---|---|---|---|
| **ACTIVELY MANAGED FUNDS** | | | | | |
| Balanced Fund | 4.0 | 24.3 | 4.6 | 5.6 | 9.0 |
| Canadian Equity Fund | 5.1 | 33.9 | 4.8 | 7.5 | 10.8 |
| Overseas Equity Fund [1] [2] | 3.9 | 35.6 | -4.1 | N/A | N/A |
| U.S. Equity Fund [2] | 3.7 | 20.1 | -6.2 | -5.1 | 7.4 |
| Dividend Income Fund [3] | 3.7 | 36.0 | 11.3 | 15.9 | 17.9 |
| Short-Term Bond & Mortgage Fund | 2.7 | 8.2 | 7.1 | 6.7 | 7.6 |
| Bond Fund | 3.0 | 10.8 | 8.7 | 7.6 | 9.0 |
| Canadian Money Market Fund | 0.8 | 2.9 | 3.0 | 4.0 | 4.6 |
| **CUMIS FUND** | | | | | |
| Retirement Security Fund | 5.4 [4] | 5.6 | 6.0 | 6.4 | 7.1 |
| **PASSIVELY MANAGED FUNDS** | | | | | |
| S&P/TSX Composite Index Fund [5] | 4.8 | 37.6 | 6.0 | 7.1 | 9.1 |
| U.S. Equity Index Fund [2] [6] | 3.4 | 20.4 | -5.8 | -4.2 | N/A |
| EAFE Equity Index Fund [2] [7] | 5.9 | 40.5 | -2.6 | -2.2 | N/A |
| Universe Bond Index Fund [8] | 3.1 | 10.6 | 8.3 | 6.9 | N/A |
| Conservative Balanced Index Fund [9] | 3.5 | 18.0 | 4.0 | 4.3 | 8.1 |
| Moderate Balanced Index Fund [10] | 4.1 | 24.3 | 4.1 | 5.4 | 9.0 |
| Aggressive Balanced Index Fund [11] | 4.4 | 29.6 | 3.5 | 5.1 | 8.9 |
| **INDICES** | | | | | |
| Active Balanced Fund Benchmark | 3.9 | 23.8 | 4.2 | 4.7 | 8.3 |
| S&P/TSX Composite Index | 4.9 | 37.7 | 6.0 | 7.1 | 9.0 |
| S&P 500 | 3.4 | 20.7 | -5.3 | -3.9 | 11.1 |
| MSCI EAFE | 6.1 | 40.8 | -2.6 | -2.1 | 4.0 |
| ScotiaMcLeod Universe | 3.1 | 10.8 | 8.3 | 6.9 | 8.7 |
| 30 Day T-bills | 0.6 | 2.8 | 2.9 | 3.8 | 4.3 |

*(1) Overseas Equity Fund merged with Euro-Pacific Equity Fund March 9, 2001*
*(2) Subject to Canada Customs and Revenue Agency Foreign Content Limit of 30%*
*(3) Only available under group RSP and DPSP contracts*
*(4) Annualized*
*(5) Fund Inception: October 1999. Performance prior to November 1999 is for TSE 300 Equity Index Fund*
*(6) Fund Inception: January 2000. Performance prior to February 2000 is for Barclays U.S. Equity Index Fund - Canada*
*(7) Fund Inception: June 1999. Performance prior to July 1999 is for EAFE Equity Index Fund B*
*(8) Fund Inception: October 1999. Performance prior to November 1999 is for Universe Bond Index Fund*
*(9) Fund Inception: August 1999. Performance prior to September 1999 is modeled using the benchmark asset mix and index returns*
*(10) Fund Inception: June 1999. Performance prior to July 1999 is modeled using the benchmark asset weights and index returns*
*(11) Fund Inception: August 1999. Performance prior to September 1999 is modeled using the benchmark asset weights and index returns*

# NEWS FROM THE GOVERNMENT

## Old Age Security

Old Age Security (OAS) benefit rates are increased for the April to June 2004 quarter.

Basic OAS benefits, paid to people age 65 and over, are $463.39 per month. The Guaranteed Income Supplement is $550.73. The Spouse's Allowance and the Widowed Spouse's Allowance are increased to $822.12 and $907.64 respectively for the April to June 2004 quarter.

# **Alberta** Pension Reform Proposals

In November 2003, the Alberta Department of Finance released three discussion papers proposing a comprehensive overhaul of key components of the *Employment Pension Plans Act* (EPPA). However, it remains to be seen to what extent the province will adopt the papers' recommendations, and whether these changes will contribute to bringing Canadian pension standards closer together or to driving them further apart.

A number of the Alberta proposals are consistent with principles contained in the long-awaited model pension law principles that were released for comment in January 2004 by the Canadian Association of Pension Supervisory Authorities. Others appear to be Alberta-specific. Key points of the three discussion papers are discussed below.

## Pension Division on Marriage Breakdown

Pension-splitting rules were added to the EPPA and Regulation three years ago. This paper contains proposals to improve the rules' fairness, flexibility, and ease of administration:

- Eliminating the requirement that member spouses receive at least 50 percent of a divided benefit
- Allowing division of matrimonial property by simple agreement, instead of a court-validated consent order
- Allowing a vested member's pension partner to delay receiving a benefit until the member receives it.

### Strengthening Risk Management, Disclosure and Accountability

This paper responds to recent controversies in corporate governance and concerns about the impact of capital markets on pension funding. Its proposals are designed to increase plan member protection and disclosure, and include:

- Allowing the Superintendent to replace a plan administrator, require an independent valuation of the market value of plan assets, and withhold approval of adverse amendments where members have not been notified
- Requiring most plans to file audited financial statements, and allowing members to examine them
- Requiring more disclosure to members and participating employers
- Allowing defined-contribution plans to force terminated members to transfer their assets out
- Increasing funding flexibility for negotiated-cost plans
- Empowering the Public Trustee to receive and safeguard assets of "missing members"
- Ensuring non-member pension partners have first rights to survivor benefits

### Access to Locked-in Accounts

Alberta currently allows unlocking of pension funds in situations of financial hardship, non-residency, shortened life expectancy and small amounts. When it introduced financial hardship unlocking in May 2003, the Alberta government announced that further changes would be up for discussion.

This paper offers four different approaches – leaving the rules as they are, or making minor, moderate, or major changes.

Proposals with a **minor** or **moderate** impact include:

- Raising small amount limits
- Exempting employee contributions from locking-in
- Permitting partial withdrawals, withdrawals for non-residents, and withdrawals for shortened life expectancy

Proposals with a **major** impact include:

- Introducing creditor protection for RRIFs (done by Saskatchewan in 2003 for all non-locked-in vehicles)
- Completely eliminating locking-in
- Removing the portability requirement for pension plans

### What's Next?

Amending legislation will likely be tabled during the spring 2004 session of the Alberta legislature.

## **Ontario** – Applications for Transfer of Assets on Sale or Merger

On December 8, 2003, the Ontario Court of Appeal released its decision in *Aegeon Canada Inc. and Transamerica Life Canada v. ING Canada Inc.* On February 6, 2004, ING Canada filed an application for leave to appeal the decision of the Ontario Court of Appeal to the Supreme Court of Canada.

The decision of the Ontario Court of Appeal raises questions about the authority of plan sponsors to transfer assets between pension plans where one or more of the pension plans is subject to a trust, and casts doubt on the authority of the Superintendent of Financial Services to consent to such transfers.

Until the Supreme Court of Canada has finally disposed of this case, the Superintendent will be treating the Court of Appeal's decision as binding. Consequently, the Superintendent has taken the position that consent to a transfer of assets on sale or merger will be considered if:

- the applicant can demonstrate that none of the pension plans involved is subject to a trust; or
- the applicant can demonstrate that all of the pension plans involved are defined contribution plans with no defined benefit liabilities of any kind.

In addition, the Superintendent will consider applications for the transfer of assets if the applicant can demonstrate that the *Aegeon Canada Inc. and Transamerica Life Canada v. ING Canada Inc.* decision does not otherwise apply to the application.

Please note that all pension plans must continue to be fully administered in accordance with the *Pension Benefits Act,* R.S.O. 1990 and Regulation 909, R.R.O. 1990, as amended, without consideration of any potential transfer of assets or merger.

## **Ontario** – Restrictions on Payments in Deficit Situations

The Financial Services Commission of Ontario has released a policy regarding restrictions on payments in deficit situations. As stated in the policy, a question has arisen concerning whether an administrator may transfer the commuted value or purchase a life annuity for members, former members, and other beneficiaries when a plan is being wound up in whole or in part with a deficit that requires additional funding under Section 75 of the Pension Benefits Act (PBA).

The answer depends on whether all the pensions and other benefits being funded under Section 75 would be guaranteed by the Pension Benefits Guarantee Fund (PBGF) under Section 84 of the PBA. The policy commentary can be viewed at FSCO's web-site at www.fsco.gov.on.ca.

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