Response to Dan Hallett's April 7, 2008 comments
"Fund fees revisited: Number twisting continues with fees"

As academics, we embrace the notion that careful research and public debate can inform business practice and public policy. Therefore, we are happy to respond to Mr. Hallett, and seek to correct his misunderstanding of our results. This response will at times refer to our forthcoming paper, which is available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=901023

First, we believe it may be useful to provide a little background on the academic publishing process. In our field of finance, there are three top scholarly journals, one of which is the *Review of Financial Studies,* where our paper will be published. In aggregate, these journals receive hundreds of submissions a year, of which a handful are published. For the *Review of Financial Studies*, acceptance rates are currently less than 11% (http://www.sfs.org). The review and editorial processes are not speedy, often taking a few years for a paper to go from first submission to publication. During this time, peer reviewers and Editors comment on the paper, and the authors often respond by conducting different analyses, resulting in multiple versions of the work. In addition, one presents the work to many audiences, which in our case, involved formal presentations to over a dozen groups, including a number of practitioner audiences. In addition, we had informal discussions and received written comments from a wide variety of sources. What Mr. Hallett calls "tweaking" is the process of subjecting the paper to rigorous reviews.

Second, Mr. Hallett noted that over the course of the past few years, we changed the way we report numbers in our tables. The explanation is quite simple: there are at least two ways to calculate an average: either by treating each observation (fund class) equally or by weighting the observations (such as by assets). There are pros and cons to both weighting schemes. It is typical to report one method fully and reference the other so as not to produce excessive numbers of tables. Initially, we presented equally-weighted results—treating each fund as an observation. In later versions, our Editor asked that we present asset-weighted results as our primary results. We did so and referenced the equally-weighted results in footnote 9 in the paper. While the actual numbers changed, none of our conclusions materially changed with this alternative weighting scheme.

Third, Mr. Hallett and other Canadian commentators were worried that we might have overstated Canadian fees. We treated these comments quite carefully. Recall that our paper deals with fund fees in 18 countries and the offshore market, and is not a Canada-specific paper. Our primary goal was to produce numbers that were consistent across countries. Some of the claims—that we had treated Canada differently or that it was considerably different from other countries—were simply not true. For example, the assertion that Canadian funds include fees that are separate in other countries demonstrates a lack of understanding of our calculation of total shareholder cost as well as the institutional practices in most other countries, especially Europe, which consists of the bulk of our countries. We had made this point clearly in our response to IFIC in 2007.

Nevertheless, to make sure that we had not overstated any of our results—in particular with regard to Canada, we returned to one of our data providers (Morningstar Canada) for additional information.[1] In brief, in our original calculations, if the loads for a particular fund were not reported, we treated it as "missing" and the data for that fund were excluded from the calculations. In our new version—which we feel is a conservative estimate, if the information is missing and we have no positive confirmation that the fees exist, we treat the load to be zero. This will tend to underestimate the fees. However, our fundamental conclusions were unaltered.

Next, Mr. Hallett takes some comfort that the Total Shareholder Costs (one of three measures) is reported to be higher in Denmark than Canada. We feel that this conclusion is not fully warranted, and that a number of factors need to be taken into account:

a) In Europe, one must differentiate between funds that are domiciled in a country and funds that are sold in that country. In the US and Canada, these are the same. Denmark's *domiciled* funds have Total Shareholder Costs below those of Canada, as reported in Table 2 of our paper (162 versus 241 basis points). Furthermore, if one looks at the management fees, total expense ratios, and total shareholder costs, Canada's fees—for bonds, equities and the full sample, are higher than those of any other domicile in our sample.
b) What Mr. Hallett is referring to are the value-weighted costs of funds *sold* in Denmark. The Danish numbers are higher for two reasons: (i) the mix of more expensive offshore and onshore funds sold in Denmark; and (ii) the mix of equity and non-equity products sold in Denmark.
c) It is for these reasons that one can only look at fee residuals, after controlling for fund and family characteristics. These characteristics include items like fund objective (e.g., equity vs. debt), fund size, and complex size. These residuals are reported (for management fees) in Table 4. Here, after controlling for all of these factors, Canadian funds are considerably more expensive than other funds, ranking 119th of the 119 domicile/country of sale country pairs. To forestall any questions, while Table 4 reports management fees, the TERs and TSCs show a similar pattern, as reported below. Each of the numbers is a country-effect, AFTER controlling for the characteristics above

Fee	Country Residual	Rank
a. Management Fees	184 basis points	119/119
b. Expense Ratio	224 basis points	119/119
c. Total Shareholder Cost	158 basis points	119/119

In conclusion, we would like to reiterate the point that we made in our response to IFIC. Our goal was, and is, to examine the worldwide structure of the fund industry's fees. We

[1] We want to reiterate our thanks to the staff at Morningstar Canada for their assistance with obtaining and interpreting these data, although we make it clear that our conclusions do not represent the views of that organization.

have consulted experts all over the world to ensure that our data are reliable and have subjected the paper to extensive reviews. While our interest is to determine the determinants of fund fees, one clear side result from our data—now a few years old—is that the Canadian industry had the highest fees among developed countries. We make no value judgment about whether these fees are too high or too low—nor what to do about them—leaving these decisions up to Canadian fund companies, investors, and regulators.

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