May 4, 2007

Ms. Joanne De Laurentiis
President and CEO
The Investment Funds Institute of Canada
11 King Street, West, 4th Floor
Toronto, Ontario M5H 4C7

By Email

Dear Ms. De Laurentiis:

Thank you for your letter regarding our study, Mutual Fund Fees Around the World. We appreciate the helpful comments we received from you. Over the past few months, we have confirmed our data, collected additional information, conducted additional tests, and rewritten the paper as part of the normal academic review process. Attached is the latest version of the paper. (An electronic copy of the paper is available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=901023.) Our original results are quite robust, and we are confident that our analyses are correct. We sought to understand the determinants of fund fees across countries. Across the entire sample of countries, we find that national fees are related to measures of investor protection, investor sophistication, and certain supply factors. Your comments did not address these central conclusions of the paper.

We can understand why you and your members are troubled by our findings. We find that fees vary from country to country around the globe. We carefully and consistently control for fund characteristics, fund family characteristics, and other factors that might affect fees in all countries. We measure fees in three different ways to capture the full costs of fund ownership. We find that after controlling for all these factors, management fees, total expense ratios, and total shareholder costs in the Canadian industry in 2002 were higher than those in Australia, Austria, Belgium, Denmark, Finland, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Norway, Spain, Sweden, Switzerland, the United Kingdom, the United States, and the so-called offshore domiciled funds from Dublin, Luxembourg and the various island offshore locations. We make no value judgments in the paper about the level of fees in Canada, or in any other country.

The CBC News website quotes you as saying that our research "was not a credible study." (http://www.cbc.ca/cp/Money/070426/J042602AU.html) To the contrary, we have used the highest standards of academic care in producing this study. We have consulted with scores of industry experts in many countries. We have obtained and confirmed our data from the major international data vendors. We have voluntarily subjected this work to comment and criticism, presenting it widely to many audiences and going through the rigorous academic peer reviewing process. Finally, in the attached version of the paper, we have re-estimated our tests in many ways, and our results are robust. With any empirical study, there are limitations imposed by available data, and, as seasoned researchers, we work hard to design proxies and methodologies to control for these factors as much as possible. While you are free to interpret our results as you wish, we strongly disagree with your characterization of our work. If you disagree with our results, we encourage IFIC to conduct its own cross- country study to advance our understanding of the world fund industry.

Attached is a detailed response to some of your specific comments. We appreciate the interest you have shown in our work.

Sincerely,

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Response to Specific Points Raised in the IFIC Comment Letter

Text from IFIC's letter to us is given first; *the italicized indented sections are our responses.*

Low-fee Canadian funds excluded, low-fee US funds included.

In the calculation of average expenses, you use data which exclude certain low-fee funds for Canada but include the similar low-fee funds for the US. Funds held by US investors through workplace savings plans, for example, which carry lower fees than funds sold through advisors, are generally included in Morningstar's US data, but excluded from the Canadian data. The inclusion of Canada's institutional pension investments in the overall Canadian costs would have significantly lowered the reported fees.

> *First, it is important to recognize that this is not a study of Canada versus the United States. While we acknowledge that Morningstar Canada does not cover workplace savings plans, it also does not include workplace investing options, such as separate accounts that hold defined benefit plans, which are available in many countries. Conversely, we do not study hedge funds or other investing options that surely charge higher fees. We attempt to consistently measure the retail fund industries in major countries, as defined by major fund data vendors. Furthermore,to address concerns like the one you raise, our work controls for a number of fund factors that might drive fee differences. In particular, one of these factors is whether the fund class is an institutional fund class such as used in omnibus workplace plans, or a class designed for large investors. We proxy for these characteristics using the log of the minimum investment required for new investors.*

Published maximum loads are not representative of the Canadian investor experience.

In Canada, it is the practice that loads are negotiable but disclosed at their maximum rates. The front-end load charged to the investor is typically lower than the published rate, and is most often not charged at all, while back-end loads may be rebated in the case of fund transfers, subject to a 10% annual free sale, or avoided entirely if the investment is held to the load date. The Canadian published loads, used in this study, do not reflect the most typical Canadian investor's experience.

> *We acknowledge that in Canada, but also elsewhere in the world, published fees, such as loads, may be negotiated to lower levels. For example, in another working paper, Tufano and other coauthors have reported that US industry insiders claim that the actual loads paid by US investors are considerably lower than the posted loads. We have no reason to believe that the posted-charged differential varies between Canada and other countries. However, to the best of*

> *our knowledge, actual loads are not normally disclosed in any of the countries in our sample.*
>
> *Furthermore, the fee differentials we report for Canada are not limited to loads and the related Total Shareholder Costs (TSCs). Rather they are substantial for management fees and total expense ratios (TERs) as well.*

Average holding periods are longer in Canada than in the US

You calculate average loads as the sum of front-end and back-end loads amortized over an assumed holding period of 5 years. The assumed 5-year holding period, however, is shorter than the average Canadian holding period of 6 to 7 years, and longer than the average US holding period of 3 to 4 years. This results in an overstatement of Canadian potential loads and an understatement of US charges.

> *First, we must point out that you continue to focus on US-Canadian differentials, whereas our work looks not just at those two countries, but many more. Second, the holding period assumption merely affects TSCs, not TERs or Management Fees, where our results are similar. Third, by using a consistent holding period to calculate TSCs, we pose a well formed question: How do the fees vary for investors with the same holding period? Fourth, if we had data on holding periods in different countries (which we do not), we could address a different question: Do investors hold funds longer when fees, especially back end loads, are higher? Your comment that Canadian holding periods are longer than US holding periods would be consistent with this conjecture.*

Canadians strongly prefer an advisor

Most Canadians purchase mutual funds with the help of an advisor following a thoughtful discussion of risk, past performance, and reputation of the fund company involved. Recent research conducted in the Canadian funds market showed that 85% of Canadian investors purchase their funds through an advisor, and in the vast majority of cases they rate the advice experience very highly. When investors were asked their level of satisfaction with their financial advisor, 85% indicated they were satisfied or completely satisfied. 94% indicated that their advisors had discussed investment objectives and risk tolerance, and 90% indicated they had discussed suitability of the investments with respect to objectives. The use of advisors is much less prevalent in the US market. The greater use of advisors by Canadian investors compared to the United States leads to a very different mix of business and price structure.

> *Again, your focus on just the US and Canada does not recognize the broader scope of our study. Even in the US, however, many investors buy funds with embedded advice components (loads and 12b-1fees) from brokers and advisors,*

> *as do investors in many other countries. In 2002, 53% of the assets in non-institutional retail funds in the US were in the broker channel. Therefore, it is not apparent why it is inappropriate to compare Canadian funds with those in other countries.*
>
> *Furthermore, we find it intriguing that Canadian investors apparently have fewer alternatives to buy funds without embedded advice or feel the greater need to use advisors. If true, why would Canadian investors feel less able to select funds on their own?*
>
> *However, the more general question that your response raises is the value-added by advisors. In a separate working paper, Tufano and other coauthors have studied whether US investors in the broker-sold fund sector earn higher or similar risk-adjusted returns, prior to the imposition of any marketing charges, than do direct investors. They do not find that the pre-expense returns of the broker-sold segment are substantially better, nor do they exhibit any better timing with respect to market cycles. It would be interesting to replicate this study in Canada.*

Pricing is more all-inclusive with net return fund performance in Canada

It is very rare in Canada for additional fees to be charged over and above the MER by either the fund company or the advisor working with the client. This leads to very transparent net return performance reporting. Your study observed this distinction to some degree but dismissed any attempt to correct your analysis for this difference between countries.

> *We make clear that we do not have information on wrap fees, whether in Canada or elsewhere. Since these fees are not fund specific, but rather are account specific, it is not possible to relate them to individual funds. We agree that the presence of these additional fees could relate to explicit fund fees.*
>
> *We do not have a strong independent reason to believe, nor has your response given us a reason to believe, that Canada's practices are substantially different from those in most of the countries in our sample. Even in the United States, it appears that separate fees affect only a small fraction of accounts. The Money Management Institute reported 1.8 million US managed accounts at the end of 2002; the Investment Company Institute reported 251.2 million mutual fund accounts as of year end 2002.*

In researching the Canadian industry in response to your letter, we have come to learn about other fees charged to Canadian investors, which include switch fees, transfer fees, asset allocation service fees, account closing fees, and others. We have not included those in our analysis, as we do not have them systematically across countries. However, our failure to include them would underestimate Canadian fees.

Much more Money Market fund use in the United States.

Based on your sampling it appears that Americans use their Money Market funds, which have a much lower fee in both countries, to a much greater degree than in Canada. Canadians are invested much more heavily than Americans in pure equity funds and within that grouping in international funds which are more expensive. These differences have a significant impact on the average costs presented.

Country	Money Market %	Bonds %	Balanced %	Equity %
Canada	0.8%	32.6%	6.1%	57.0%
United States	8.9%	27.3%	22.5%	39.6%

Source: Mutual Funds Fees Around the World, Draft Paper, May 7, 2006

> *Our analysis accounts for fund type, so the mix of the type of funds is already controlled for in our research. Furthermore, not only are the raw numbers in Table 2 reported by fund type, but more importantly the empirical analysis in the remainder of the article explicitly controls for fund type as well. We call to your attention that the figures in Table 2, and our econometric analysis later in the study, now reflect asset-weighted fund fees.*

Comparisons already dated.

For the study's conclusions to have any relevance to current market conditions, every effort should be made to use the most recent data available. Comparisons made on the basis of the 2002 data used in this study are already out of date. In the time period between 2001 and 2005, MERs in Canada are known to have fallen between 3% and 11%, depending on the fund category.

> *We regret that our data are from 2002, but collecting and cleaning this large multinational database took a number of years.*
>
> *Your point that Canadian MERs have fallen would affect our results only to the extent that they fell more quickly than those in other countries in our sample. Furthermore, our results apply not only to MERs but management fees and TSCs as well.*

Summary

We are interested in an accurate depiction of mutual fund features and costs in the Canadian environment. There are other factors not highlighted here such as the federal tax on management fees in Canada (7% at the time of this study, now 6%) that also contribute to differences between the countries.

> *We too are interested in an accurate depiction of the Canadian environment, but in the context of the global fund industry.*
>
> W*e now explicitly control for the GST in Canada and Australia by removing these taxes in our regression analyses. Thank you for calling this point to our attention. Our findings are unchanged.*
>
> *Since the last version of the paper, we have tested three new methodologies to estimate our results and used more conservative methods to estimate the standard errors we use to calculate confidence levels. All of these alternative methods produce consistent results, which we report in the paper.*
>
> *Some Canadian writers were concerned that we might have double-counted fees by adding front-end and back-end loads. We have not done so.*