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## **Fund fees falling in wake of Ottawa ending foreign cap**

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Mutual fund management fees are falling, thanks to Ottawa's decision to eliminate the foreign content restrictions for retirement plans.

The most immediate effect will be a drop in fees for so-called "clone" funds, a vehicle most observers expect will disappear. Because those funds are expensive to administer, their demise should eventually lead to reduced fees across the board.

"Clone funds are dead. They are obsolete as of yesterday," mutual fund analyst Dan Hallett said of the class of more than 200 funds.

Clone funds have provided a way of circumventing the foreign content restrictions while still remaining eligible for registered retirement savings plans. They mirror the performance of foreign asset funds by using derivatives that are considered Canadian content. The complexity of using derivatives makes the clone funds costly, and that is reflected in fees charged to the investor.

On Wednesday, Finance Minister Ralph Goodale scrapped the 30-per-cent foreign content ownership limit on RRSPs and pension plans. The financial services industry applauded the surprise move and predicted it will help fuel interest in out-of-favour U.S. and foreign equity mutual funds.

Indeed, Brandes Investment Partners & Co. of Toronto was quickly out of the blocks yesterday, cutting the fees investors pay for its group of clone funds by an average of 20 basis points, to about 2.7 per cent from 2.9 per cent of the assets an investor puts in the fund.

"We very much support this decision within the budget to remove the limit and to pass the savings on to the client immediately," said Oliver Murray, Brandes president and chief executive officer.

It's expected many fund companies will soon follow suit, trimming clone fund fees or moving to merge clones with their lower-cost foreign funds.

Several fund executives interviewed expect operating costs will fall, savings that will be passed on to investors through a cut in management expense ratios, the annual fee that unitholders pay a fund company.

"The real benefit for investors is this should bring costs down," said David Feather, president of Mackenzie Financial Services Inc. in Toronto.

But the sweeping changes mean investors must be much more vigilant when it comes to understanding what is in their mutual fund portfolio.

Financial advisers and their clients "are going to have to be a lot more aware of what's going on," said Peter Loach of BMO Nesbitt Burns. "It will make things more complicated and will ultimately require a lot more research because the universe has expanded exponentially."

Many classes of mutual funds -- from Canadian equity funds to high-yield bond funds -- hold as a rule of thumb about 30 per cent foreign content. As of Wednesday's budget, those tried and true asset allocation rules have gone out the window.

"Every fund manager and every fund company is going to have to take a look at the whole positioning of their fund," said Dan Richards, a mutual fund marketing consultant. "The whole notion of a Canadian equity fund having a 30-per-cent foreign component may become less and less relevant."

Mr. Richards predicts the industry will adapt quickly. By next RRSP season, he expects fund companies will be marketing a mix of new products, including pure Canadian equity funds and global equity funds, a concept pioneered in 2002 by Fidelity Investments Canada Ltd.'s Fidelity NorthStar Fund.

"You are going to see more 'go anywhere' funds that have the ability to basically pick and choose from around the world," he said.

Several fund executives interviewed yesterday were grappling with the budget's implications and what it means for asset allocation within funds that hold foreign content.

"Where do you see the best investment opportunity? That's the real issue," said William Ashby, president of Beutel Goodman & Co. Ltd., a Toronto institutional and mutual fund manager. He expects any shift to greater foreign content in Canadian equity funds will be "gradual rather than sudden," citing this country's resource-rich economy, the federal budget surplus and relatively cheap stocks.