

# INVESTMENT *facts*

SPECIAL EDITION

W r a p A c c o u n t s

## About *INVESTMENT facts*

Investment Facts is published by the Investor Learning Centre of Canada, an independent not-for-profit organization. Our aim is to help people like you become better informed about your investment choices.

The ILC works closely with the Canadian Securities Institute – the official educator of the securities industry – and other highly regarded organizations. This helps ensure our publications and programs are accurate and non-promotional.

This issue of Investment Facts is part of an ongoing series. It complements our many other national investment learning programs, including books, seminars and a walk-in-phone-in resource centre.

For more information, call one of our offices listed on the back page. We'll be happy to help!

### What are wrap accounts?

A wrap account is the industry term for a bundle of investment services all 'wrapped' up under one fee.

Think of it as an all-inclusive vacation package. You can book your flight, hotel, meals and bus tours on your own, or you can pay a fee to an agent to arrange the whole trip for you. A wrap portfolio is the opposite of do-it-yourself investing. Differing from a regular investment account where you are charged a sales commission for every trade, the annual wrap fee covers a professionally managed portfolio, trade transactions and account administration, along with other services.

Wrap programs appeal to investors who do not have the time, the inclination, or the expertise to manage a financial portfolio.

### Are all wrap accounts alike?

No. Wrap accounts come in as many shapes and sizes as the financial institutions that offer them. Brokerage firms, financial planners, mutual fund companies and your local bank or trust company all sponsor wrap products.

In the last four years, the popularity of wrap accounts has mushroomed and new products sprout up every year. Descriptions such as professionally managed accounts, asset allocation, balanced portfolios and diversification are often used to describe wrap products.

### Two types to choose from...

There are essentially two types of wrap investment products on the market: a traditional wrap account and a mutual fund wrap account. Traditional wrap accounts offer a full range of securities, along with the expertise of outside money managers with different investment styles. These traditional wrap accounts are customized according to your investment horizon, goals and risk tolerance.

Mutual fund wrap investments, as you might guess, are made up of only mutual funds. These wrap accounts are generally based on an asset allocation selected from several, non-customized allocations generated by a computer program. In the simplest terms, asset allocation is a strategy used to spread your assets among cash, stocks and bonds – not putting all of your eggs in one basket – to reduce your risk in any one market area. A choice of portfolio models do this by mixing and matching various funds and management styles together, like holding funds within a fund. If you think of a pie chart made up of slices of different flavoured funds, the entire investment pie or portfolio may include seven funds or investment styles in one, blending stock, bond and short-term funds for instance.

Often investors in mutual fund wrap account programs will graduate to traditional wrap programs as their assets grow.

### Similarities

With both traditional and mutual fund wrap accounts, investors have a choice of portfolio scenarios based on risk tolerance that range anywhere from conservative, bond-based portfolios to more volatile, equity-based accounts. An investor's age, financial goals and time horizon are all factored in before choosing the most suitable portfolio. For example, a younger investor with a longer time frame and greater risk tolerance may prefer a wrap portfolio that emphasizes equities, while an older investor reaching retirement may prefer a portfolio that holds more conservative, income-producing securities such as bonds.

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## Services offered under one fee

Both types of wrap accounts offer these services under the umbrella of one fee:

- consulting
- asset allocation (maintaining a mix of cash, stocks and bonds to reduce risk)
- custodial services
- transaction costs
- quarterly performance monitoring

## What is the minimum investment?

Traditional wrap accounts offered by financial institutions usually require a minimum investment of \$100,000 to \$200,000. Most mutual fund companies offer wrap products with a minimum investment of \$10,000 to \$15,000. But that minimum is quickly changing in both cases.

Initially wrap accounts were only available to wealthy investors with a large asset base but 'mini' wrap products are now available for smaller investors looking for the same convenience.

## How expensive are wrap accounts?

Fees vary according to the type of wrap account, the complexity of management and size of the portfolio. For example, annual fees for a wrap account through a full-service brokerage firm usually range between 2 and 3.5 per cent based on the assets in the portfolio. As your assets increase, the asset-based fee structure usually becomes cheaper. In other words, the more assets you hold, the less you pay – in percentage terms - in fees.

Mutual fund wrap accounts tend to offer lower fees but often charge sales commissions. For instance, you may have to pay a front-end load when you buy a mutual fund product or be charged a redemption fee if you sell.

## Be aware of multi-fees

There are as many variations on the fee structure with wrap programs as there are products. Unless you read the information describing the particular wrap product, such as the *annual report and the prospectus* in the case of a mutual fund wrap, you may not be aware of extra costs. *Look at the fine print.*

Services such as asset allocation or rebalancing of securities in a wrap program may be described as a free, automatic service but it is included in the management fee expenses (MERs) or operating expenses. In

the case of mutual fund wrap products, this expense does not show up on your account statement. When you look at the performance numbers, the MERs have already been deducted from the fund. However, if you hold your wrap account in a registered plan, such as an RRSP, you can pay the management fee outside the plan. But you cannot avoid management fee expenses. It is the way fund managers are paid for their expertise.

Annual fees or commission fees may be added if the mutual fund wrap product is purchased through a broker.

With a traditional, full-service wrap account investing in stocks and bonds, the trade commissions are included in an annual flat fee but some full-service wrap accounts charge an additional annual fee.

## What are the tax consequences?

With traditional wrap accounts investors receive a tax receipt and the fees can be deducted from income as an investment expense. In a mutual fund wrap account, fees are deducted internally from the income earned within the fund.

Closing your wrap account could trigger capital gains (or losses) since Revenue Canada considers that you have disposed of assets.

Personal tax situations vary and investors should check with their financial advisor or tax consultant regarding the tax consequences of wrap products.

## How do I choose among wrap products?

Use the same prudence in choosing a wrap product as choosing any other invest-

ment for your portfolio. Your age, financial situation, investment goals and risk tolerance all play important roles in your choice.

Sponsors of wrap products can supply you with marketing information, along with user-friendly questionnaires to help you determine your risk tolerance and the appropriate product for your needs.

## Can I get out of a wrap account easily?

The ease or difficulty in getting out of a wrap account depends on the type of account and where you hold it.

If your wrap account holds managed products specific to the sponsor or the financial institution involved, you can't transfer that account to an advisor with another company. So if your advisor left the firm, another advisor would take over the responsibility of your wrap account.

If you close your wrap account, you could face fees, depending on the type of investments in your account. For example, you may have to pay deferred sales charges if your account holds certain mutual funds.

## The bottom line: Be a wise investor

As with all investment choices, it is important to understand the securities you purchase and whether they fit in with your financial needs, goals and risk tolerance. If you have any questions or concerns, an investment advisor, financial planner or tax consultant can help.



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