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Fee competition heats up

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THERE IS A CLASH OF TITANS underway that is benefiting both financial advisors and their clients.

The new Canadian division of ***Vanguard Group Inc.***, with more than US$2 trillion in assets under management (AUM), is challenging the Canadian subsidiary of ***BlackRock Inc.***, which handles more than US$3.5 trillion in AUM, in the fast-growing exchange-traded fund (ETF) sector.

This competition will increase ETF selection. But, more important, it will place downward pressure on management fees. Costs are a drag on performance at any time, but, in today's world of diminutive bond yields, any reduction is particularly advantageous.

Most advisors are aware of BlackRock's iShares brand, the longtime leader in the ETF realm. BlackRock's purchase of Claymore Investments Inc. earlier this year further advanced its dominance in Canada. As of July, BlackRock had more than 77% of Canada's $50.1-billion ETF market.

Many advisors probably are not as familiar with Vanguard. Founded in 1974 by John Bogle, Vanguard has a unique ownership structure, in that it is owned by its U.S.-domiciled funds, which are owned by the fund unitholders. What it costs Vanguard to manage a fund is what it costs its clients. Vanguard is generally recognized as the low-cost leader in the U.S. fund sector; its average management expense ratio is 0.2%.

Vanguard was way ahead in recognizing that low-cost index funds, on average, outperform higher-cost, actively managed funds. Vanguard's relentless advocacy of the benefits of its funds is the reason why index mutual funds play such a large role in the U.S. At the end of 2011, U.S. index mutual funds had US$1.1 trillion in AUM and, of households that own mutual funds, 33% own at least one index mutual fund.

In contrast, the Canadian fund sector has focused on higher-cost, active investing. The modest offering of index mutual funds here has been at higher fees than in the U.S. Until the arrival of ETFs, Canadians had little choice but to invest in higher-cost funds.

With Vanguard's commitment to low-cost mutual funds, the firm was slower to move into the global ETF arena. But in the past few years, it has made up for lost time. According to research firm ***ETFGI LLP***, Vanguard outpaced BlackRock in net inflows into ETFs globally through August of this year - at US$37.8 billion vs US$34.3 billion. Vanguard's ultra-low fee structure has been critical to its growing appeal.

In Canada, ***Vanguard Investments Canada Inc.*** launched six ETFs in November 2011 and rapidly garnered almost $300 million in AUM, as its fees tend to be among the lowest. For example, Vanguard Canadian Aggregate Bond Index ETF has a management fee of 0.2% vs iShares DEX Universe Bond Index Fund's management fee of 0.3%. Due to the Vanguard fund's smaller size, its expenses are higher, 0.11% vs 0.03%, but as Vanguard fund grows, its expense percentage will fall.

Vanguard has just filed a prospectus to add five ETFs to its Canadian lineup, including Vanguard FTSE Canadian Capped REIT Index ETF and the Vanguard FTSE Canadian High Dividend Yield Index ETF. With management fees of 0.35% and 0.3%, respectively, these funds bring much needed price competition to their fund categories. You should expect more of this price competition. **IE**

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