

Are ETFs an obvious choice for Capital Accumulation Plans?



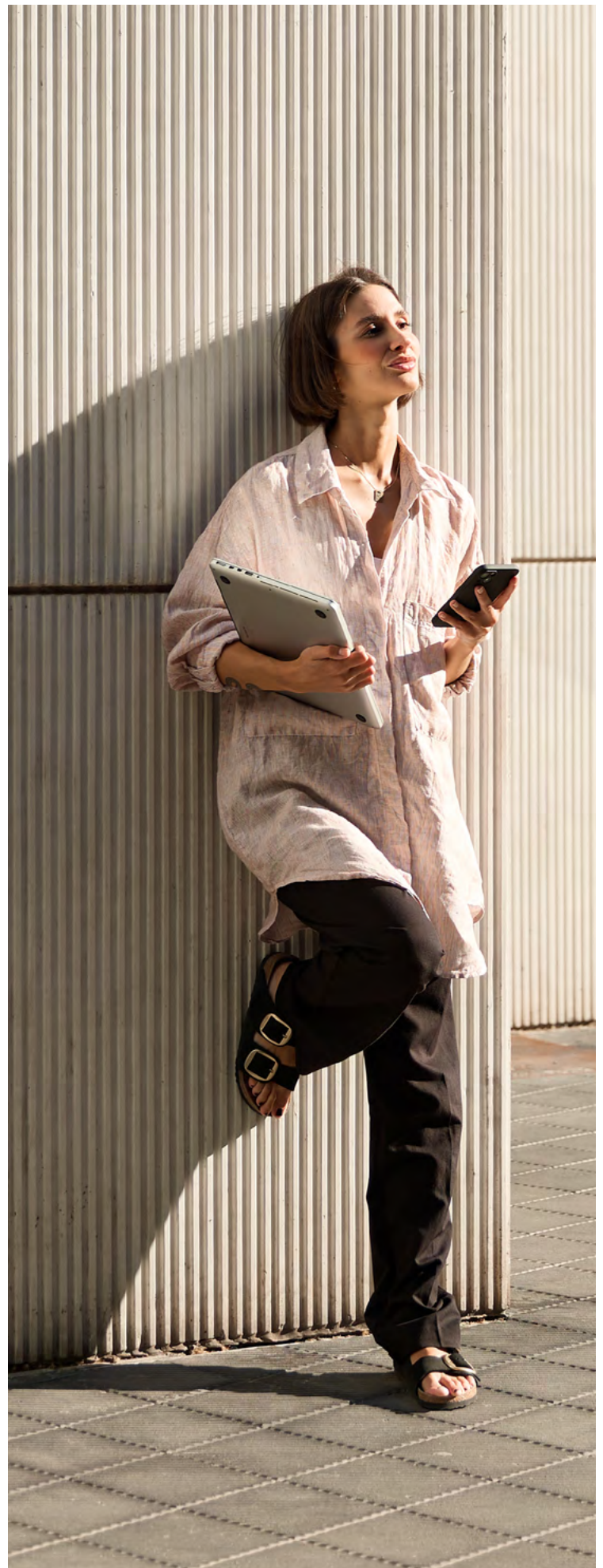


Passive or index investing is compelling to Capital Accumulation Plan (CAP) sponsors and members, whose goal is to mimic broad markets, while minimizing investment fees. With fees being a key driver of plan member retirement savings, it's no surprise that passive investing represents a significant part of CAP assets and collectively are a prominent offering. For Sun Life's Group Retirement Services platform, passive or index funds represent about 44% of total assets under administration¹.

While pooled index funds are currently the common option for passive investing, Exchange Traded Funds (ETFs) may seem like another obvious choice to offer plan members. ETFs are certainly mainstream in the retail space, but the decision to offer ETFs is not so clear-cut for CAP sponsors.

To level set, a pooled or mutual index fund holds securities, like stocks and bonds, which mimic the composition of a market benchmark, such as the S&P/TSX Composite Index, S&P 500 or MSCI World. Index funds are priced at the end of a trading day. ETFs also mimic market benchmarks, but unlike index funds, investors can buy and sell ETFs on the open market at any point in the day, just like a stock.

ETFs are not typically offered in the CAP space as stand-alone investment options to plan members. Among the 7,500+ plans Sun Life administers, none currently offer ETFs on a stand-alone basis to plan members.



Here are some considerations for CAP sponsors.

All-in fee comparisons

CAP fees include investment management, operating expenses² and record-keeper fees.

When comparing pooled index funds to ETFs for major asset classes, an apples-to-apples comparison should consider record-keeper fees, embedded ETF fees/operating expenses and sometimes brokerage commissions. On this basis, pooled index funds are just as, if not more, cost effective than ETFs.

Let's consider some examples of investment management fees:

- [iShares Core MSCI All Country World ex Canada Index ETF, a global equity ETF](#), has a Management Expense Ratio (MER) of 0.22%³
- Vanguard All Equity ETF Portfolio ([VETQ](#)), another global equity ETF, has a MER of 0.24%⁴
- Vanguard Growth ETF Portfolio ([VGRO](#)), a balanced ETF, made up of 80% global equities and 20% global fixed income has a MER of 0.24%⁴

If an ETF is offered as an investment option in a CAP, it's important to consider both the investment management fees and the record-keeper fees – an apples-to-apples comparison is a must.

Although the ETF investment management fees alone can sometimes be lower than the fees on index funds, discount brokerages may charge a transaction fee each time an investor buys or sells an ETF. If ETFs were available in CAPs, transaction fees could lower returns for CAP members, whose contributions come in small, regular installments every month. By contrast, there are generally no trading commissions for pooled Index funds offered in CAPs.

So, if offered by a CAP, the all-in ETF fee would likely be higher than the all-in Fund Management Fee of a comparable Global Equity or Balanced Index fund available via your record-keeper, when all costs, including transaction fees, are considered.



Trading Frequency

One of the key features of ETFs is that investors can buy and sell them during the trading day, like stocks on an exchange. However, this benefit does not exist in the CAP space, where on a record-keeper platform, all transactions from the business day pend overnight and are bought or sold the next business day through the record-keeper's broker. The record-keeper applies the price obtained from the broker to those trades. Effectively, the ETF benefits of intra-day trading would not exist if ETFs were offered in CAPs.

Lack of diversification for sector-specific ETFs

Generally, we believe that sector-specific ETFs (e.g. gold) do not meet CAP diversification guidelines if offered as stand-alone options, as they are not diversified enough for a typical CAP.

Tax implications for non-registered plans

If we were to offer ETFs in group plans, Sun Life would have to use the system built to administer company stock. The value of the ETF would be the closing price on the stock market.

ETFs have return of capital distributions, making administration and tax reporting cumbersome. Additionally, tax reporting for ETFs differs significantly from Company Stock (ie. T5 vs. T3 slips) and record-keeper platforms would require a significant and costly build to accommodate ETFs, resulting in increased fees to plan sponsors or members.

With these issues, if ETFs were offered in CAPs, they could not be offered in non-registered (taxable) plans.

ETFs within pooled index funds

Passive funds offered to CAP members, including Target Date and Target Risk funds, do occasionally invest in underlying ETFs. In certain asset categories (e.g. Emerging Markets equities), passive investment managers prefer the benefits of using an underlying ETF (liquidity, intra-day trading, access to smaller markets), rather than holding an index fund or direct securities. The investment manager decides to use the ETFs within pooled index funds, when they believe that the benefits outweigh the costs.

For example, a target date or target risk fund manager may invest in underlying ETFs as a cost-effective way to get a broad exposure to a certain asset class or region, as compared to buying individual securities. This is particularly true when the allocation to that asset class or region is small and is not easily available through a pooled index fund.

It is important that underlying operating expenses are disclosed to sponsors and members, including indirect operating expenses. Sun Life GRS asks investment managers to disclose embedded operating expenses when ETFs make up a strategic allocation of more than 5% in the pooled fund.

Summary

While ETFs might seem like a “cheap and cheerful” option for members, our findings indicate that pooled index funds continue to be the most cost effective and efficient way to provide passive investment options to CAP plan members.

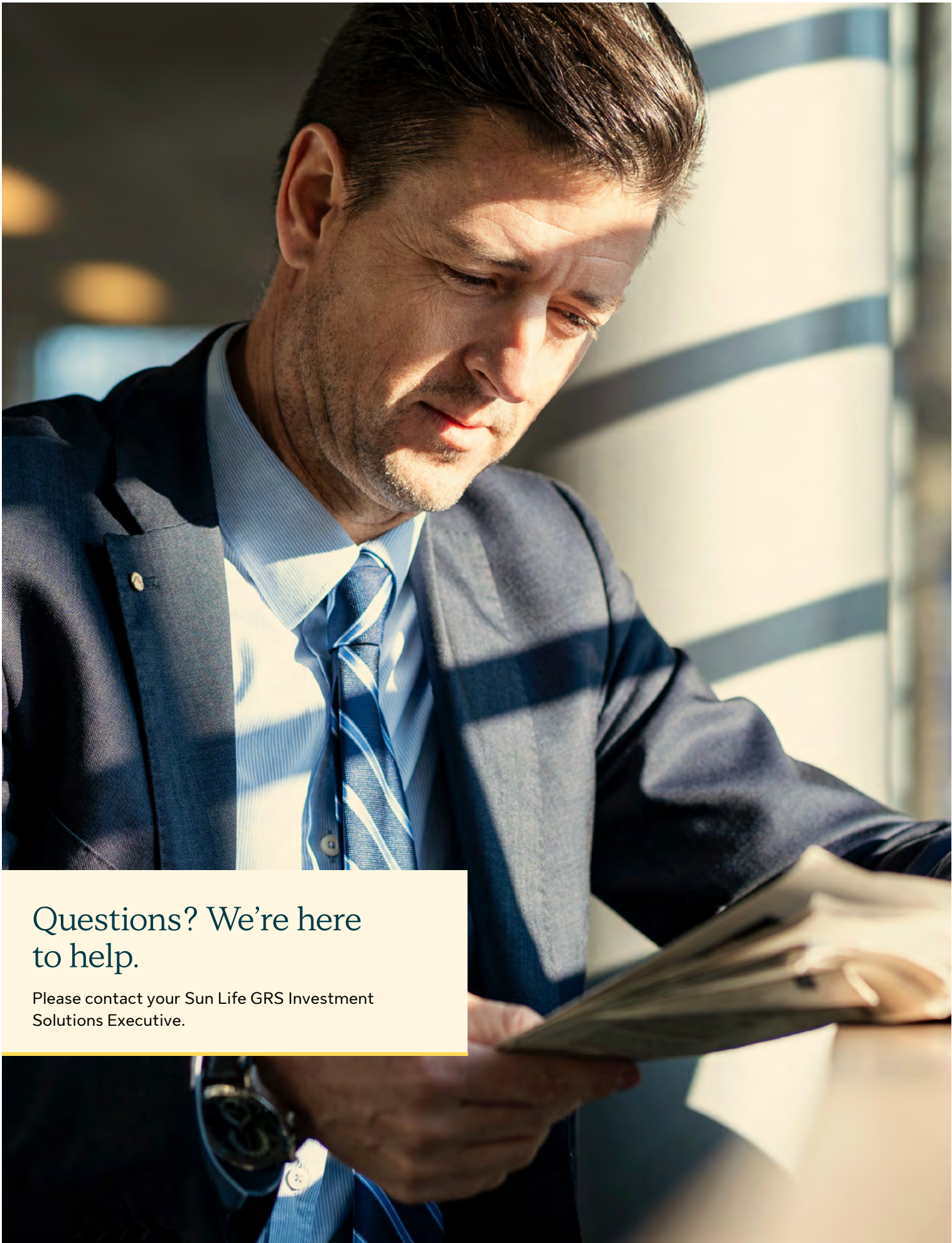


¹ Sun Life GRS data as of June 30, 2024.

² Operating expenses means all expenses relating directly to the fund or indirectly to the underlying fund, other than investment management fees, income taxes, applicable sales taxes and brokerage commissions and includes without limitation and as applicable, audit, legal and custodial fees, costs of financial statements and other reports or filings, interest charges, and transfer agency, pricing and bookkeeping fees.

³ MER As reported in the fund's most recent Semi-Annual or Annual Management Report of Fund Performance. MER includes all management fees and GST/HST paid by the fund for the period, and includes the fund's proportionate share of the MER, if any, of any underlying fund in which the fund has invested. (Source: iShares site mentioned in examples)

⁴ The management expense ratio (MER) is the MER as of March 31, 2024, including waivers and absorptions and is expressed as an annualized percentage of the daily average net asset value. The MER would have been 0.24% without any absorptions or waivers. Vanguard Investments Canada Inc. expects to continue absorbing or waiving certain fees indefinitely but may, in its discretion, discontinue this practice at any time. (Source: Vanguard site mentioned in examples)



Questions? We're here
to help.

Please contact your Sun Life GRS Investment
Solutions Executive.