Wrap accounts: The investment package with an all-in-one fee

If you are tired of worrying how much money you paid in commissions last month for each trade you executed or if you simply have no time to track your portfolio, there is a solution that might service your needs better. Ask your investment advisor if your firm is offering *wrap accounts* (don't worry, we are not referring to a new clothing fashion). Because wrap accounts typically offer a variety of investment services for a flat fee, or a percentage fee, they can usually produce significant cost savings for certain types of investors. Depending on your particular circumstances, wrap accounts might be just what you are looking for.

Wrap accounts were introduced in early 1990s, offering Canadians a bundle of investment services all "wrapped" up under one fee. This wealth management service combines investment management, and securities selection with order execution, reporting and custodial services. In these programs, the client assigns day-to-day management of an account to a qualified investment advisor and, for an annual fee, gets professional money management and related services.

Quite a mouthful, isn't it? Think of them 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. Wrap programs appeal particularly to investors who do not have the time, the inclination, or the expertise to manage a financial portfolio.

Characteristics of wrap accounts

As already stated, wrap accounts are fee-based products which combine or "wrap" all services into a flat annual fee. The fee typically ranges from 1.5% to 3% of the value of the assets in the account. Your account statements might compare your returns to benchmarks like stock and bond indexes, so you can see how your returns measure up.

Customized investment advice is a feature of both wrap accounts and also of traditional, full-service brokerage accounts. The assets in the wrap account may be individual stocks and bonds, pooled funds or mutual funds.

There are different types of wrap accounts:

- A mutual fund wrap uses mutual funds as its assets.
- Pooled wraps are similar to mutual fund wraps, but use pooled funds as their assets. You would generally need at least $50,000 to get into these. The asset pool might be Canadian stocks, Canadian fixed-income securities, U.S. stocks and overseas stocks and fixed income investments.

Other wraps use individual securities, typically stocks and bonds. The minimum investment in this case is usually about $150,000.

Another type lets you build your own portfolio in collaboration with your investment advisor. These also charge a fee based on asset size, with a certain number of "free" transactions included in that set fee. After a certain number of transactions, a fee would be charged. This type of wrap appears to be the direction the industry is headed in for the smaller retail clients, many of whom invest solely in mutual funds.

Key questions to ask

Key questions to ask about wrap accounts include:

- what are you getting for the annual fee;
- do you want or need the services included; and
- how much are you willing to pay for it.

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With a wrap account, the cost of a certain number of trades is generally included in the flat annual fee. This is an advantage, in the minds of some investors, because it removes a potential conflict of interest where your advisor might otherwise recommend trades because they generate a commission and not necessarily because they benefit you.

Yet, there is probably not a financial advantage to you using a wrap account instead of a full-service brokerage account holding mainly individual stocks and bonds. A commission-based account of $100,000 with a modest amount of trading would likely cost you less than either a wrap account or mutual funds, according to recent research.

Fees on Fees

As well, if you use a mutual fund wrap, by holding mutual funds in your wrap, you will be paying an extra set of fees on top of the fees charged by the mutual fund. Canadian equity mutual funds, for example, charge annual management expense ratios (MER) that average more than 2% a year. If you hold these in a wrap account that already charges you, say, 2%, you will end up paying 4% in combined management costs.

Another thing to watch out for with wrap accounts is the possible difficulty of leaving the wrap account. In some cases, the wrap account uses investments that are proprietary to the brokerage firm or mutual fund company. In this case, you may not be able to transfer the investments to another firm. This means that if you wanted to switch brokerage firms or mutual fund companies, you may have to sell the investments. And this could create a substantial capital gains tax bill if the investments had good returns.

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 Canada Customs and Revenue Agency (CCRA) considers that you have disposed of assets.

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

The bottom line: Be a wise investor

Use the same prudence in choosing a wrap product as when choosing any other investment 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.

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

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