April 12, 2013

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Financial Services Commission
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
New Brunswick Securities Commission
Registrar of Securities, Prince Edward Island
Nova Scotia Securities Commission
Superintendent of Securities, Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon Territory
Superintendent of Securities, Nunavut

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Re. Canadian Securities Administrators Discussion Paper 81-407 – Mutual Fund Fees

Thank you for the opportunity to comment on Discussion Paper & Request for Comment 81-407 *Mutual Fund Fees* published by the Canadian Securities Administrators ("CSA") on December 13, 2012.

Credit Union Central of Canada (“Canadian Central”) is the national trade association for its member organizations - the provincial / regional Centrals - and through them 348 Canadian credit unions.

The Discussion Paper provides an overview of the roles of market participants in the Canadian mutual fund industry and identifies what the CSA considers to be potential investor protection and fairness concerns arising from certain current mutual fund fee structures. The Discussion Paper states that it is intended to be a platform to begin discussion on the current mutual fund fee structure in Canada. Any such discussion must necessarily take into consideration the financial institutions that interface directly with Canadian investors. All too frequently such discussions ignore the important role played by Canada’s credit unions.

Canadian Central believes that any policy discussion on Canada’s mutual fund fee framework must take into account the small financial institutions and, in particular, any impacts on the independent fund distribution network that is an important competitive alternative to the Big Six bank channel. Moreover, we believe that the investor protection and fairness concerns raised in the Discussion Paper are not issues for credit unions due to their member-owned structures.

Canada’s Credit Unions

Credit unions are full service, co-operative financial institutions that are owned by their member customers. Canada’s credit unions hold approximately $140 billion in assets and operate a branch network with more than 1,700 locations outside of Quebec and these branches serve more than five million members and employ almost 26,000 people.

Credit unions are co-operative financial institutions, owned and controlled by their members. One of the fundamental principles of a credit union is democratic control. As shareholders, all credit union members have a voice in setting their credit union’s direction at the local level. Each credit union member has one vote, regardless of the amount of deposits or shares they have in their credit union. Members also elect their credit union’s board of directors, which is responsible for governing their credit union. While earnings are important for meeting capital and other operational requirements, and to provide a return of funds to their members, the co-operative principles that guide credit unions lead them to focus their activities on the needs of their member-owners and their communities.

As a member, joint owner and shareholder in their local credit union, members have access to a full range of financial products and services to help them achieve their financial goals. In terms of investment products, Canada’s credit unions offer their members a wide array of mutual funds and market investment solutions through their strategic partnership with Credential Financial Inc. which provides integrated wealth management solutions and services to the Canadian credit union system. Credential Financial is the national wealth management dealer founded by the Canadian credit union system.

Credit Union Distribution Network:

It is our view that any changes to the mutual fund compensation framework must be considered primarily in terms of the effect on the Canadian investor and also with a view to the potential impact on competition in the financial services market in Canada.

Distribution of mutual funds through credit unions is one of the last remaining independent fund distribution networks in Canada. The credit union network is an important distribution channel for reaching the small investor and providing ongoing robust financial advice to members is fundamental to credit unions. Trailing commissions contribute to the many costs of distribution of a suite of mutual fund products but, more importantly, embedded compensation in mutual funds ensures the provision of ongoing advice to the investor. We believe that the current embedded compensation structure ensures the continued flow of excellent personalized advice to credit union members and that there is some risk that a fee for service model would disadvantage the small investor.

It is interesting to note that commission reform measures in the UK and Australia indicate that the introduction of policies such as banning trailing or capping trailing commissions have resulted in advisors refocusing their books of business towards larger investors, to the detriment of the smaller investor. Any proposed changes to fee structures needs to be examined in terms of its impact on the small investor and credit unions provide valued service to the small investor segment.

The Value of Advice Report (2012) published by the Investment Funds Institute of Canada confirms the critical role of financial advice in helping individuals reach their long-term financial goals and underscores the importance of promoting a viable advice sector as a public policy objective. Credit unions provide this advice sector for small investors many of whom would not otherwise access these services at a large bank. Credit unions serve an important role in delivering financial services to the under-served areas of Canada. The community reach of Canadian credit unions is unmatched by the large commercial banks and strong community roots and focus on member service has allowed credit unions to offer wealth management advice where it is truly needed.

Canadian Central believes that maintaining strong competition should be a primary consideration for the CSA in its review of mutual fund fee structures. It is a stated policy objective of the federal government that it wishes to encourage competition in the financial services sector. This objective is a response to the overwhelming dominance of six commercial banks in the Canadian financial services industry. With the combined market share of the Big Six banks exceeding 85% in terms of domestic assets, Canada has one of the most concentrated financial services industries among G20 nations. Canada’s credit unions are the primary source of competition to the six large commercial banks. The credit union system stands as a distinct alternative to the banking system and this alternative is growing in terms of membership and asset size. Credit unions have a physical presence in their communities and almost one-quarter of credit union locations serve small communities where they are the only financial services supplier.

The importance of this network of strong second tier financial institutions cannot be overstated. Canada's banks with their large diversified businesses including broad wealth management channels will be able to more easily adapt to any proposed changes to mutual fund compensation models. Conversely, credit unions which are small independent financial institutions would have significantly more difficulty adapting to fundamental changes to the mutual fund distribution model that currently allows them to provide valued investment advice and products to their members. Changes to the mutual fund compensation framework risks disrupting the independent distribution network which could lead to further concentration of wealth management business into the Big Six banks.

Canadian Central urges the CSA to review the mutual fund fee framework with the objective of promoting more competition in Canadian financial services, enhancing the strong tier of smaller financial institutions and preserving the independent fund distribution channel. Moreover, we consider it important that small investors in Canada have access to excellent financial advice and services and we therefore urge the CSA to consider the impact of any proposed changes on the small investors and the financial institutions that have over the years supported those investors.

Discussion Paper Concerns:

The CSA's Discussion Paper has identified several potential areas of concern arising from the current mutual fund fee structure in Canada. We would like to comment on two of these concerns, namely (1) the lack of investor understanding of mutual fund costs and (2) the potential for conflicts of interest resulting from trailing commissions. In our view, the nature of the credit union business model guards against these problems.

1. ***Imperfect investor understanding of mutual fund costs***:

   The Discussion Paper expresses the concern that Canadian investors have a limited understanding of the embedded nature of advisor compensation and thus limited opportunity to control these costs. In our view, the lack of understanding of mutual fund costs is indicative of the broader need for higher levels of financial literacy in Canada. Enhancing the financial literacy of its members is fundamental to a credit union. Member education is one of the seven principles of the international co-operative movement that profoundly shapes the mission, values, governance, culture and business decisions of credit unions in Canada. Principle Five says that co-operatives should strive to provide their members with "*education, training and information*." The practical result of this is that credit unions offer their members a wide variety of programs aimed at helping them better understand the choices available to meet their financial challenges, opportunities and responsibilities.

   A credit union's staff, including its investment advisors, have a dedicated focus on member service. A member seeking an investment product at a credit union would be given full disclosure of the fees associated with the investment. Since credit unions have a closer relationship with their members and strive to have a deeper understanding of their financial needs, this disclosure obligation goes beyond any regulatory requirements. It is fundamental to the member relationship.

2. ***Potential conflicts of interests at the advisor level***:

The Discussion Paper also elaborates on the concern that embedded compensation provides incentives for advisors that are not aligned with the interests of investors. Advisors in the credit union system are employed by the credit unions. They have the same focus on the member relationship as other staff members. While, advisors are subject to securities legislation standards of conduct requiring them to deal fairly, honestly and in good faith with clients, those in a credit union also hold to a strong member service standard. An advisor in the credit union system is focused on the member's financial goals which mitigates the potential for conflict of interest.

There is also stronger alignment between a credit union advisor's compensation and the services provided to member investors. Trailing commissions are paid to the credit union which then determines its own formula for advisor compensation. This formula will vary from credit union to credit union. However, a member-centric focus is fundamental to all credit unions and an advisor employed in a credit union would be firmly focused on member needs.

In conclusion, Canadian Central would like to thank the CSA for the opportunity to comment on Discussion Paper 81-407 – *Mutual Fund Fees*. If you have questions about the comments made in this letter please feel free to contact me.

Regards,

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