Credential

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

Attention:

The Secretary
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
Toronto, Ontario M5H 3S8
Email: comments@osc.gov.on.ca

- And -

Me Anne-Marie Beaudoin, Corporate Secretary
Autorité des marchés financiers
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Montreal, Québec H4Z 1G3
Email: consultation-en-cours@lautorite.qc.ca

April 12, 2013

Re: CSA Discussion Paper 81-407: MUTUAL FUND FEES

Through its subsidiaries, Credential Financial Inc. provides dealer services on both MFDA and IIROC platforms for our primary client base of more than 220 credit unions across Canada. We greatly appreciate the opportunity to comment on the Canadian Securities Administrators (CSA) Discussion Paper examining the mutual fund fee structure in Canada. Our response reflects the views of Credential in our capacity as a provider of wealth management solutions to our credit union distribution partners and their respective members.

We preface this response with a full endorsement of initiatives that improve investors' understanding of mutual fund costs and compensation. Without question, we believe that increased transparency and disclosure aligns with the best interests of the investor. In fact, the CSA's focus on educating and increasing the financial literacy of the retail client truly complements the ideals and philosophy of the cooperative movement, whose emphasis has always been and will continue to be, to serve its members' best interests while providing products and services that satisfy members' needs.

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Because of the member-centric environment in which credit unions operate, conflicts of interest are not generally viewed as a looming concern within the credit union system. Credit union advisors are tuned into the membership's interests by virtue of the focus placed on placing investor members' needs ahead of their own. As such, we do not see an urgent need to implement wide-sweeping compensation changes around mutual fund fees.

Our comments to the CSA Discussion Paper relate to a number of key areas:

Current Regulatory Regime

The paper appropriately references the CSA's recent focus on initiatives designed to improve investors' understanding of the cost of ownership of mutual funds through greater fee transparency and clarity to the client. The Client Relationship Model (CRM) and other enhancements regarding the Point of Sale Framework yet to be implemented will provide for uniform minimum disclosure standards across the industry. We think that these developments are important and support their implementation.

The credit unions' inherent philosophy of putting investor members' needs first yields a focus on members' financial literacy today. As member service is ingrained throughout the cooperative model, advisors in the credit union system spend considerable time getting to know their members, understanding their needs, and as a part of the overall member value proposition, helping their members better comprehend the investment and financial products available to them. Accordingly, we believe that even before the CSA's investor transparency initiatives, credit union members were well educated and informed as to the fees they paid for mutual fund investments. Furthermore, we believe that trailing commissions help enable credit unions to offer the enriched services that they do.

The CSA's initiatives will serve to increase the transparency and clarity of fees for Canadian investors generally. However, it is important to note that several of these initiatives have only recently launched or have yet to be launched. It is our position that the outcome of these initiatives be monitored over time and fully considered before any decisions regarding mutual fund fee structures are made. It may well be the case that these increased education and transparency initiatives addresses regulatory concerns surrounding mutual funds fees.

Trailing commissions do not equal advisor compensation

While there are many retail investment products offered in Canada with embedded compensation, the paper singles out mutual fund fee transparency as it relates to trailing commissions. As such, the comments in this section will be limited to discussion of the cost of ownership of mass market mutual fund products only.

As a dealer operating on multiple platforms, we agree with the CSA that investment advice is rightly a component of the trailing commission. Equally important to point out in our dealer structure is the recognition that in order for a dealer to properly offer a full suite of competitive products, trailing commissions also support the infrastructure required for distribution. These other components include administrative and operational requirements, for example, the production, printing and mailing of disclosure documents, processing of distributions, and the preparation and dissemination of tax reporting information. Furthermore, trailing commissions also contribute to offset a portion of the dealer's costs associated with providing compliance, custodial, technological, and client call centre services, all of which are necessary components of distribution.

With respect to the distribution of mutual funds through our online self-serve channel, Credential Direct, while direct advice is not supplied, the need for investors to be able to make informed investment decisions is no less important than in a face to face channel. Accordingly we subscribe, at considerable expense, to third party data and information feeds to ensure our clients have access to up to date information (including all fees) and tools. This is in addition to the aforementioned infrastructure costs, all of which apply equally here.

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At Credential Direct there are no trade charges on mutual fund transactions, therefore the only opportunity for this distributor to recoup some of these costs currently is through commission trailers. Furthermore, mutual fund balances within the self-serve online distribution channel are relatively modest. Only 7.5% of accounts have mutual funds, with an average holding of just over $27,000.

Commissions from mutual fund manufacturers is distribution's primary source of revenue for advice and all the costs associated with making a comprehensive suite of mutual fund products and complementary services available to investors.

Adverse effects resulting from capping or eliminating Trailing/Advisor Commissions on competition, on smaller firms, on smaller investors

Federal government policy has been supportive of the concept of competitive balance within the financial services industry. We are of the opinion that our credit union partners provide a viable alternative to the big six banks. In order to promote this strong second tier of financial institutions, federal policy needs to be shaped by considerations of competitive balance. An unintended outcome of compensation reform may result in less competition through the reduction of non-bank owned or independent providers. This issue of reduced competition has also been raised as a concern in other jurisdictions, i.e. in the UK and Australia, as potential outcomes in reaction to the financial reform initiatives being launched in those areas.

Early indications from the reform measures in the UK and Australia further suggest 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. Similarly, capping or banning trailing/advisor commissions in Canada could reduce the number of advisors servicing the smaller investor segment. The most vulnerable segment of the market to be affected will be the smaller investor, as the surviving advisors necessarily restructure their books of business to focus on the more profitable larger accounts, leaving smaller investors with a more diluted advice proposition.

If capping or banning trailing commissions is implemented in Canada, we question the longer term benefits if consolidation is a forced outcome. Consolidation would likely impact what is considered a healthy level of competition within the financial industry. We maintain that the independent credit union distribution of mutual funds is an important competitive balance issue. As such, legislative policy should foster the second tier alternatives to the banks and not make smaller financial institutions less competitive.

Unbundling of fees

The CSA has suggested that moving from an embedded fee structure where expenses, including trailing commissions are included as part of the mutual funds' Management Expense Ratio (MER) to a structure where certain fees, if charged outside of the net asset value, will increase transparency of the fees allocated towards advice. Credential agrees that such a move would increase transparency of fees overall, however, a number of potential operational and administrative challenges exist that would require resolution in order for an unbundled fee structure to be supported under the MFDA model. These solutions would need to address constraints in operating systems to manage unbundled fees (client name versus nominee name) where development to the operating systems may be required in order to facilitate processing. Also, discussion is required as to whether only trailing commissions would be charged outside of the embedded MERs or whether other components would be included.

Ease of administration should be considered when developing policy, in order to ensure adoption by advisors. With increased administration required, for example the US-12b solutions referenced in the Discussion Paper, preliminary evidence indicates that solutions that are administratively burdensome to sell will not be supported by advisors. Basically, because of the complexity around the administration of the plan calculations, it is viewed as affecting advisor efficiency negatively. Again, negative efficiency may impact the value proposition afforded to smaller investors.

International changes

A large number of changes have recently been launched in other jurisdictions, as mentioned in the Discussion Paper. We feel it is prudent to monitor the implications and outcomes of the regulatory changes for areas where policy changes have resulted in both positive and negative outcomes.

In summary, as an investment dealer servicing the Canadian credit union network, Credential is in full support of initiatives that improve investors' understanding of mutual fund costs and compensation. We feel it is prudent to monitor the effects of the regulatory changes currently underway in Canada, while keeping informed on outcomes of policy changes implemented internationally. We would support taking these learnings and identifying specific areas that current regulatory initiatives are found to require further attention, and then focusing on addressing those gaps.

We thank you for providing the opportunity to comment on this very important discussion affecting Canadian investors.

Regards,

Kim Thompson
SVP, Advisory Services
Credential Financial Inc.