FAIR

Canadian Foundation *for* Advancement *of* Investor Rights
Fondation canadienne *pour* l'avancement *des* droits *des* investisseurs

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Re: Request for Comments regarding Review of IIROC Arbitration Program

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We are pleased to provide you with the comments of the Canadian Foundation for Advancement of Investor Rights (**FAIR Canada**), in response to the request for comments on the Investment Industry Regulatory Organization of Canada's (**IIROC**) Review of the IIROC Arbitration Program (the **Arbitration Program**).

FAIR Canada is a non-profit, independent national organization founded in June 2008 to represent the interests of Canadian investors in securities regulation. Additional information about FAIR Canada, its governance, and priorities is available on our website at www.faircanada.ca.

Background

The current state of investor redress mechanisms in Canada was summarized in the recently published Final Report and Recommendations of the Expert Panel on Securities Regulation as follows (the Expert Panel Report):

> "Although many mechanisms have been put in place to provide investors with simpler, more cost-effective alternatives to the courts, the numerous organizations, the multi-step processes, and the lack of uniformity across Canada pose challenges for investors to properly understand and achieve a proper conclusion in an expeditious manner. Based on some of the personal accounts, it appears that investors are often not provided with the information required to understand the full range of options available to seek redress."[1]

[1] Final Report and Recommendations of the Expert Panel on Securities Regulation at page 34.

In reviewing its arbitration program, IIROC's objective should be to address some of the concerns expressed in the Expert Panel Report and, in particular, aim to provide a simpler, more cost- effective alternative to the courts.

FAIR Canada does not get involved in individual dealer-client disputes, and therefore does not have hands-on experience with the IIROC Arbitration Program. However, as a national investor-focused advocacy organization, we strive for improvements in all investor complaint-handling and dispute resolution mechanisms. FAIR Canada believes that IIROC plays a crucial role in the individual investor complaint-handling and dispute resolution processes. We welcome IIROC's review of its arbitration program.

In addition to carefully considering the IIROC request for comments within FAIR Canada, we have canvassed the views of a number of individuals who focus on advancing individual investor interests, including: lawyers, dispute resolution specialists, advisors, and consumer advocates. We have also had the benefit of reviewing the submission prepared by the Small Investor Protection Association (**SIPA**) in order to arrive at our four specific recommendations. Within our submission, we make specific reference to the individuals or organizations that provided their perspectives.

Summary of FAIR Canada's recommendations

1. **Create no- or low-cost service to assist investors.** Improve dispute resolution and access to arbitration for investors by creating a no- or low-cost service that assists investors with organization and preparation of relevant paperwork and claim-related documentation. FAIR Canada suggests that: (a) the service be funded out of IIROC's restricted funds and (b) investor rights groups across Canada be given the opportunity to provide the service.

2. **Parties should each bear their own costs, with no discretion for cost award**s. FAIR Canada recommends that a rule under the IIROC Arbitration Program be put in place: (a) requiring that each party bear its own costs, and (b) removing the discretion that arbitrators currently have to make cost awards, except in cases where a dealer has acted in an abusive or unfair manner.

3. **Improve transparency of arbitration process**. IIROC should publish (on a no-names basis) a summary of each arbitration case, including the decision and award amount. This would improve the visibility of the IIROC Arbitration Program, assist investors in better assessing their claim, and assist individuals in understanding whether arbitration is a preferable route for their case.

4. **No cap on award limit, or minimum cap of $1 million**. FAIR Canada recommends that: (a) there be no limit on the award that an arbitrator may make or (b) if a limit is deemed necessary, the limit be increased to a minimum of $1 million.

Responses to Specific Questions from IIROC

In its request for comments, IIROC posed three specific questions about the Arbitration Program. We deal with each of the questions below and, for purposes of this letter, have combined our responses to Questions 1 and 2 under one heading.

1. Benefits of Arbitration, the Viability of the Program, Experience of Parties to Arbitration Cases under the Program and Suggestions to Improve Effectiveness and Utilization of Program

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There is a benefit to the arbitration option being available to individual investors. The majority of the individuals and organizations consulted acknowledged the benefits of arbitration. They noted that, on the whole, investors benefit from having a program in place through which they can, outside of the court system, access an independent decision-maker to resolve their investment disputes.

As described in the IIROC notice, clients wishing to resolve a dispute with an IIROC dealer member can choose among three different options, beyond the dealer's internal complaint handling process: (1) the IIROC Arbitration Program, (2) non-binding dispute resolution through OBSI, and (3) civil litigation in the courts.

As IIROC acknowledges in its notice, there has been a significant decline in the number of investors who have accessed the IIROC Arbitration Program over the past several years. In order to remain a viable alternative to the non-binding OBSI dispute resolution program and to civil litigation through the courts, there are a number of problems facing the IIROC Arbitration Program that should be addressed:

a. Lack of access to, and knowledge about, the IIROC Arbitration Program

Glorianne Stromberg, the well-known author of several reports on the financial services industry and investor protection, notes that access to dispute resolution is one of the biggest challenges facing investors. Many investors are not aware of the existence of the IIROC Arbitration Program. When they do become aware of it, many feel intimidated by it. They find it very legalistic and, unless they retain legal counsel, they are at a huge disadvantage in pursuing their claims. The potentially high costs of arbitration (see discussion below under b.) with no right of appeal are also a deterrent.

Garth Rustand, Executive Director at Investors Aid Co-operative (the **Co-op**), noted that investors are often reluctant to choose the IIROC Arbitration Program due to: (a) lack of knowledge about what caused the loss and about whether the loss is 'fair' or excessive compared with a more suitable investment, (b) lack of understanding about statements and account opening documents, and (c) lack of services to assist them in interpreting investments and claim-related documents.

Mr. Rustand noted that, even when the Co-Op refers a case to a lawyer, Co-Op staff are often still needed by investors to define: (a) existing and suitable asset allocations, (b) risk assessment, (c) commissions paid, (d) past product history, and (e) return expectations. Mr. Rustand commented separately that the Co-Op was involved in two recent cases where unsuitably aggressive asset allocations increased losses in the 2008 financial crisis from -8% to -25%.

Some commentators noted that, due to the lack of access by individual investors to arbitration, investors often feel that their interests are not being properly protected under the current system. The "suitability" concept is not well understood by individual investors, and little guidance is available to investors from IIROC.

The complexity of the "suitability" concept for individual investors (and dealer member firms) was addressed in FAIR Canada's December 1, 2008 submission to IIROC regarding IIROC's "Guidance Note: Know Your Client and Suitability Guidelines". In that submission, we made the following recommendations:

> **"FAIR Canada recommends that IIROC issue more comprehensive guidance on the know your client and suitability obligations of its Dealer Members in two forms:**
>
> 1) For its Dealer Members: a detailed guidance note or manual that provides comprehensive guidelines on the application, implementation and administration of the KYC and suitability rules;
>
> 2) For individual investors: a manual written in plain language that explains the KYC and suitability obligations and the rights of investors, and provides related advice on dealing with investment firms and advisors.
>
> **FAIR Canada suggests that the investors' manual cover:**
>
> 1) Investors' Rights – Explain the KYC and suitability obligations of investment dealers, and the benefits of these requirements for clients;
>
> 2) Limitations of KYC and Suitability – Explain the difference between fiduciary duties and suitability requirements; and
>
> 3) Advice for Investors – Outline the steps investors should take to ensure that those obligations are met, their KYC information stays up-to-date, and their investments remain suitable."

Individual investors face many challenges in understanding the options available to them, and particularly in understanding the nature of their claim, the extent of damages, as well as the necessary paperwork that needs to be organized and prepared. The difficulty of determining the calculation of loss

incurred in a non-suitable investment (as compared with a more 'suitable' investment) was highlighted during a recent consultation meeting with OBSI, which FAIR Canada attended together with a number of other individuals who focus on advancing investor interests. Part of the meeting was focused on the process used by OBSI to assess suitability claims. It became clear during the meeting that few investors would know how the suitability concept applies to them, and how it relates to the KYC and new account application requirements. Individual investors would also have difficulty comparing their loss in a specific time period with investment returns on a more suitable portfolio, and that difference is a key question that should be considered before a complaint is brought to arbitration.

FAIR Canada considered a number of options before arriving at its final recommendation, including suggesting that IIROC assume the role of assisting investors with understanding their claim and getting it organized. However, we recognize that this option may not be practical, given that dealer members fund IIROC and may not be amenable to funding an investor-focused service in disputes with dealers. It is also worth noting that a number of investor rights groups try to offer this type of service, but do not have sufficient funding. On the other hand, IIROC has substantial restricted funds (over $28 million as of March 31, 2009), a portion of which could be made available to assist individual investors with dispute resolution.

<u>Recommendation #1</u>: Based on the comments and concerns noted above, FAIR Canada recommends the creation of a no- or low-cost service that assists individual investors with understanding their claim, including organizing and preparing relevant paperwork and claim-related documentation. FAIR Canada suggests that: (a) the service be funded out of IIROC's restricted funds and (b) investor rights groups across Canada be given the opportunity to provide the service.

b. Costs

Costs are another major concern. Under the IIROC Arbitration Program: (a) arbitrators are empowered to award up to $100,000 plus interest and costs, (b) arbitration fees are usually divided equally between the parties, and (c) both parties often retain legal counsel. In addition, dealers often retain experts, which then compels investors to retain experts – and this adds further to an investor's costs. As noted below, since the award of costs is solely within the arbitrator's discretion, there have been instances where complainants under the IIROC Arbitration Program have been ordered to pay significant costs, including awards of legal costs. Fear of potentially being required to pay significant costs, in addition to their own costs and the amount already lost, is a significant disincentive to using the IIROC Arbitration Program.

In contrast, under the non-binding OBSI dispute resolution process: (a) OBSI can recommend compensation of up to $350,000, (b) there is no charge to complainants for OBSI's services, and (c) OBSI complainants do not usually retain legal counsel.

Robert Goldin, an experienced forensic financial auditor and investment dispute consultant, confirmed that many clients are dissuaded from using the IIROC Arbitration Program due to the potentially high costs that can be awarded against them. Mr. Goldin said that he was aware of an investor who, some time ago, took her claim to arbitration and was ordered to pay over $30,000 in legal costs. Mr. Goldin also noted that, where brokerage houses are represented by senior securities lawyers, the legal costs can be considerable. Based on his experience, Mr. Goldin suggests that the following processes be put in place: (a) the Arbitration Program should be amended so that each side pay its own costs, and (b) the arbitrator can, in his/her discretion, order that the winning party be reimbursed for out-of-pocket expenses. In its comment letter, SIPA provided an extensive analysis of the high costs of arbitration, and a discussion about why costs are a huge problem for investors contemplating the IIROC Arbitration Program.

FAIR Canada agrees that the costs associated with the IIROC Arbitration Program can be potentially prohibitive, and notes that creating a no- or low-cost service to assist investors could help to reduce those costs dramatically. However, in order to remain a viable and more cost-effective alternative to both the non-binding OBSI dispute resolution process and civil litigation options, IIROC should consider implementing a rule requiring that each party bear its own arbitration costs, and removing the discretion that arbitrators currently have to make cost awards, except when a dealer acts in an abusive or unfair manner.

<u>Recommendation #2</u>: In addition to creating a no- or low-cost service to assist individual investors, FAIR Canada recommends that a rule under the IIROC Arbitration Program be put in place: (a) providing that each party bear its own costs in the arbitration, and (b) removing the discretion that arbitrators currently have to make cost awards, except when a dealer acts in an abusive or unfair manner.

c. Limited Transparency

There is currently limited transparency for investors built into the IIROC Arbitration Program. There is no requirement for decisions, or even summaries of facts, to be published. Given many of the concerns noted above regarding the lack of access to, and knowledge about, the IIROC Arbitration Program, FAIR Canada believes that it would benefit all parties to make decisions and facts about arbitration cases more transparent. This would be particularly helpful in the area of arbitrators' interpretations of the "suitability" concept, as well as the methods used for calculating losses. We recommend the publication

(on a no-names basis) of a summary of each arbitration case, including the decision and award amount. We believe this would greatly assist investors in better determining whether arbitration through the IIROC Arbitration Program is the appropriate route to take, as well as assist them in preparing their case.

<u>Recommendation #3</u>: In order to improve the visibility of the IIROC Arbitration Program and to assist investors in better assessing whether arbitration is a preferable route for their case, publish (on a no-names basis) a summary of each arbitration case, including the decision and award amount.

2. IIROC's Proposal to Increase the Award Limit under the Program to $350,000 or some other Amount

FAIR Canada agrees with IIROC's proposal to increase the award limit. The majority of the individuals and organizations consulted confirmed that the current award limit is too low, particularly given the $350,000 OBSI limit. As SIPA noted in its submission, SIPA supports an increase of the award to $500,000. Robert Goldin recommends an increase to the limit, but believes the limit should be capped at $350,000. Glorianne Stromberg and Julia Dublin, a senior securities lawyer with Aylesworth LLP, questioned the appropriateness of placing a cap on the award. Ms. Dublin asked whether other considerations should be paramount, such as the value of the investor's remaining assets, and noted that, unless the rationale for having a limit is clearly articulated, it is not possible to usefully assess the merits of different dollar amounts.

As described in the IIROC notice, the current limit under the IIROC Arbitration Program was established in 1999. At that time, OBSI did not have the mandate to consider investment-related claims, and therefore the non-binding OBSI dispute resolution route (with its higher $350,000 limit) was not an option for investors. In December 2003 (more than six years ago), the Ontario Securities Commission's Regulatory Burden Task Force recommended increasing the IIROC Arbitration limit to at least $350,000. It is worth noting that the IIROC notice also describes the FINRA arbitration program which, although quite different from the IIROC process, does not have an award limit.

As we note above, clients wishing to resolve a dispute with an IIROC dealer member can choose among three different options, beyond the dealer's internal complaint handling process: (1) the IIROC Arbitration Program, (2) non-binding dispute resolution through OBSI, and (3) civil litigation in the courts.

OBSI: Non-binding dispute resolution program

As described in the IIROC notice, OBSI is an ombudservice providing a non-binding dispute resolution program for participating financial services providers and their customers. There is no charge to complainants for OBSI's services, and OBSI can recommend compensation of up to $350,000. OBSI complainants do not usually retain legal counsel. The parties do not appear before a third party to present their respective cases. When an investor files a complaint with OBSI, OBSI staff investigate the facts by reviewing documents provided by the parties, interviewing the complainant and representatives of the dealer members, and speaking with relevant third parties. OBSI staff will also give appropriate consideration to industry practice and the law, and complete any necessary research and loss calculation. OBSI will then make a determination regarding compensation based on what is considered "fair" under the circumstances (which is often a difficult concept to grasp) and, although its recommendation is non-binding, the names of member firms that refuse to implement its recommendations are disclosed to the public, together with a description of the circumstances of the case.

Arbitration and litigation

Arbitration shares many similarities with civil litigation, including: parties often retain legal counsel, parties present their respective cases to an impartial third party, and arbitrators and judges both impose binding decisions based on the facts and arguments presented. However, arbitration is intended to be more flexible than civil litigation, and more expeditious and cost-effective. Conduct of arbitration proceedings can be determined through agreement by the parties. In arbitration, there are fewer opportunities for procedural delays, since discovery, motions and appeals are usually more limited in scope. Another key difference is that, in arbitration, the proceedings and decisions are confidential. Court filings and proceedings are generally made available to the public.

Bringing a claim to court is often costly, time-consuming and immensely frustrating for investors. Bringing a case through the court system can take more than a decade to resolve, and invariably incurs exorbitant and unnecessarily high legal fees.

FAIR Canada believes that, in order for the IIROC Arbitration Program to become viable, it must become a more attractive alternative for investors to civil litigation, particularly for larger claims. In our view, there should be no limit placed on the size of the award, or the limit should be increased to a minimum of $1 million. Under the current regime: (1) investors with claims up to $350,000 will generally choose the OBSI option, and (2) investors who wish to claim over $350,000 in losses are forced to resort to civil litigation through the court system due to the limit on arbitration awards. Given the OBSI option, increasing the limit to $350,000 would not necessarily make the IIROC Arbitration Program a serious alternative to litigation. The limit needs to be increased to much more than $350,000. Elimination of the

current limit or an increase to a much larger limit, such as $1 million, would provide investors with a viable and attractive alternative to the costly and time-consuming civil litigation route.

<u>Recommendation #4</u>: FAIR Canada recommends that: (a) there be no limit on the award that an arbitrator may make or (b) if a limit is deemed necessary, the limit be increased to a minimum of $1 million.

We would be pleased to discuss our comments with you in more detail. Feel free to contact Ermanno Pascutto at 416-572-2282/ermanno.pascutto@faircanada.ca or Ilana Singer at 416-572-2215/ilana.singer@faircanada.ca.

Sincerely,

Canadian Foundation for Advancement of Investor Rights