FAIR | Canadian Foundation *for* Advancement *of* Investor Rights

June 1, 2011

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RE: FAIR Canada Supports Mandatory OBSI Participation for IIROC and MFDA Member Firms

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FAIR Canada supports continued mandatory OBSI participation for IIROC and MFDA member firms and urges securities regulators to protect investors by resisting the attempt to undercut OBSI and render it ineffective.

1. Overview

1.1. FAIR Canada urges the members of the CSA, IIROC, and the MFDA not to succumb to industry pressures to revise IIROC Rule 37.2 and Section 24.A.1 of MFDA By-law No. 1 to remove the requirement for member firms to participate in OBSI.

> **Recommendation 1:**
>
> Complaint handling and redress mechanisms need to be improved, not weakened. The CSA should continue to require IIROC and MFDA member firms to participate in OBSI.

1.2. FAIR Canada notes that OBSI was originally the creation of the banking industry, to pre-empt the imposition of a statutory ombudservice. In 2002, the investment industry was required to join OBSI on a mandatory basis. The banking and investment industry is now attacking the entity it created and supported for the level of independence it has achieved and for not being subservient to industry's interests. FAIR Canada does not agree with the proposition to abandon OBSI and rather urges reforms to strengthen the accountability of OBSI in the public interest. OBSI currently operates according to a Joint Forum of Financial Market Regulators ("Joint Forum") framework for ongoing collaboration[1], through which OBSI has some accountability to regulators. FAIR Canada recommends a more formal recognition of OBSI, through recognition orders issued by CSA members, which would improve oversight and accountability.

> **Recommendation 2:**
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> Provincial securities regulators should formally recognize OBSI through recognition orders.

1.3. FAIR Canada suggests that regulators also consider extending OBSI as a dispute resolution option to clients of non-SRO member firms.

1.4. Removing the national independent dispute resolution service and permitting SRO member firms to retain multiple dispute resolution service providers would likely lead to fragmentation and inconsistencies in the procedures used in resolving investment disputes. Removing the requirement for member firms to participate in the OBSI would create an alternative dispute resolution framework fraught with conflicts of interest and complainant confusion. It would also augment the power asymmetries between member firms and consumers and would weaken protections for financial consumers.

[1] Joint Forum of Financial Market Regulators, "The Financial Services OmbudsNetwork – A Framework for Collaboration", online:
< http://www.jointforum.ca/en/init/fson_framework/august_10_2007_a_framework_for_collaboration-en.pdf>.

1.5. As noted in the January 2009 Report of the Expert Panel on Securities Regulation regarding the inadequacy of complaint handling and redress mechanisms in Canada[2]:

> 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.

1.6. FAIR Canada submits that permitting multiple approved providers of dispute resolution services would worsen the problem of poor complaint handling and redress mechanisms.

1.7. Additionally, as a single, national ombudservice, OBSI is able to identify and investigate systemic or widespread issues that arise from complaints in the course of its work. Under its Terms of Reference, OBSI has the ability to take action in response to systemic issues uncovered when reviewing an individual consumer complaint. This would be lost in a system of separate, disconnected private dispute resolution service providers.

1.8. In FAIR Canada's view, OBSI remains a simple, inexpensive alternative for retail investors, even though it is a system in which member firms hold a great deal of power, expertise and knowledge. Permitting member firms to choose their dispute resolution service provider, negotiate the contracts with these providers and provide remuneration directly to these providers would threaten the fairness and independence enshrined in the current system.

1.9. FAIR Canada does not want to see OBSI undermined and, instead, suggests opportunities to improve its dispute resolution services, which are set out below. The only alternative to OBSI that FAIR Canada would support for financial consumer complaints would be the creation of a statutory ombudservice.

2. Dispute Resolution Services Need to Be Independent, Impartial and Free from Conflicts of Interest

2.1. FAIR Canada understands that the banking and investment industry's displeasure with OBSI has led the industry to seize on the wording of section 13.16 of NI 31-103 in an attempt to move to a dispute resolution service framework which it would find more acceptable but would not be in the interests of financial consumers. Accordingly, FAIR Canada recommends that the wording of NI 31-103 needs to be amended to serve the public interest and, in particular, the interests of financial consumers.

2.2. We are aware that at least some member firms are in favour of removing the current language of IIROC Rule 37.2 and Section 24.A.1 of MFDA By-law No. 1 and replacing these provisions with language similar to that included in section 13.16 of NI 31-103, which provides that a registered

[2] Expert Panel on Securities Regulation, "Final Report and Recommendations" (January 2009) at page 34.

firm must ensure that independent dispute resolution or mediation services are made available, at the firm's expense, to an investor to resolve a complaint made by the investor.

2.3. The language in NI 31-103 reads:

> 13.16 Dispute resolution service
> (1) A registered firm must ensure that independent dispute resolution or mediation services are made available, at the firm's expense, to a client to resolve a complaint made by the client about any trading or advising activity of the firm or one of its representatives.

2.4. The language "made available" suggests that member firms would have the privilege of selecting the service provider. The language "at the firm's expense" implies payment of remuneration directly from member firms to the service providers. Allowing member firms to select and pay the service provider(s) made available to their clients to resolve complaints against them poses significant potential for conflicts of interest, both real and perceived.

2.5. OBSI is a non-profit organization that is impartial, free of bias and independent of both industry and government. The for-profit nature of private dispute resolution service providers contributes to significant concerns regarding conflicts of interest that would arise if the current language requiring participation in OBSI was replaced with language similar to that of section 13.16 of NI 31-103.

2.6. Direct payment by member firms to dispute resolution service providers raises significant cause for concern. Neutrality, impartiality and an absence of an alignment of interests with any party is essential to a fair dispute resolution service. Dispute resolution service providers' financial interests (namely being the award of service contracts by member firms and the resultant remuneration) would be aligned with the investment firm's interests which could compromise their neutrality and impartiality. These providers could be incentivized to make decisions and recommendations that are favourable to the member firms that are paying their fees in order to maintain a positive relationship with these member firms and to be awarded future contracts.

2.7. The first objective outlined in the guidelines endorsed by a Dispute Resolution Committee established by the Joint Forum is independence.[3] Guideline No. 1 (Subject Matter: Independence) states:

> …"independence" means the absence of relationships with the affected financial sector industry, or firms within it, which would cause a reasonable person to question whether the person can fairly and effectively resolve complaints…or provide objective and disinterested oversight…

2.8. In our view, direct payment from a member firm for dispute resolution services dealing with a complaint against that member firm would cause a reasonable person to question whether or not that dispute resolution service provider could fairly and effectively resolve complaints.

[3] Guideline No. 1, being Annex B to the Framework for Collaboration, *supra* note 1.

2.9. Even if safeguards were introduced to reduce the potential for conflicts of interest, the potential for the perception of a conflict of interest is too great to warrant the introduction of such language into IIROC Rule 37.2 and Section 24.A.1 of MFDA By-law No. 1. If unfairness resulting from conflicts of interest is perceived by clients, it has the potential to undermine the purpose of an independent dispute resolution service. It is crucial that investors perceive the decision-maker to be free of conflicts of interest. Changing the language of IIROC Rule 37.2 and MFDA By-law No. 1, as suggested by some member firms, would lead to the significant problem of conflicts of interest (perceived or real) that are absent from the current status quo.

2.10. To prevent this from occurring, FAIR Canada recommends that the CSA amend the language of section 13.16 of NI 31-103 to provide protection to financial consumers from the potential for conflicts of interest in dispute resolution by requiring registered firms to participate in an approved ombudsperson service.

Recommendation 3:

The CSA should amend the language of section 13.16 of NI 31-103 to require registered firms to participate in an approved ombudservice. The CSA should recognize OBSI as the approved ombudservice.

3. Consistency in Decision-Making

3.1. OBSI provides a single, national dispute resolution service, with initiatives in place to detect and minimize inconsistencies in its approach to complaints handling between matters with similar facts, between investigators and over time.

3.2. The development of a body of knowledge is important for fairness, and would be difficult to build with multiple independent, disconnected dispute resolution service providers. For consistency, FAIR Canada supports the continued mandatory OBSI participation for member firms, or, in the alternative, a single, national statutory ombudservice.

4. Industry Concerns About OBSI

4.1. FAIR Canada is aware of some of the arguments made by the industry[4] regarding their complaints about OBSI. While we do recognize that some improvements could be made, we fail to see sufficient merit in these arguments to revise the requirement that member firms participate in OBSI. We are aware that industry and regulators had a meeting about OBSI at the OSC's offices on May 12, 2011; however, investor advocates were not invited to or present at the meeting. FAIR Canada understands, based on media reports, that regulators have rejected

[4] RBC Dominion Securities made a number of arguments in favour of the revision of IIROC Rule 37.2 in its submissions to IIROC in letters submitted on March 15, 2010 (online: <http://docs.iiroc.ca/DisplayDocument.aspx?DocumentID=B1CED3E64BEC4AA6B2E90BB2E3E81CF5&Language=en>) and October 8, 2010 (online:<http://docs.iiroc.ca/DisplayDocument.aspx?DocumentID=67DE19697BBB4EC88631A4CD998EF844&Language=en>).

the industry members' request and have pushed back, encouraging member firms to continue to participate fully in OBSI's processes. FAIR Canada recognizes the regulators' measured approach and encourages them not to give in to further industry lobby efforts. The known arguments of industry and FAIR Canada's response to them are set out below.

Fairness and Transparency

4.2. An ombudservice is not intended to fill an arbitral role. The International Ombudsman Association's Code of Ethics includes an ethical principle of informality, stating that an ombudsman "as an informal resource, does not participate in any formal adjudicative or administrative procedure related to concerns brought to his/her attention."[5]

4.3. Fairness is the fundamental principle upon which OBSI's decisions are based. Transparency in processes and clear rules governing the processes are not essential, or necessarily conducive, to reaching decisions that are fair in substance (as opposed to procedurally fair). As stated in Guideline No. 4 (Subject Matter: Fairness), to achieve the objective of fairness, "[t]he objective of complaint resolution through the ombudservice is not to provide a parallel court system, but to establish a dispute resolution framework which will encourage fair business dealings, broadly and reasonably conceived."[6]

4.4. FAIR Canada encourages transparency to ensure that financial consumers and member firms understand OBSI's investigation steps and the reasons underlying its recommendations. However, a perceived need by member firms for improvement in this area does not mean that mandatory OBSI participation should be eliminated cavalierly.

Loss Calculation Methodology

4.5. Some industry participants have complained that OBSI does not have a clear, consistent assessment of damages methodology. They allege that "OBSI currently applies a standard, demonstrably flawed, methodology to all complaints"[7]. OBSI has recently published a consultation paper on its approach to suitability and loss assessment. FAIR Canada submits that member firms should provide their opinions and recommendations regarding the methodology used to achieve redress for investors rather than reacting to the problem by dismantling OBSI.

4.6. FAIR Canada supports the principles upon which the loss methodology calculations for investment complaints are based – that is, that OBSI's approach is to determine a reasonable estimate of the financial position the investor would be in had the unsuitable investment advice not been given and acted upon. For fairness, it is important that this methodology works both ways. If an investor would have sustained losses had the appropriate recommendation been made by the member firm, this should be reflected in the loss calculation.

[5] International Ombudsman Association, "IOA Code of Ethics" online: <www.ombudsassociation.org>.
[6] Guideline No. 4, being Annex B to the Framework for Collaboration, *supra* note 1.
[7] *Supra* note 4.

4.7. FAIR Canada believes that the increase in complaints arising from the 2008 market crash has meant that industry is likely facing having to pay out more money to wronged investors and this has led to a greater focus by industry on the appropriate "methodology" for awards as it seeks to limit the amount of redress it must pay.

Publication of Reasons

4.8. Some industry participants have been critical of the fact that OBSI does not publish reasons for its decisions. FAIR Canada understands that reasons are provided to the parties once OBSI has reached its recommendations (if any) in a given case. It is essential that the parties receive reasons in respect of the complaint. FAIR Canada believes that the publication of more broadly applicable "sample" cases, with client identifying information redacted, would be of benefit to both member firms and investors. We encourage OBSI to continue efforts to publish such information. We suggest that the sample cases should identify the investment firm or bank involved.

4.9. While the industry complains that there are no published reasons for OBSI's decisions which results in a lack of precedent, the ADR Chambers Banking Ombuds Office Annual Report for 2010, which is RBC's dispute service provider for its banking clients, also does not publish reasons for its decision and only publishes case studies. There are no indications that independent dispute resolution or mediation services would address this industry complaint.

4.10. In our view, permitting the use of multiple private dispute resolution service providers would only make it more difficult to publish sample cases and to identify complaint trends. We encourage the CSA, IIROC and the MFDA to examine this issue with a view to improving the current situation, rather than taking steps backward.

Recommendation 4:

OBSI should continue efforts to publish more broadly applicable OBSI sample cases for the benefit of investors as well as member firms.

Cannot Make Binding Decisions

4.11. By their nature and function, ombudservice offices are to make recommendations and their conclusions are not legally binding.[8] IIROC's arbitration program is available to investors dealing with IIROC member firms who desire a binding decision.

4.12. While some industry members argue that the penalty of publishing a dealer's name if the recommendation of OBSI is not accepted is "ineffective", there has not been a publication made since 2007, which, at that time, was the first time a recommendation had not been accepted in the previous ten years. This suggests that the threat of the publication of a failure to comply with a recommendation may lead to recommendations being accepted by the parties. However,

[8] David J. Mullan, *Administrative Law*, 5th ed (Toronto: Emond Montgomery Publications Limited, 2003).

a voluntary system is only effective to the extent that the industry "buys in" to OBSI. If industry firms join together to oppose OBSI the threat of "name and shame" loses much of its force and OBSI could be undermined.

4.13. The industry may prefer the confidential nature of the arbitration process since the decision of the arbiter is final, binding and confidential. Keeping the information confidential creates a knowledge imbalance in favour of the industry. FAIR Canada believes the continuance of an independent ombudservice as a method of dispute resolution is an essential option for financial consumers who have a complaint.

Complaint about Costs of OBSI

4.14. Some industry members also complain that member firms are required to pay a "substantial fee in order to participate in OBSI" and argue that IIROC Rule 37.2 and Section 24.A.1 of MFDA By-law No. 1 discourage members from offering other options for dispute resolution to investors at the firm's expense because participation in both OBSI and other dispute resolution mechanisms is cost prohibitive.

4.15. The total cost to participating firms for the OBSI fiscal year ended October 31, 2010 was $7.7 million while total OBSI expenses for the fiscal year were $7.3 million (online: < http://obsi.ca/images/document/up-OBSI_Annual_Report_2010.pdf>). A sample fee for a large OBSI participating firm (such as a major bank-owned investment dealer) is $763,000 annually. For a small bank-owned investment subsidiary, a sample annual fee would be $45,000 and small firms would pay much lower annual fees. FAIR Canada does not view these fees to be significant nor unreasonable relative to the rest of the member firms' operations. Further, we consider that the overall costs of operating a national investment and banking ombudservice are reasonable and cost effective.

5. Introduce a Statutory Ombudservice

5.1. FAIR Canada submits that if the industry is dissatisfied with OBSI, improving the current body would be a far more productive solution than opening up the field to multiple entities which would lead to additional concerns. A statutory ombudservice could meet the industry's desire for greater transparency, bringing with it additional procedural safeguards to address issues of natural justice, while also improving investor protection. FAIR Canada supports converting OBSI into a statutory national ombudservice for investment and banking services.

Recommendation 5:
If the financial industry opposes OBSI remaining the mandatory dispute resolution service, we recommend the establishment of a mandatory national statutory ombudservice for all banking and investment services.

6. Conclusion

6.1. FAIR Canada supports mandatory OBSI participation for IIROC and MFDA member firms and steps which would improve the transparency and accountability of OBSI. In the alternative, FAIR Canada strongly supports the introduction of a mandatory statutory financial services ombudservice. FAIR Canada is opposed to the efforts of the investment and banking industries to undermine OBSI by permitting them to choose and remunerate private, for-profit dispute resolution service providers. Such efforts raise a serious threat to investor protection and would likely further exacerbate existing weakness in complaint handling and consumer redress mechanisms. We thank you for considering our comments and views in this letter. We welcome its public posting and would be pleased to discuss this issue with you at your convenience.

6.2. The financial industry has had an opportunity to present their arguments to the CSA and OSC in the absence of any representation for consumers and investors. FAIR Canada urges the CSA and OSC to meet with investor and consumer organizations. Please contact Ermanno Pascutto at 416-572-2282 (ermanno.pascutto@faircanada.ca) or Marian Passmore at 416-572-2728 (marian.passmore@faircanada.ca).

Sincerely,

Canadian Foundation for Advancement of Investor Rights

cc: Small Investor Protection Association

Ontario Securities Commission's Investor Advisory Panel