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Dear Mr. Fleming,

**Re: OBSI Consultation Paper on its Suitability and Assessment Process**

**Contents:**

Introduction

I. OBSI's Suitability and Assessment Process

1. Three-step Assessment Process
2. OBSI View of KYC and Suitability Obligations
3. KYC Review
4. Interviews
5. Recording and Disclosure of KYC Information

II. Comments concerning OBSI's Assessment Process

1. Overview
2. KYC Suitability Obligations under NI 31-103
3. Duty to take reasonable steps to collect sufficient KYC information
4. OBSI's concept of "actual KYC facts"
5. Leading questions
6. Suitability
7. Assessment of Compensation

III. Recommendations on OBSI's Process

## **Introduction**

Thank you for the opportunity to comment on OBSI's consultation paper concerning the Suitability and Assessment Process (the Consultation Paper.)

Advocis is a national professional association that is committed to preparing, promoting and protecting financial advisors in the public interest. We do this by providing a professional platform including career support, designations, best practices direction, education, timely information and professional liability insurance. This strengthens the relationship of trust and respect between financial advisors and their clients, the public, and government. Advocis is Canada's largest association of financial advisors, representing life and health insurance licensees, and mutual fund and securities registrants across the country for over a century. Our members are individuals, the majority of whom carry on business as either sole proprietors or independent, small businesses. A smaller proportion of Advocis members operate under employee-employer arrangements of financial services firms. We represent advisors at all stages of the business cycle, ranging from new entrants to the industry through to mature practices led by leaders in the industry serving a significant client base.

## **I. OBSI's Suitability Assessment Process**

### **1. Three Step Assessment Process**

The Consultation Paper describes a three-step assessment process: In Step 1, OBSI assesses the investor's KYC information, to determine whether the dealer accurately collected the complainant's KYC information. In Step 2, OBSI analyzes the investments and strategies recommended by the advisor, to determine whether they were suitable for the investor based on the KYC information. Finally, if Step 2 has led OBSI to conclude that the investments and strategies recommended by the advisor were not suitable, in Step 3 OBSI determines whether the complainant incurred financial harm as a result of unsuitable investments, and determines the amount of compensation and whether the complainant should bear responsibility for some of the loss.

### **2. OBSI view of KYC and suitability obligations**

The Consultation Paper in its summary of the KYC and suitability obligations of dealers and their advisors, states that they "must learn each client's personal and financial circumstances, investment knowledge and experience, investment time horizon, investment objectives and risk tolerance (known as "Know Your Client" or "KYC" information). "

We note that the summary in the Consultation Paper does not acknowledge that the dealer's KYC and suitability obligations are not unlimited. The dealer's actual obligation is to take reasonable steps to inform itself about the client's investment needs and objectives, financial circumstances and risk tolerance, in order to assess suitability. While the dealer should of course be responsible to compensate clients for losses due to unsuitable advice, the suitability of the advice should be assessed on the basis of what the dealer knew or should have known about the client.

### 3. KYC document review

The “KYC review” outlined in the Consultation Paper focuses on a wide range of documents, that go beyond what would be generated during the dealer’s KYC process. According to the Consultation Paper, the review also considers whether the documents were “clear and expressed in terms that the investor was likely to understand.”

### 4. Interviews

The KYC Review also involves far-ranging interviews that appear to go beyond the dealer’s KYC process and the question of whether the dealer made a reasonable assessment of the client’s “KYC facts” as a foundation for assessing the suitability of advice.

The description of what OSBI delves into in the Interviews states in part:

*The topics we discuss may include but are not limited to: the recorded KYC information and the process used to collect and discuss it; any documents or information that appear to support or contradict recorded KYC information; the investor’s personal and financial circumstances, including their employment status and background, family circumstances, income, net worth, and how these circumstances may have changed over time; the investor’s investment experience and knowledge; the investor’s financial goals and objectives, liquidity requirements and time horizon for the investments in question; the investor’s willingness and ability to take risks and bear losses;*

### 5. Collection and recording of KYC information (Whether KYC info was recorded accurately, and disclosure was understood)

The Consultation Paper notes that the OBSI assessment frequently focuses on whether the information recorded on KYC forms was accurately recorded and understood by the investor, and whether that information accurately reflects “the investor’s actual KYC information.”

The Consultation Paper goes on to suggest that questions about whether KYC information was recorded accurately, whether the client understood the KYC forms and whether the client understood other documents, are an important focus of OBSI’s suitability and assessment process:

“Documents, such as KYC forms, are central to our investigation. However, in many suitability complaints, the investor complains that their KYC information was not accurately recorded, that they did not understand the KYC forms they signed, and/or that their advisor did not review the KYC forms or explain their significance. Therefore, we often need to collect and consider additional evidence by interviewing the parties and conducting research to determine if the KYC forms reflect the investor’s actual KYC information during the period of time in question.”

In the Consultation Paper, below the list documents, the following “Key Principle” is set out in a box:

*KEY PRINCIPLE When reviewing KYC forms and other relevant documents, whether signed or not, we will consider when and how they were completed, whether copies were provided to the investor, and whether the wording on the documents is clear and expressed in terms that the investor was likely to understand.*

The foregoing suggests that OBSI makes questions about whether the KYC information was recorded accurately, and whether the investor understood the KYC forms and other disclosure documents, a significant focus of OBSI's assessment.

## II. Comments concerning OBSI Assessment Process

### 1. Overview of our submission

Dealers and advisors (hereafter, *when we refer to the dealer here we generally include the advisor*) are subject to know your client (KYC) and suitability obligations in their dealings with consumers. When a consumer complains to OBSI that they received advice that was not suitable, and suffered a potential or crystallized loss as a result, OBSI investigates whether the dealer fulfilled their KYC obligations and whether the advice was suitable.

We submit that there is a fundamental error in OBSI's suitability and assessment process, as outlined in the Consultation Paper, regarding the scope of the KYC information that should inform OBSI's assessment of suitability.

We also submit that OBSI's suitability and assessment process is in error in two significant respects:

- OBSI proceeds on the erroneous premise that it can establish through its suitability and assessment process, the "actual KYC facts" that will be relevant to OBSI's assessment of whether advice was suitable, without being limited to the KYC information that the dealer actually collected or should have collected. The "actual KYC facts" that OBSI seeks to establish are not limited to the KYC facts that the dealer and advisor collected in the course of the dealer's KYC process, even if the dealer and the advisor took reasonable steps to comply with their regulatory obligations with regard to KYC; and
- OBSI appears to invite complainants to challenge the KYC information collection process undertaken by the dealer and the advisor on the basis that "the KYC information was not accurately recorded, that they did not understand the KYC forms they signed, that their advisor did not review the KYC forms or explain their significance" or that disclosure was not understandable. This approach in this regard is akin to asking the complainant leading questions about the dealer's KYC process, that is likely to elicit responses concerning the dealer's KYC process that are self-serving and coloured by the client's dissatisfaction.

We also have comments concerning the assessment of suitability of particular "high risk" investments in the context of the investor's overall portfolio. We also note that the Consultation Paper may be suggesting that OBSI's default position is to override the judgment of the dealer and advisor whenever the client holds particular investments that have a risk rating that is greater than the client's identified risk-tolerance level.

Finally, we note with regard to the calculation of loss to compensate the investor on the basis of how suitable investments would have performed, that the comparison should take into account what the investor would likely have done through the dealer, and should be subject to the same fees and expenses and risks, if they had not made the unsuitable investment.

Our comments are set out below in more detail. We have included comments concerning the dealer's KYC obligations, as a basis for our comments regarding OBSI's suitability and assessment process.

## **2. KYC and suitability obligations under NI 31-103**

The dealer has an obligation to take reasonable steps to collect sufficient information about the client's personal and financial circumstances, risk tolerance and goals (the client's "KYC information") in order to assess the suitability of investment advice.

The dealer's KYC and suitability obligations are set out in National Instrument 31-103. These obligations are not absolute. Dealers are not under an obligation to undertake an exhaustive inquiry into all conceivably relevant facts about the client's personal and financial circumstances, risk tolerance and goals. Neither are dealers under an obligation to ensure that their client fully understand all forms, questions and disclosure documents. It is in any event not clear how the dealer could ever establish this.

Section 13.2 of NI 31-103 provides that a dealer must take reasonable steps to ensure that it has sufficient information about the client's investment needs and objectives, financial circumstances and risk tolerance to enable it to meet its obligations under the suitability requirement.

Section 13.3 of NI 31-103 provides that a dealer must take reasonable steps to ensure suitability, before it makes a recommendation to or accepts an instruction from a client to buy or sell a security.

We note that the Consultation Paper does not acknowledge that the dealer's KYC and suitability obligations are not unlimited. The dealer's actual obligation is to take reasonable steps to inform itself about the client's investment needs and objectives, financial circumstances and risk tolerance, in order to assess suitability. The suitability of the advice should be assessed on the basis of what the dealer knew or should have known about the client.

If the dealer took reasonable steps to obtain sufficient information about the client's investment needs and objectives, financial circumstances and risk tolerance to enable it to meet its obligations under the suitability requirement, the dealer will have fulfilled its obligations regarding KYC.

## **3. Duty to take reasonable steps to collect sufficient KYC information**

The KYC obligations require the dealer to take reasonable steps to ensure that they have sufficient information about the client's investment needs and objectives, financial circumstances and risk tolerance to enable the dealer to meet its obligations under the suitability requirement. In order to fulfill these obligations, the advisor and the client are expected to follow procedures that are established by the dealer for the express purpose of ensuring that the KYC and suitability requirements are complied with. This process typically begins with an initial client interview and completion of account-opening and KYC forms, and continues throughout the relationship. Absent unusual circumstances that prompt further inquiry, the information provided by the client is accepted at face value.

The dealer should be accountable to the client for advice that is not suitable for the client.

The suitability of the dealer's advice should be assessed on the basis of the client's KYC information, including the information that the dealer actually collected, and any information that the dealer should have collected.

The KYC information that will be relevant to an assessment by OBSI of the suitability of a dealer's advice should not extend to all possibly relevant information about the client's personal and financial circumstances, risk tolerance and goals. Rather, the KYC information should be limited to the KYC information that the dealer actually collected, and information that the dealer should have collected if it had taken reasonable steps to collect sufficient information.

In the process of assessing suitability, OBSI should determine what KYC information the dealer actually collected, as well as information the dealer should have collected but did not collect.

We submit that the test for whether the dealer should have collected particular KYC information that it did not in fact collect ("additional KYC information"), should be whether the dealer would have been expected to collect that particular KYC information in the course of its KYC process or in the course of any reasonable approach to collecting sufficient information. To put it another way, it should be possible for OBSI to say that the dealer, if it had taken reasonable steps to collect sufficient KYC information, would necessarily have collected that additional KYC information or could not have failed to collect that information.

#### **4. OBSI's Concept of "actual KYC facts"**

The concept of the "actual KYC facts" that OBSI refers to in the Consultation Paper indicates that OBSI seeks in its suitability and assessment process to ascertain all relevant information about the client's personal and financial circumstances, risk tolerance and goals.

The "actual KYC facts" are not limited to the KYC information that the dealer actually collected or could have been expected to collect in the course of any reasonable approach to collecting KYC information. OBSI then assesses the suitability of the advice and holds the dealer accountable on the basis of the "actual KYC facts."

The Consultation Paper sets out an extensive list of the documents that OBSI reviews in the course of its "KYC Determination Process". The list includes documents that appear to us to be entirely relevant to determining the relevant KYC facts, and also includes many types of documents that we believe extend the inquiry beyond what is relevant.

The documents listed by OBSI that we believe are entirely relevant to a proper assessment of the KYC facts are as follows:

- a. new account application forms, and any updates;
- b. supplementary KYC collection documents, and any updates;
- c. financial plans and investment policy statements;
- d. the investor's account statements;
- e. any contemporaneous notes taken by the investor and advisor during the course of their relationship;
- f. any correspondence exchanged between the investor and advisor during the course of their relationship; and
- g. the dealer's internal investigation file.

The documents listed by OBSI that we believe may not be relevant to a proper assessment of the KYC facts, are the following documents that would appear to go well beyond the limits of the dealer's KYC information collection process:

- h. disclosure documents signed by the investor and/or provided to the investor by the advisor;
- i. any other documents signed by and/or provided to the investor before, at the time, or after the advisor recommended that the investor buy, sell or hold an investment in their accounts;
- j. any documents or information relied on by the advisor in formulating their recommendation to the investor;

The Consultation Paper describes the interview phase of OBSI's KYC Determination Process, and as with the document review process, the interview process appears to be intended to collect "actual KYC facts" without regard to whether the information was collected by the dealer or should have been collected. Here is part of the description of what OSBI delves into in the Interviews:

*"The topics we discuss may include but are not limited to: the recorded KYC information and the process used to collect and discuss it; any documents or information that appear to support or contradict recorded KYC information; the investor's personal and financial circumstances, including their employment status and background, family circumstances, income, net worth, and how these circumstances may have changed over time; the investor's investment experience and knowledge; the investor's financial goals and objectives, liquidity requirements and time horizon for the investments in question; the investor's willingness and ability to take risks and bear losses;"*

The Consultation Paper does not include any express reference to the dealer's KYC obligation to take reasonable steps to collect sufficient information.

The Consultation Paper also does not raise the question of whether the dealer should be held accountable on the basis of "actual KYC facts" based on an open-ended assessment by OBSI, or only on the basis of the KYC information that the dealer actually collected or could have been expected to collect in the course of any reasonable approach to collecting KYC information.

In the Consultation Paper, OBSI appears to accept without analysis that it should ascertain the "actual KYC facts" or "the investor's actual KYC information", and that information will necessarily be more reliable than the KYC information that has been documented by the dealer. (*"In some cases, the evidence supports the documented KYC information. In other cases, the evidence indicates that the investor's actual KYC information was different from what was documented."*)

Pursuant to OBSI's approach based on the "actual KYC facts" the dealer is in effect held accountable on the basis of OBSI's assessment of the suitability of the dealer's advice, based on KYC facts that the dealer did not actually collect and could not reasonably have expected to collect. Even if the dealer took reasonable steps to collect sufficient information, and fully complied with its KYC and suitability obligations, the dealer's advice could be found by OBSI to be unsuitable on the basis of KYC information elicited by OBSI in a wide ranging inquiry, that was not collected by the dealer in the course of its KYC process.

## 5. Leading questions

The Consultation Paper notes that the OBSI assessment frequently focuses on whether the information recorded on KYC forms was accurately recorded and understood by the investor, and whether the documented KYC information accurately reflects “the investor’s actual KYC information.” The Consultation Paper goes on to suggest that questions about whether KYC information was recorded accurately, whether the client understood the KYC forms and whether the client understood other documents, are an important focus of OBSI’s suitability and assessment process:

*“Documents, such as KYC forms, are central to our investigation. However, in many suitability complaints, the investor complains that their KYC information was not accurately recorded, that they did not understand the KYC forms they signed, and/or that their advisor did not review the KYC forms or explain their significance. Therefore, we often need to collect and consider additional evidence by interviewing the parties and conducting research to determine if the KYC forms reflect the investor’s actual KYC information during the period of time in question.”*

The Consultation Papers sets out the following statement as a “Key Principle”:

*KEY PRINCIPLE When reviewing KYC forms and other relevant documents, whether signed or not, we will consider when and how they were completed, whether copies were provided to the investor, and whether the wording on the documents is clear and expressed in terms that the investor was likely to understand.*

The foregoing indicates that OBSI, in the course of its assessment, actively pursues leading questions about whether the KYC information was recorded accurately, whether the investor understood the KYC forms and other disclosure documents, whether the wording of documents was clear and understandable and whether the documented KYC information “reflect(s) the investor’s actual KYC information during the period of time in question.”

We believe OBSI’s approach in this regard is akin to asking the complainant leading questions about the dealer’s KYC process, that are likely, intentionally or not, to elicit responses concerning the dealer’s KYC process that are self-serving and colored by the client’s dissatisfaction.

We do not mean to suggest that such questions could never be relevant. However, OBSI’s description of its approach suggests that its process may be unduly focused on testing the dealer’s KYC process. Asking such questions of a dissatisfied client who has brought a complaint to OBSI, with a view to attacking the credibility of the KYC information collected by the dealer, is not likely to be productive. As well, it should be noted that the client will generally have had the opportunity to ask questions of the dealer, and also will almost certainly have signed the KYC documents that are subsequently questioned in OBSI’s assessment process.

## 6. Suitability

In the Consultation Paper, OBSI notes that “(W)hile investments of different types can be combined to reduce the overall risk of an account, it’s not a given that low-risk investments “offset” the risk of high-risk investments.”



We are concerned that the Consultation Paper may be suggesting that OBSI's default position will be to override the judgment of the dealer and advisor whenever the client holds particular investments that have a risk rating that is greater than the client's identified risk-tolerance level.

We believe OBSI should acknowledge that balancing of risks is an accepted part of investment advice, and "high risk" investments should be considered in the context of the client's overall holdings, rather than in isolation. If for example the equity portion of the client's holdings is conservative, an investment of a small portion of the total in an aggressive fund that might be unsuitable as a stand alone investment, could be suitable in the context of the client's overall holdings.

## 7. Assessment of Compensation

The Consultation Paper sets out the following "Key Principle" regarding the calculation of financial harm and compensation:

### **KEY PRINCIPLE**

*If the investments and/or strategies the advisor recommended were unsuitable for the investor, we typically calculate the performance of the unsuitable investments and then the position the investor would have been in had they been suitably invested. **If the investor's actual unsuitable investments performed worse than suitable investments would have, the difference is the investor's financial harm.** Where the investor incurs financial harm, we determine whether the investor should bear some responsibility for the harm before making a final determination regarding the amount we believe the firm should compensate the investor. [Emphasis added.]*

We agree that the investor should be compensated on the basis of how suitable investments would have performed.

However, we believe that the principle regarding compensation should be expressed in more detail, to make it clear that what would have been suitable should be as close as possible to what the investor would likely have done with the funds through the dealer, and should be subject to the same fees and expenses and risks, if they had not made the unsuitable investment.

The suitable investments that form the basis for calculation of compensation should be consistent with the investor's goals, objectives and risk tolerance. The suitable investments also should if possible be consistent with the investor's past investment history with the dealer, the products normally offered through the dealer and the fees and charges that the suitable investment would have been subject to if made through the dealer.

It may be appropriate for OBSI to look to how the investor's other, suitable investments performed, as a basis for calculating compensation. If the balance of the investor's investments which were not unsuitable incurred a net loss (after all fees and expenses) during the relevant period, it may be inappropriate for OBSI to calculate compensation on the basis of hypothetical "suitable" investments that enjoyed a net gain.

### III. Recommendations on OBSI Process

1. OBSI should begin by articulating basic principles regarding its approach to the assessment of KYC and suitability. These principles should be founded on the dealer's obligation to take reasonable steps to collect sufficient KYC information to be able to make appropriate judgments regarding suitability.
2. In assessing KYC, OBSI should start by focusing on the KYC information collected by the dealer, and dealer's process for collecting KYC information.
3. OBSI should assess whether the dealer took reasonable steps in the context of the dealer-client relationship to collect sufficient information about the client's investment needs and objectives, financial circumstances and risk tolerance. In making the assessment, OBSI should be mindful that the dealer is not expected to collect all conceivably relevant information about the investor that may be available after the investor has made a complaint, but rather to take reasonable steps to ensure that it has sufficient information to be able to assess suitability. The dealer should not be held accountable on the basis of assessments of suitability that are informed by KYC information that the dealer did not collect and could not have been expected to collect in the course of its KYC process.
4. OBSI should review the dealer's KYC documents and other documents that are directly relevant to the dealer's process for collecting information from the client about their investment needs and objectives, financial circumstances and risk tolerance.
5. Information about the client that was not collected in the course of the dealer's KYC information collection process, should not be considered by OBSI unless it clearly should have been collected by the dealer and the advisor.
6. If OBSI determines that the dealer apparently took reasonable steps to collect sufficient KYC information, OBSI should rely on that information as a basis for assessing the suitability of the advice. OBSI should not be considering information that was not collected by the dealer as part of its KYC process, even if a different reasonable process might have brought that information to the dealer's attention. Information that was not collected by the dealer should only be considered by OBSI if the dealer failed to collect that information as a result of a failure to take reasonable steps to collect sufficient information.
7. Questions about whether the client understood the KYC forms they signed, or about whether the advisor reviewed and explained the KYC forms, or about whether other disclosure documents were understandable, should only be considered by OBSI if directly relevant and material to whether the dealer took reasonable steps to collect sufficient KYC information. OBSI's review should not become an adversarial inquisition, conducted by OBSI on behalf of the complainant, with a view to attacking the reasonableness of the dealer's KYC process. If the advisor took reasonable steps to collect sufficient information about the client's investment needs and objectives, financial circumstances and risk tolerance, and recorded the answers accurately, the fact that the client asserts that the advisor did not fully explain the KYC forms or ensure that they fully understood the forms before signing, or that some disclosure might not have been easily understandable, is not likely to be relevant and should not be a key focus of OBSI's assessment process.

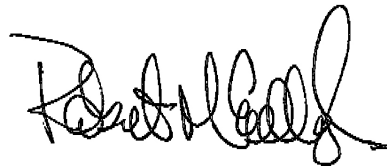
8. In assessing compensation based on suitable investments that the investor might otherwise have made but for the advice to make the unsuitable investment, the alternative suitable investments should be consistent with the investor's goals, objectives and risk tolerance. The suitable investments also should if possible be consistent with the investor's past investment history with the dealer, the products normally offered through the dealer and the fees and charges that the suitable investment would have been subject to if made through the dealer.

Advocis appreciates this opportunity to comment on OBSI's consultation paper concerning the Suitability and Assessment Process.

Yours sincerely,



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President and CEO



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