Report on Income and Canadian Financial Consumer Complaints

OBSI OMBUDSMAN FOR BANKING SERVICES AND INVESTMENTS
OSBI OMBUDSMAN DES SERVICES BANCAIRES ET D'INVESTISSEMENT

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Introduction

Who we are

OBSI is a national, independent and not-for-profit organization that helps resolve and reduce disputes between consumers and financial services firms from across Canada in both official languages. We are responsive to consumer inquiries, conduct fair and accessible investigations of unresolved disputes, and share our financial knowledge and expertise with stakeholders and the public. If a consumer has complained to an OBSI participating firm and is not satisfied with the outcome, they can bring their complaint to us and we will investigate at no cost to the consumer.

About this report

Fairness is a core OBSI value that guides every aspect of our approach to handling consumer financial complaints. We believe that all Canadians, regardless of economic circumstances, should have access to financial ombudsman services that resolve disputes and inspire confidence in the Canadian financial services sector. On that basis, we explored the relevance of household income to our case data in this year's Report on Income and Canadian Financial Consumer Complaints.

How we organized our data

Our report compiles case data and consumer demographics from cases we resolved in 2017, 2018 and 2019. Of the 2,120 cases we closed during that time, we created a database of 977 cases where information about household income was provided by the consumer. We grouped income into three categories:

- lower-income households (under $60,000);
- middle-income households ($60,000 to $100,000); and
- higher-income households (over $100,000).

For the purposes of comparison, we also provide Statistics Canada data for key national demographics relating to gender, marital status, age and education.

We hope stakeholders will find our observations and insights useful and that our report will contribute to a better understanding of the financial services experience of Canadians, and how those experiences relate to household income.

Please direct any questions regarding this report to publicaffairs@obsi.ca.

Key insights

Lower-income households represent almost 40% of OBSI cases.
Lower-income consumers of financial services need and make use of OBSI as an accessible alternative to legal action.

We recommended more than $2.5 million in compensation to lower- and middle-income households over a 3-year period.
Access to a financial ombudsman facilitates access to justice for families of all income levels.

Most lower- and middle-income complainants are over 50, while most higher-income complainants are under 50.
Older Canadians may not have the resources to access dispute resolution.

Nearly one-third (30%) of employed complainants live in lower- or middle-income households.
Canadians experience economic barriers to accessing legal services regardless of their employment status.

Key insights

Women are the primary complainant in most lower-income households. At higher income levels, men are more likely to make a complaint than women.

Investment suitability is the most common issue for lower-income complainants. Consumers over the age of 60 are the largest lower-income group impacted.

Lower- and higher-income complainants are equally likely to have compensation recommended. OBSI services result in similar compensation amounts to complainants from all income levels.

Fraud is the most common banking issue for lower-income complainants. Fraud is a particular challenge for economically vulnerable Canadians.

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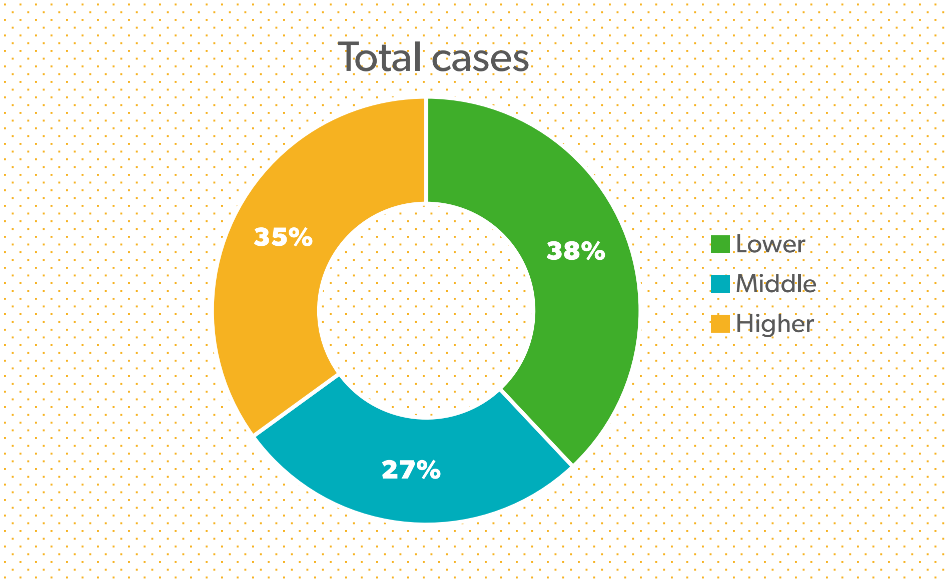
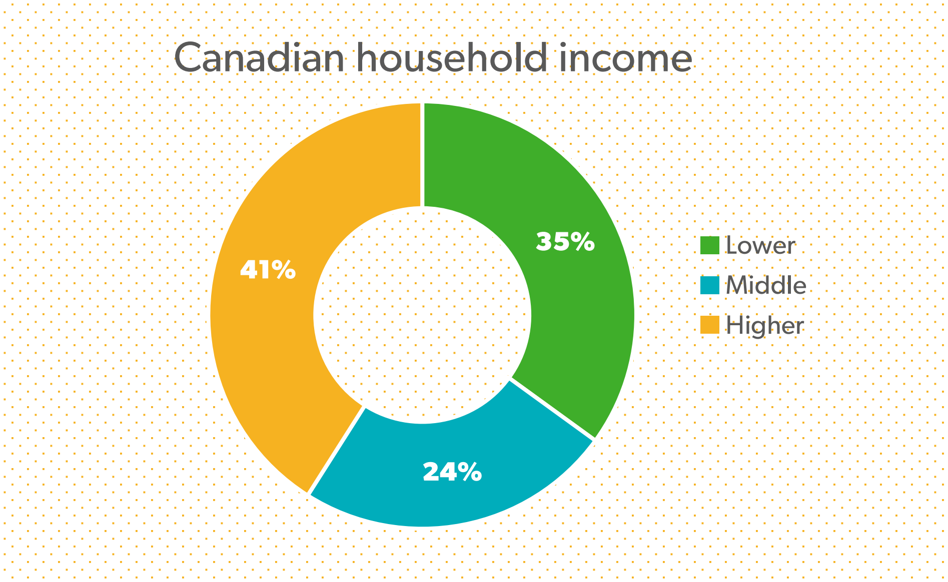
Demographic breakdown of income groups

Who is using OBSI services?

Canadians from all walks of life and different household income levels come to OBSI for help resolving their financial complaints.

Overall, our case data shows that lower- and middle-income households are more likely than higher-income households to use OBSI services. Approximately 65% of OBSI complaints come from lower- or middle-income households, while these households make up 59% of the Canadian population.[1] Our case data shows that 38% of all complainants live in lower-income households, making lower-income consumers the most common users of our services.





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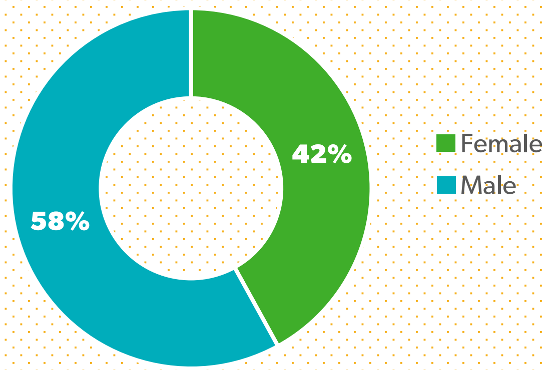
Men are more likely to make a complaint than women

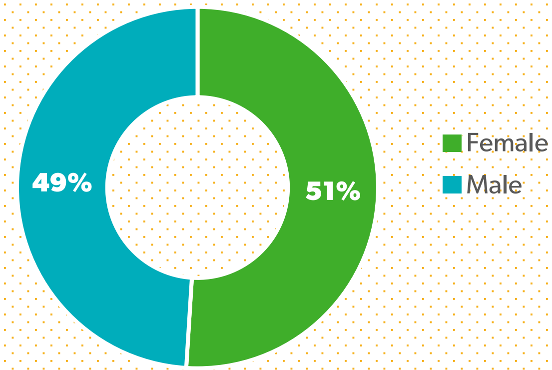
Overall, men make up more than half (58%) of all complainants to OBSI. However, complainant gender is strongly correlated to household income.

Complaints from lower-income households are more likely to be brought by women, while complaints from higher-income households are much more likely to be brought by men.

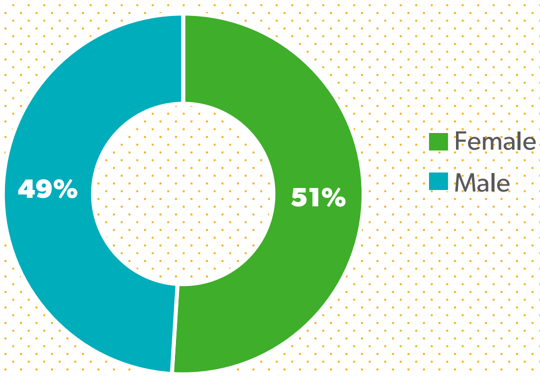
Overall cases by gender



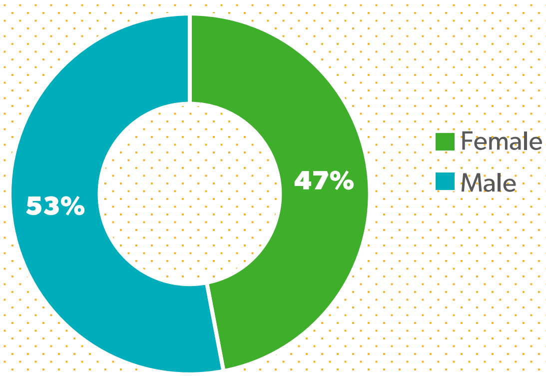
Canadian population[2]



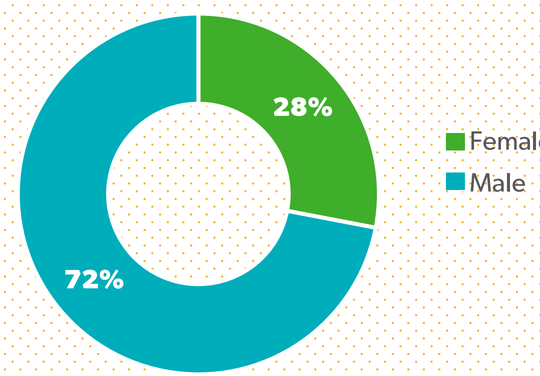
Lower income



Middle income



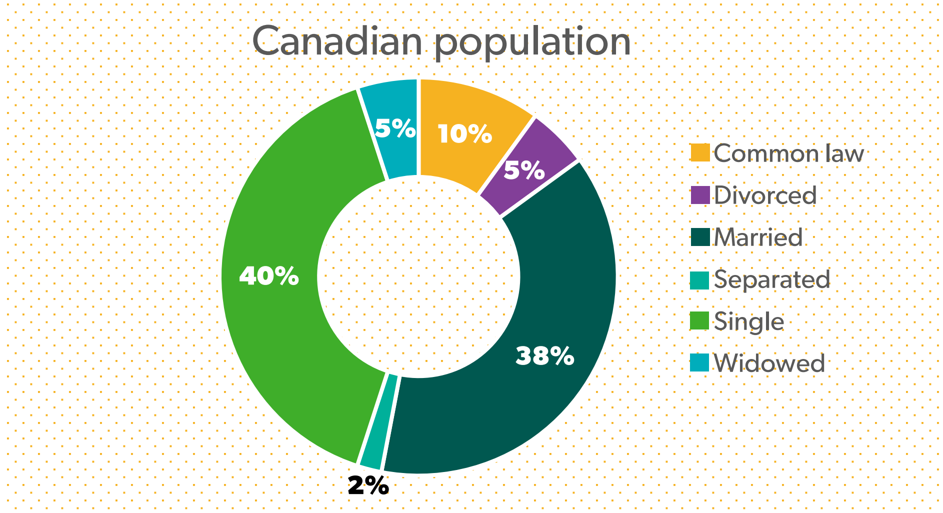
Higher income

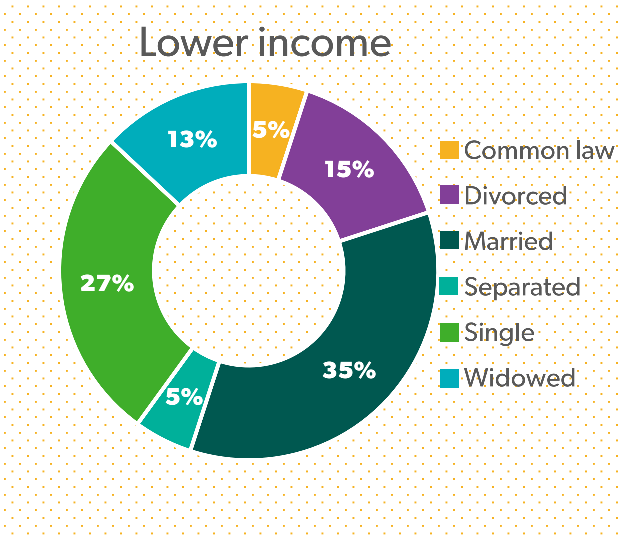


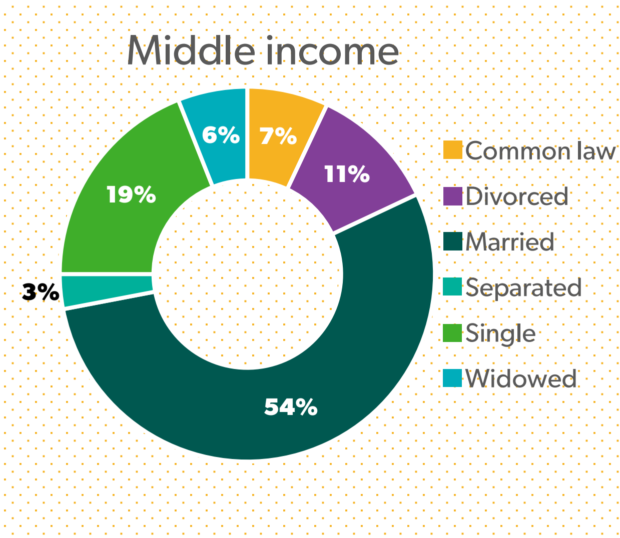
Most lower-income complainants live in single-person households

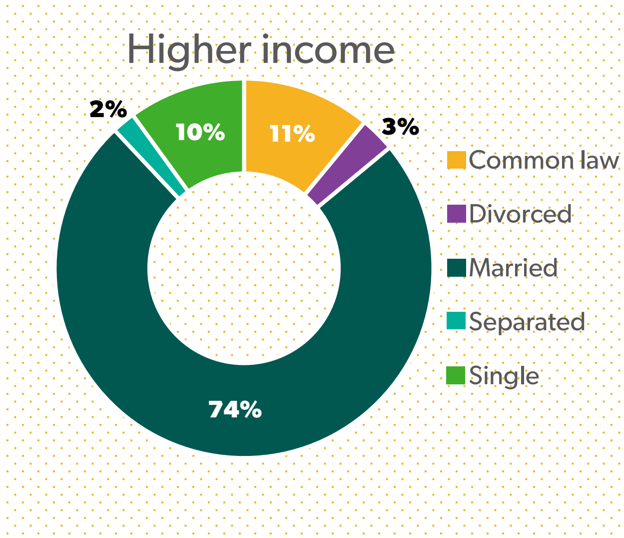
Approximately 60% of OBSI complainants who report lower income are single, separated, widowed or divorced, compared to 39% of middle-income complainants and just 15% of higher-income complainants.

Among the Canadian population, approximately 52% of people live in single-person households.[3]









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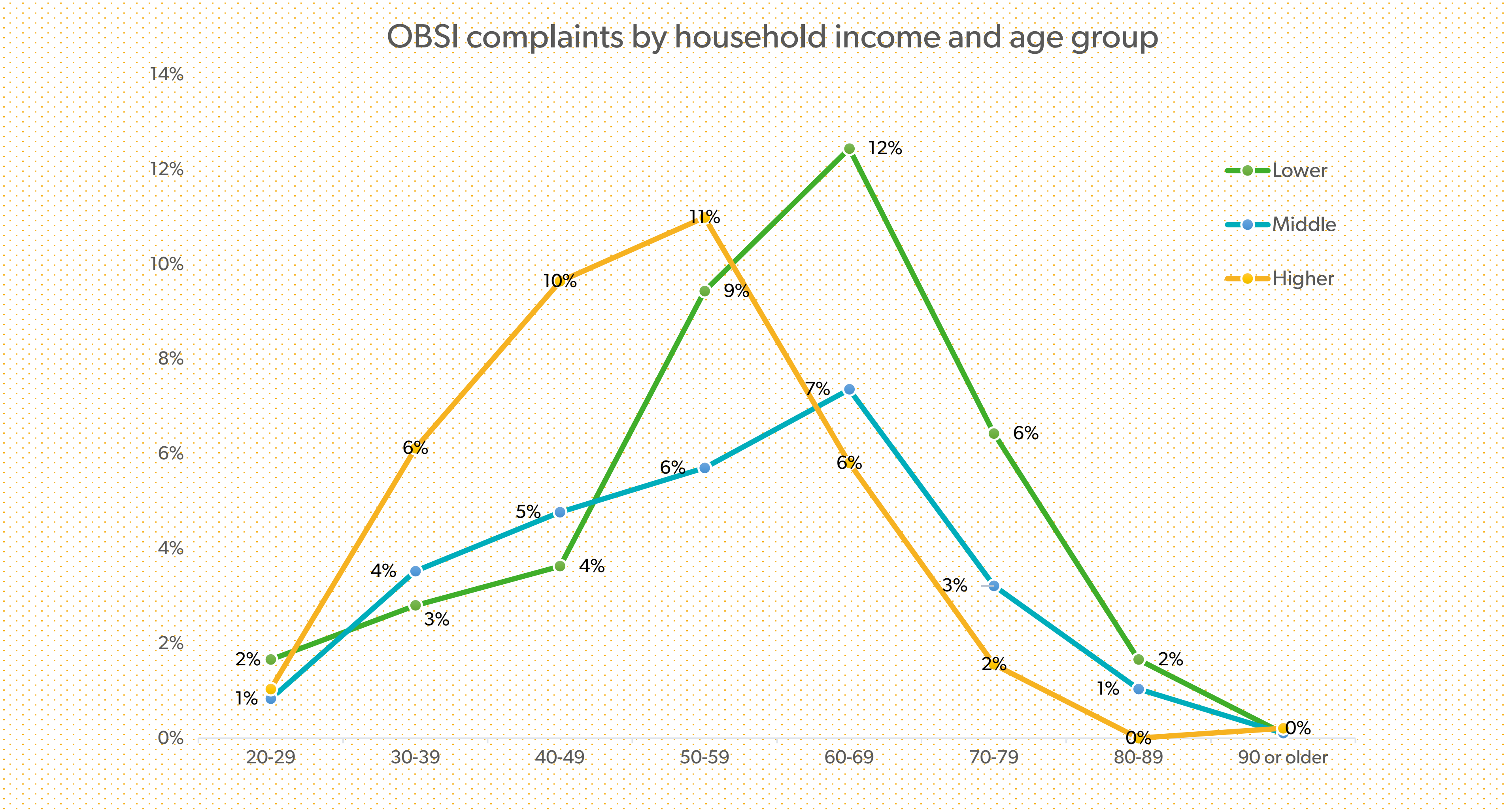
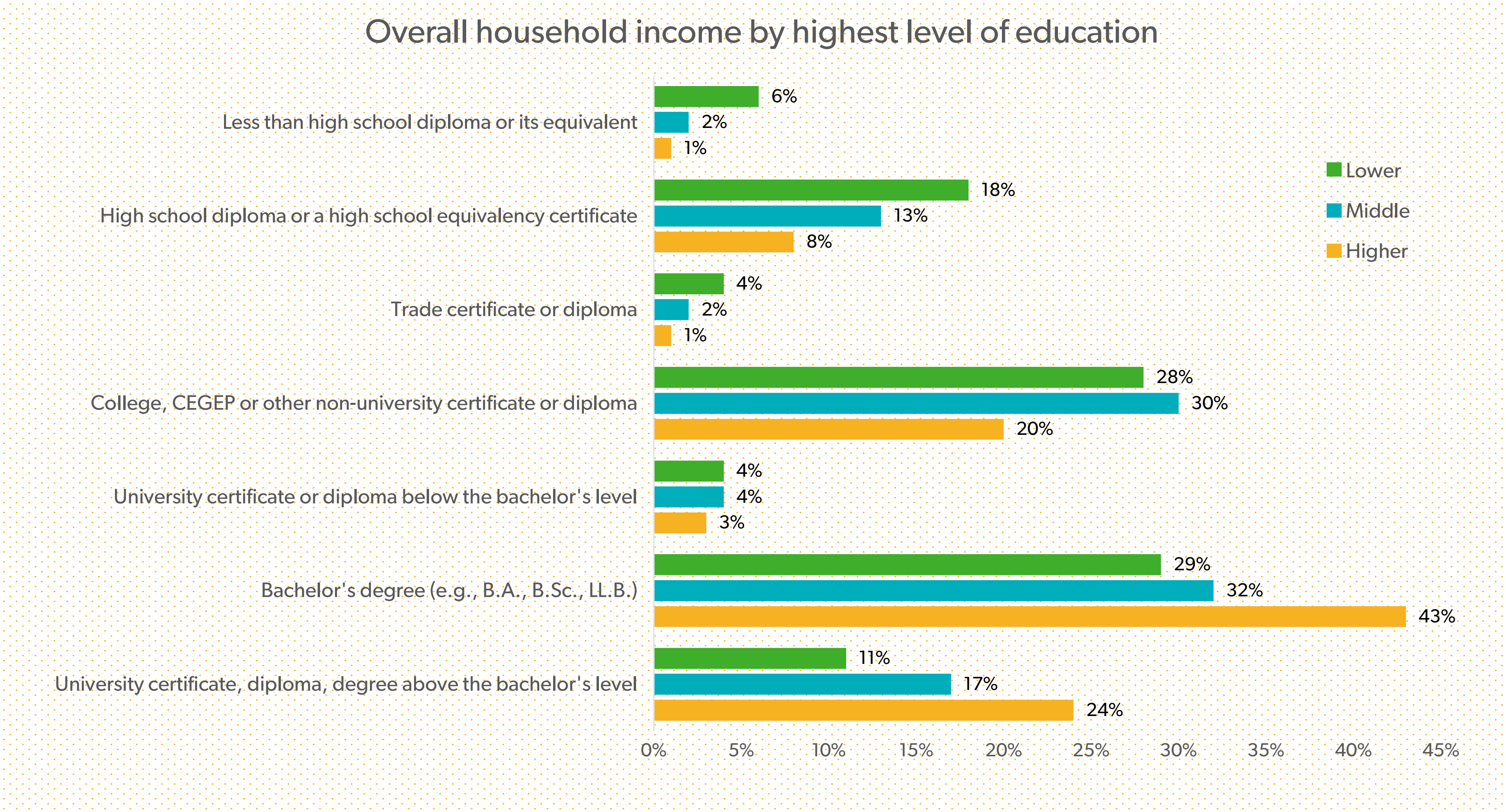
Most lower-income complainants are 60+

Most OBSI complaints from lower-income households are made by those over 60. Most complaints from middle-income households are made by those over 50, while most higher-income complainants are under 60.



Most complainants from all income levels have completed post-secondary education

Income level and education are highly correlated. While approximately a quarter of lower-income complainants report no post-secondary education, 72% of lower-income complainants, 83% of middle-income complainants, and 90% of higher-income complainants report college- or university-level education.



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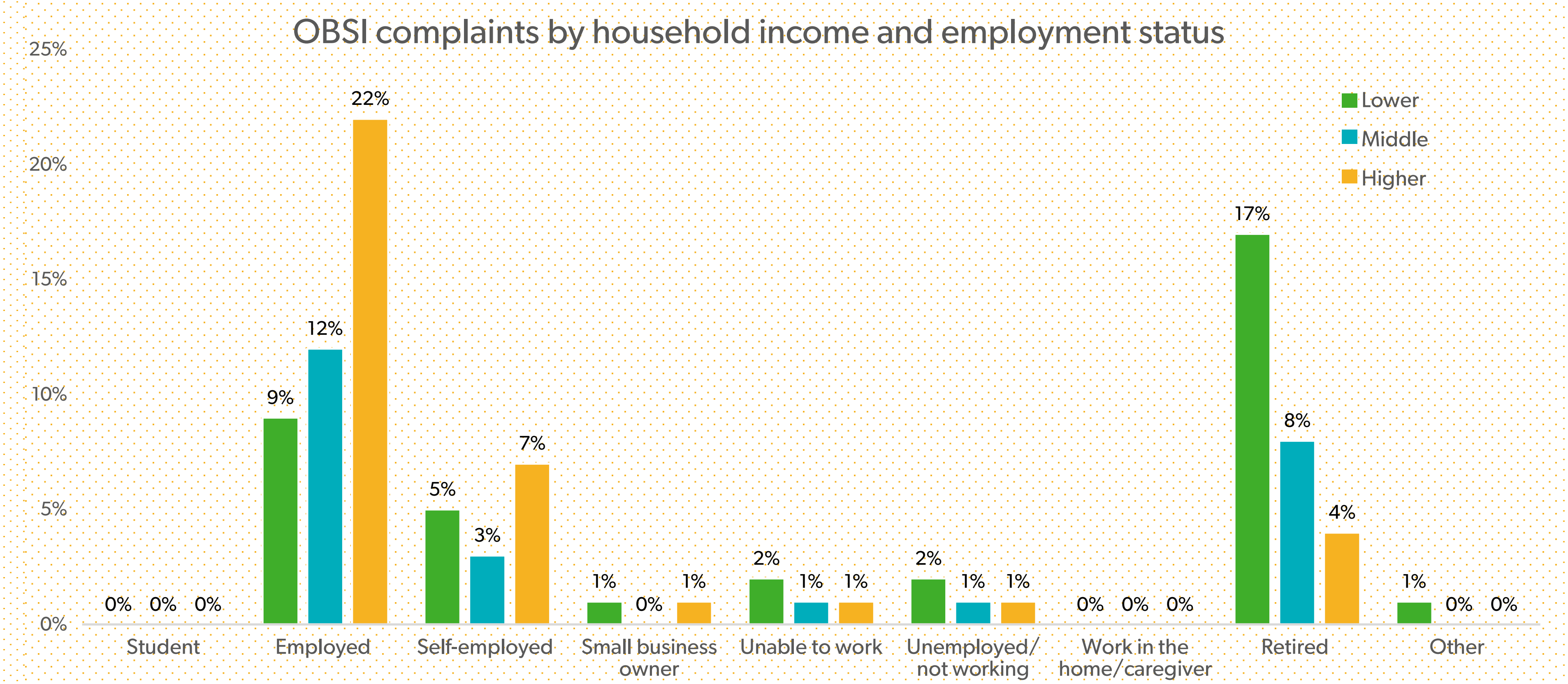
Most lower- and middle-income complainants are in the workforce

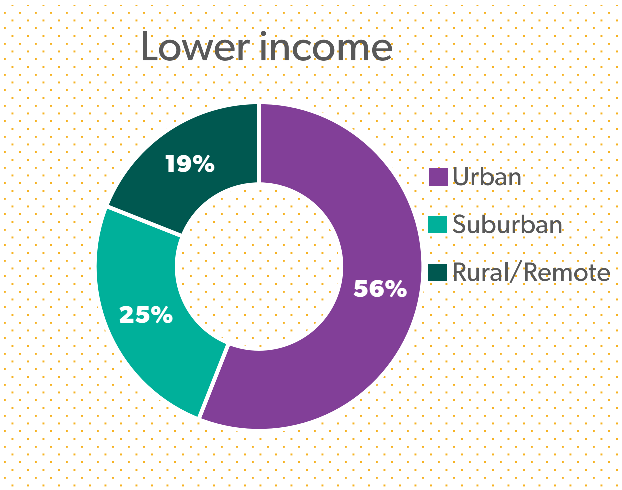
More than 40% of complainants from lower-income households and most complainants from middle-income households are in the workforce. Approximately 60% of complainants report being employed, self-employed or small business owners. Of these, half are from lower- or middle-income households and half are from higher-income households. Roughly 45% of lower-income complainants are retired, while 10% report being unemployed or unable to work.

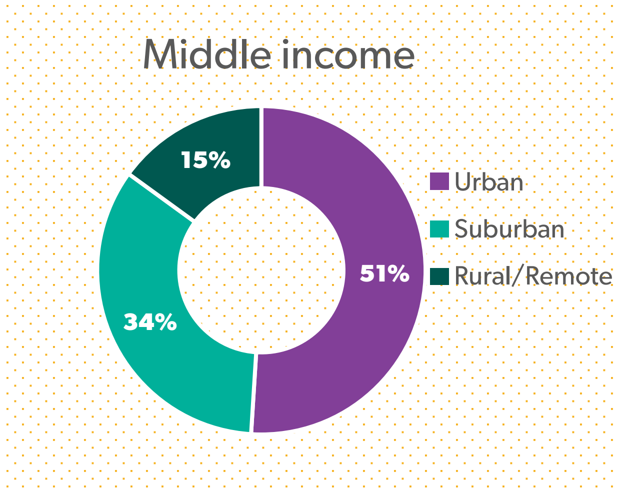


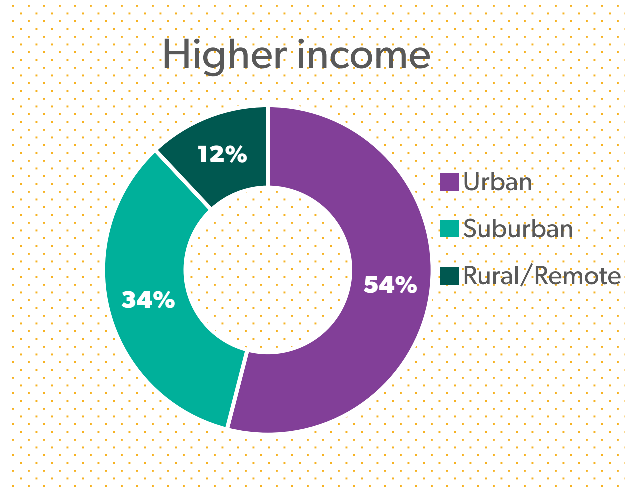
Lower-income complainants are more likely to live in rural or remote areas than middle- or higher-income complainants

Consumers who live in suburban and rural or remote areas represent more than a third of OBSI's complainants at all income levels. The proportion of complainants from rural and remote areas is highest among those who report lower incomes.

Complainants who call the suburbs home are most likely to live in middle or higher-income households. The highest proportion of complainants from all income levels live in urban areas.



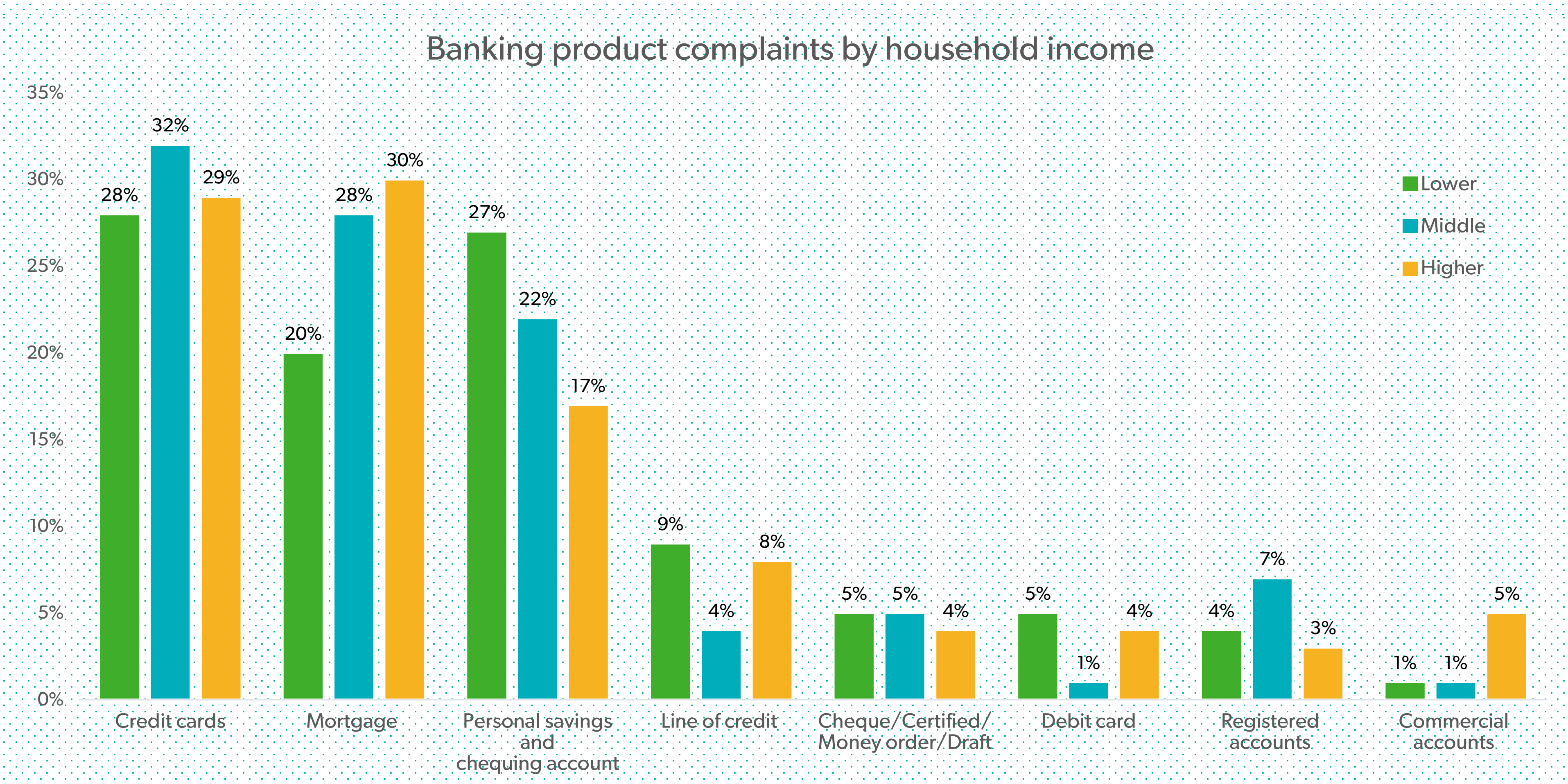




Banking complaints by income group

Banking Products: Credit cards are the most complained about product for lower- and middle-income households

While credit cards are the banking product most complained about overall, higher-income Canadians are more likely to complain about mortgages and commercial accounts. Lower-income Canadians are more likely to complain about personal accounts.



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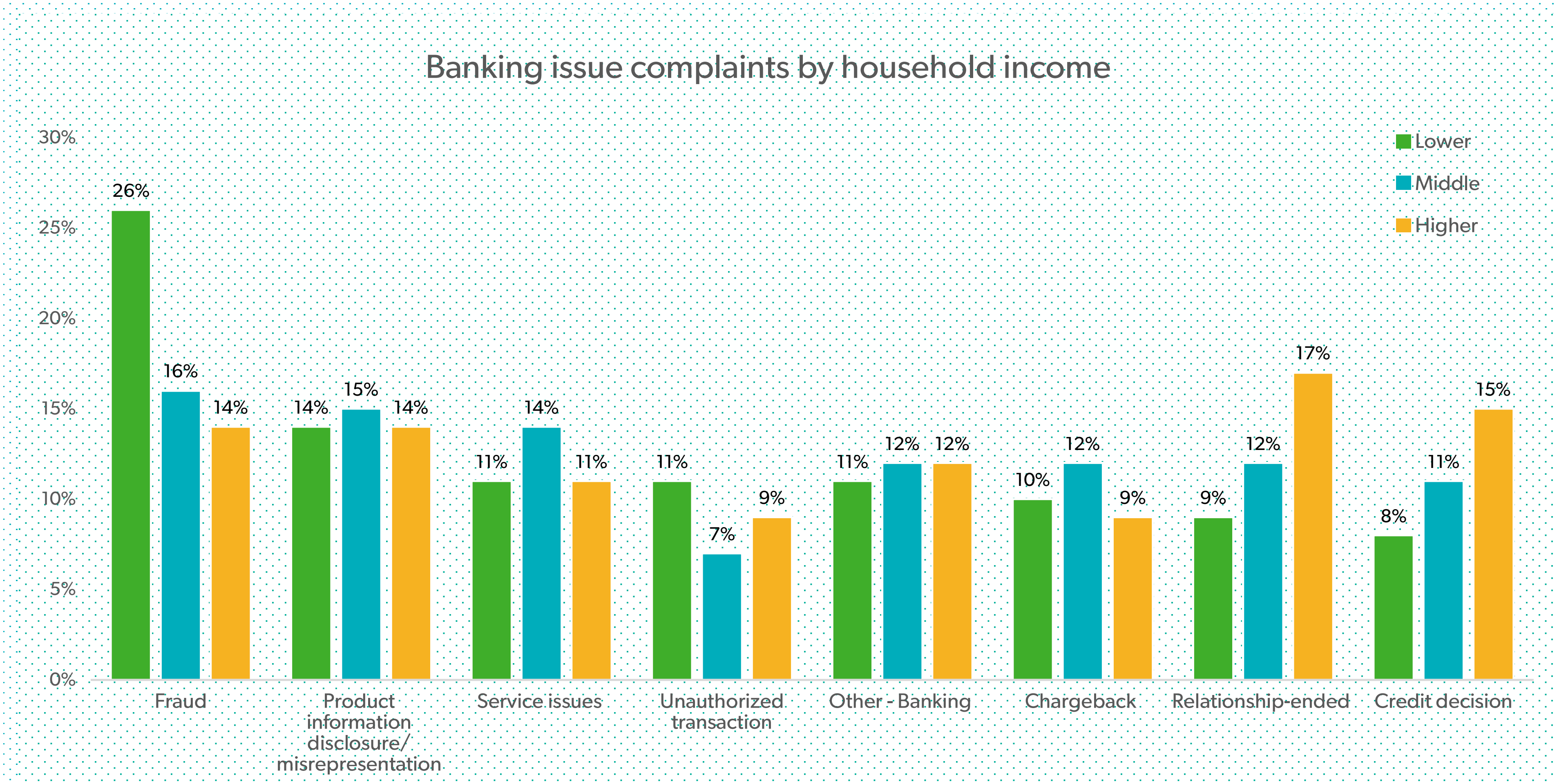
Banking Issues: Fraud is the most complained about issue, particularly for lower-income Canadians

Fraud is the banking issue most complained about overall and the subject of more than a quarter of complaints to OBSI from lower-income Canadians. Relationship-ended and credit decision complaints are more common among higher-income households.



Banking: Top three combined products and issues are similar for all income levels

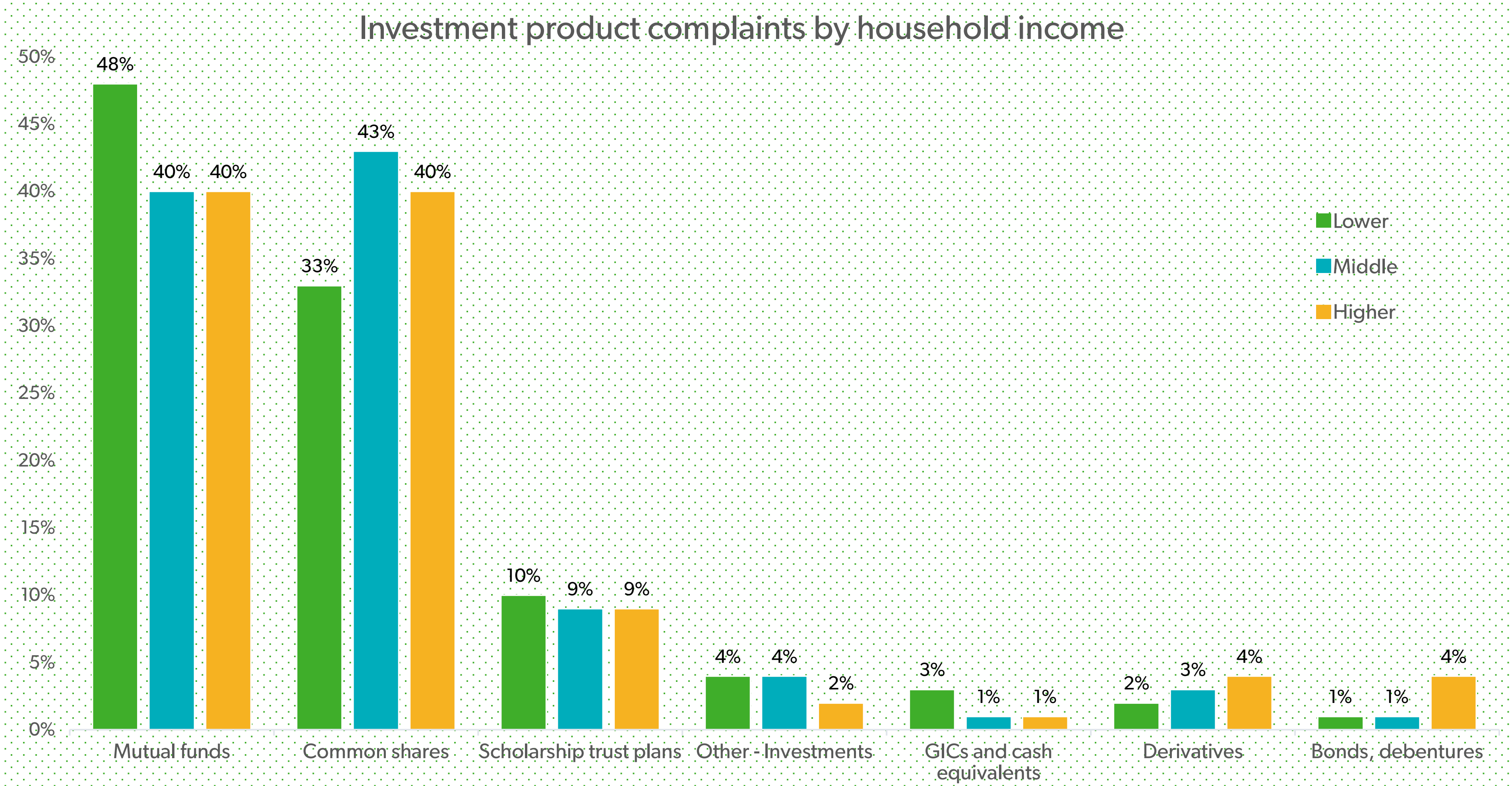
Credit card chargebacks, account closure due to relationship ended and mortgage prepayment penalties are the leading product and issue combinations for all complainants, regardless of household income level.

	Lower income	Middle income	Higher income
1	Credit card chargeback	Credit card chargeback	Credit card chargeback
2	Personal savings and chequing account – relationship ended	Personal savings and chequing account – relationship ended	Personal savings and chequing account – relationship ended Mortgage (prepayment penalty)
3	Mortgage (prepayment penalty)	Mortgage (prepayment penalty)	Mortgage – interest rate

Investment complaints by income group

Investments Products: Mutual funds are the most complained about product for lower-income Canadians

Mutual funds are the product associated with approximately half of complaints from lower-income households, while common shares lead to more complaints from middle- and higher-income complainants.



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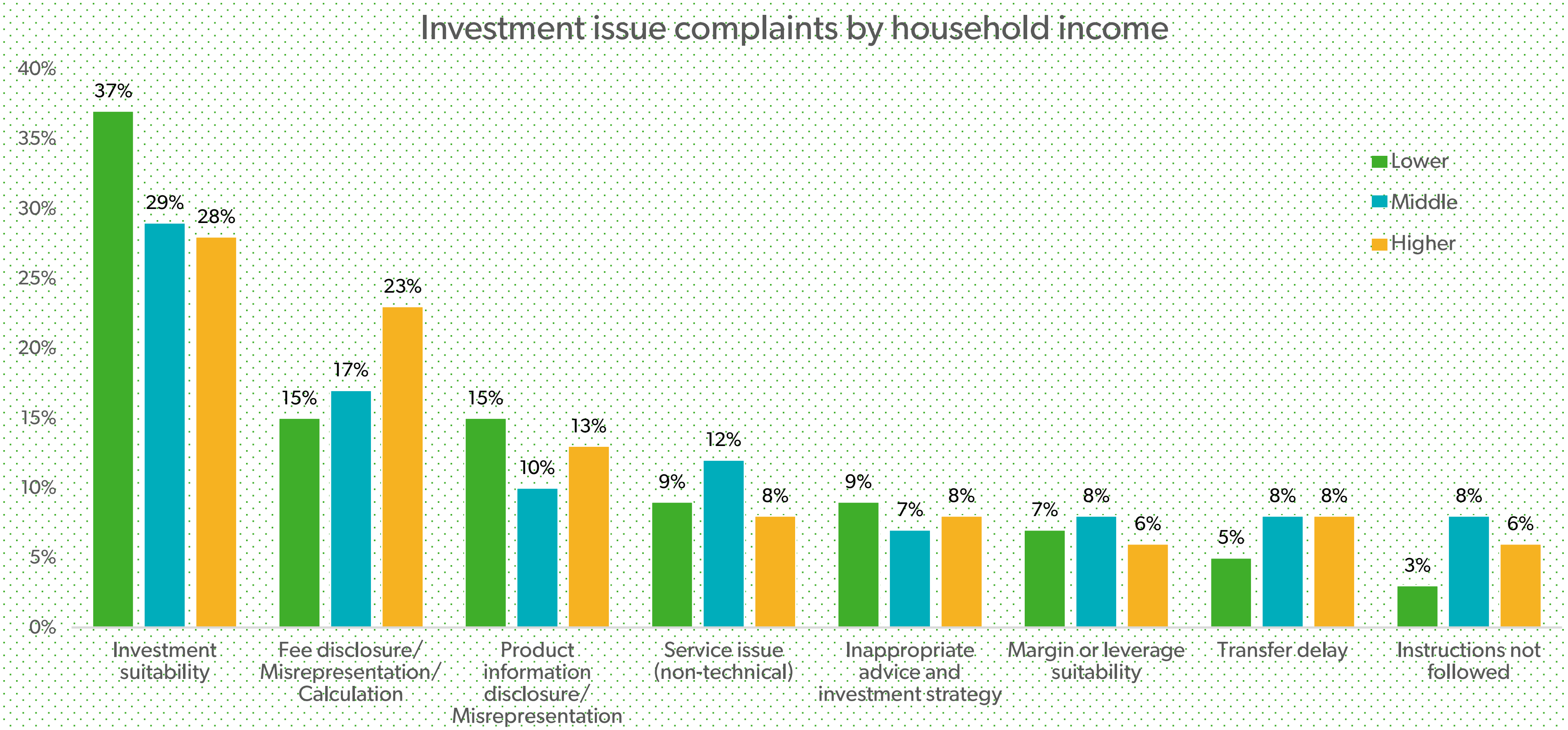
Investment Issues: Investment suitability is the most complained about issue for all income levels

Investment suitability is the issue that generates the most complaints for Canadians of all income levels but is disproportionately common among lower-income complainants. Higher-income complainants are almost as likely to complain about fee disclosure or misrepresentation as suitability.



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Investments: Top three combined products and issues differ among income levels

Common shares investment suitability is the top combined product and issue among lower- and middle-income complainants, while mutual fund complaints related to fees are the most common combined product and issue for higher-income complainants.

	Lower income	Middle income	Higher income
1	Common shares – investment suitability	Common shares – investment suitability	Mutual funds – fee disclosure/ misrepresentation/calculation
2	Mutual funds – investment suitability	Mutual funds – investment suitability	Common shares – investment suitability
3	Mutual funds – fee disclosure/ misrepresentation/calculation	Mutual funds – margin or leverage suitability	Mutual funds – transfer delay
		Common shares – service issue	Mutual funds – margin or leverage suitability
		Mutual funds – fee disclosure/ misrepresentation/calculation	Common shares – service issue

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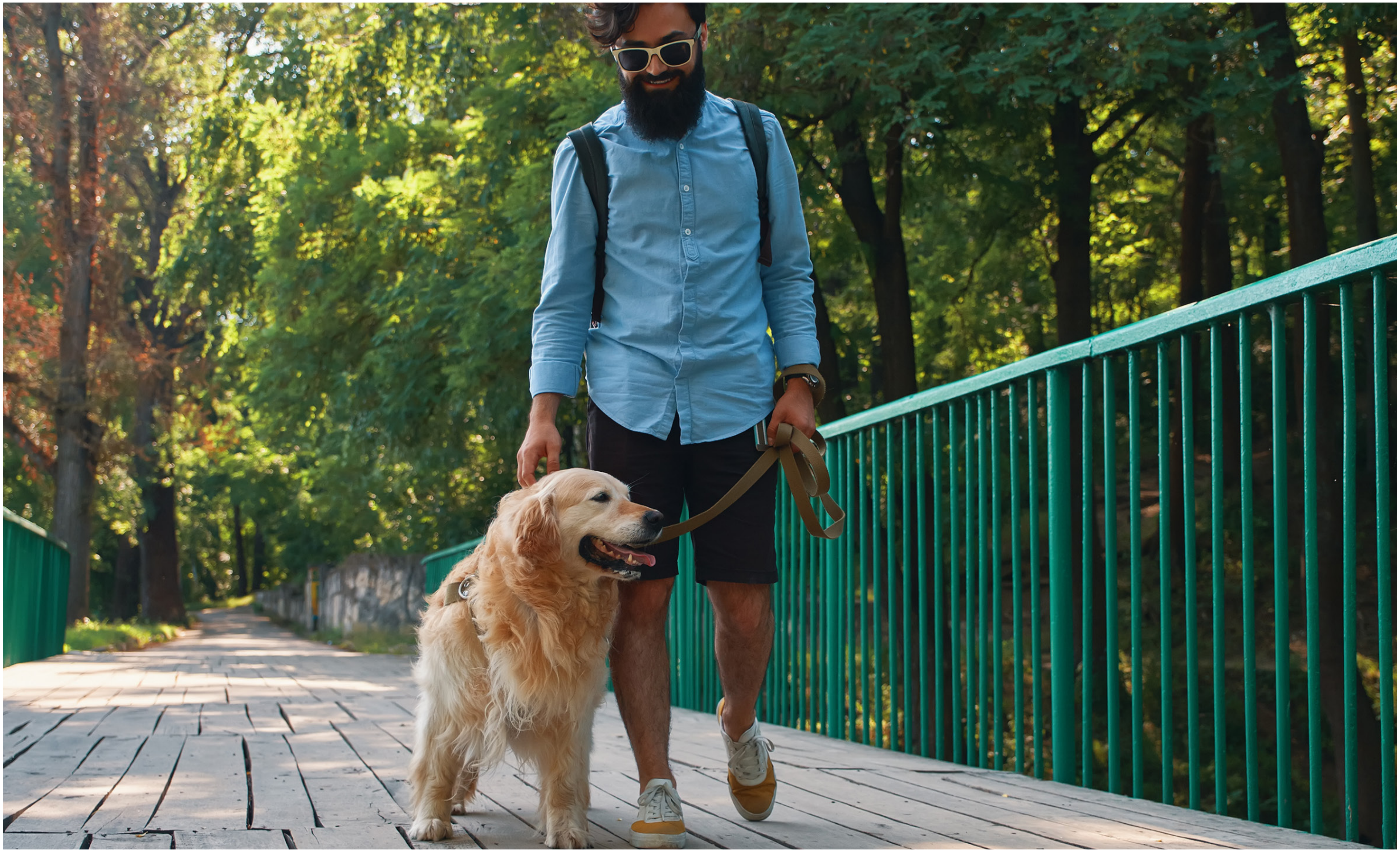
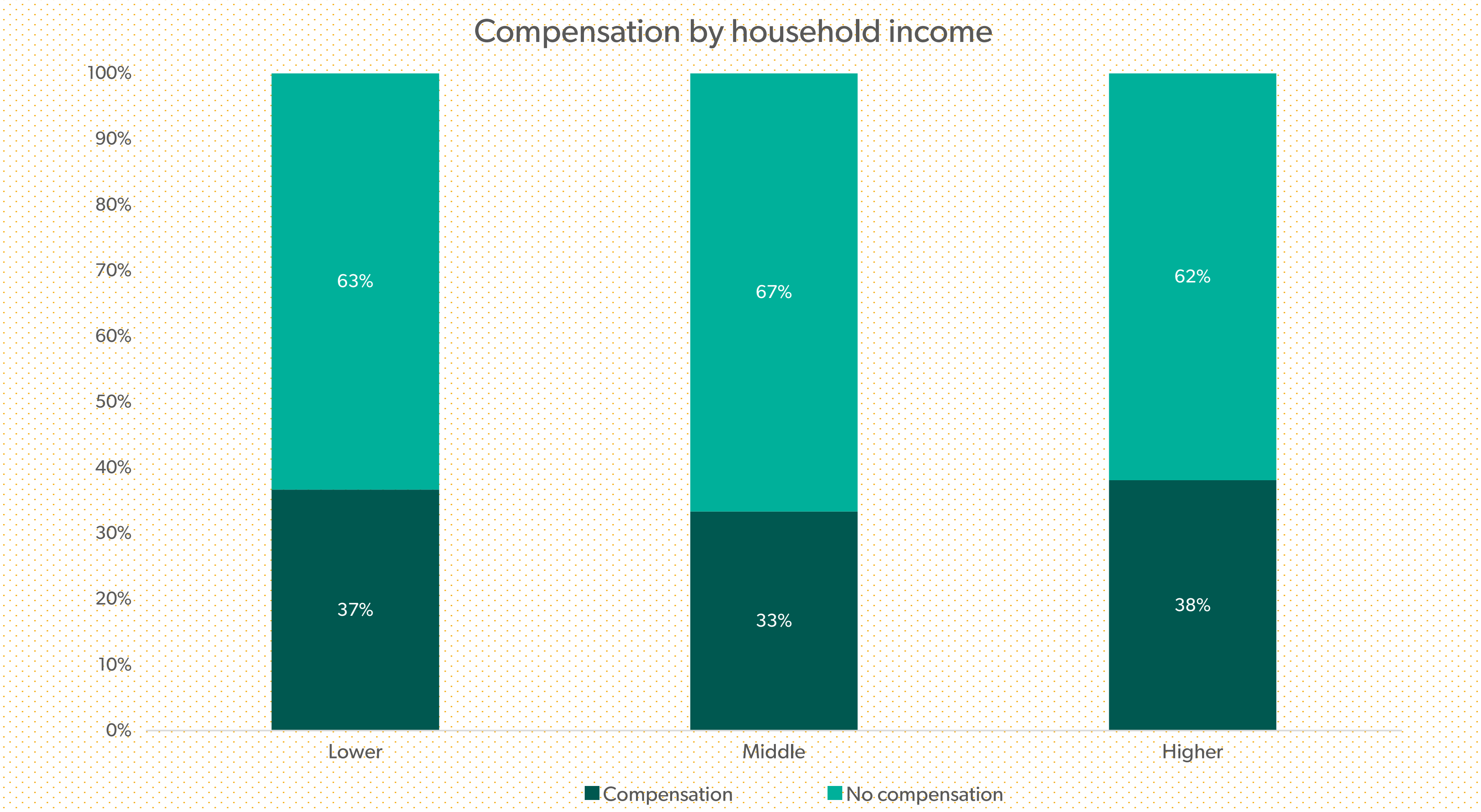
Compensation by income group



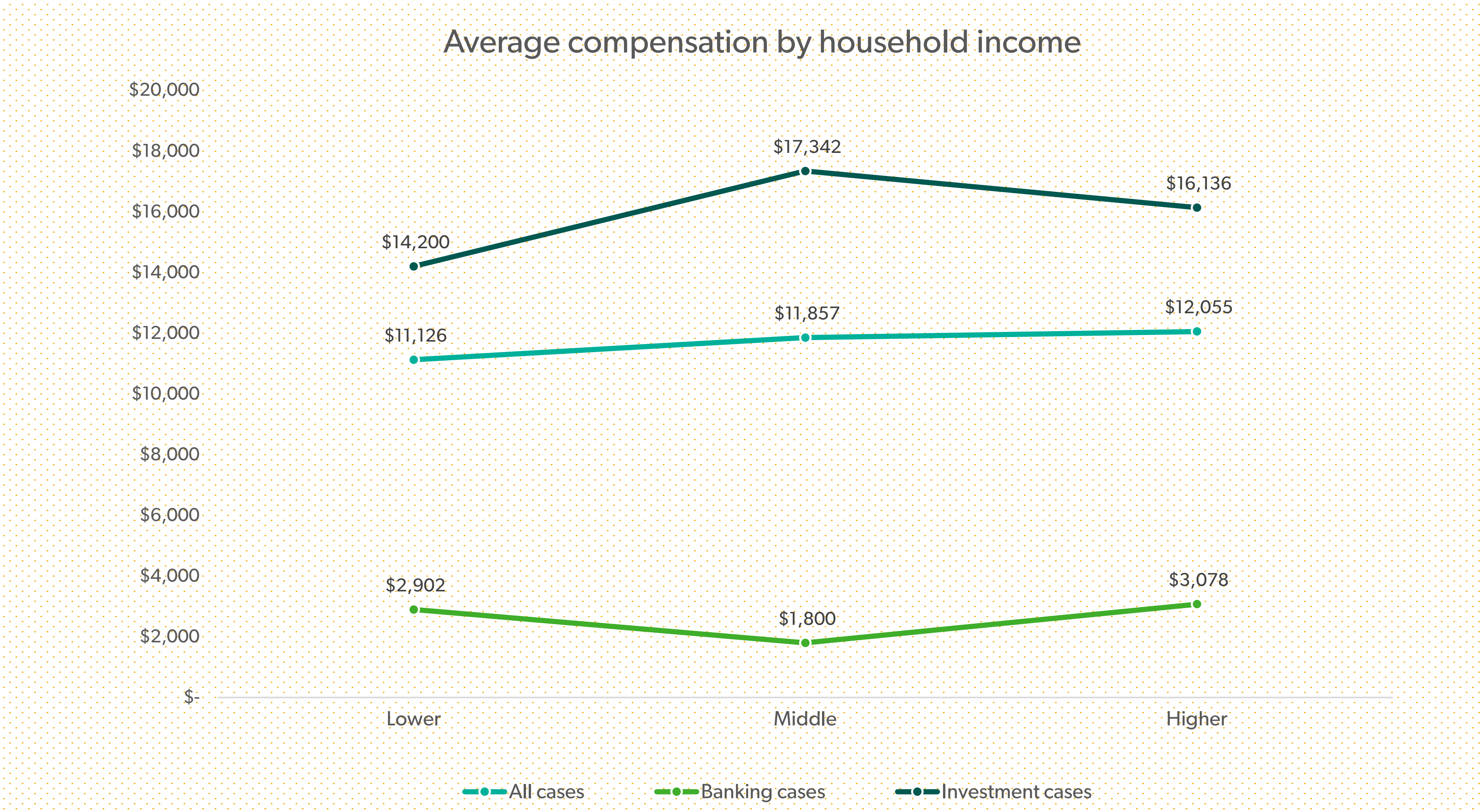
Consumers from all income levels benefit from ombudsman services

OBSI is as likely to recommend financial compensation for complainants from lower-income households as middle- or higher-income households. Compensation recommendations are roughly as likely across all three income categories.



Compensation amounts are comparable for all income levels

OBSI's average recommended compensation amounts are similar for complaints from households of all income levels. Middle-income complainants received the highest average recommended compensation for investment cases.



Observations

Overview

All Canadians, regardless of economic circumstances, should have access to financial ombudsman services that resolve disputes and inspire confidence in the Canadian financial services sector. This report takes a detailed look at our case data and provides insights into the impact of household income, an important factor in understanding the financial services experiences of Canadians.

Household income level can be difficult to consider in isolation as it is highly correlated with other factors, such as gender, age, marital status, geographic location, educational background and employment status. As illustrated by our data detailed above, lower- and middle-income complainants to OBSI are more likely to be female, older, living in urban locations, living in a single-person household, and are less likely to have post-secondary education above the bachelor's level or participate in the workforce than those who report higher household income. They also make up approximately 65% of the consumers who reach out to OBSI for assistance each year.

In Canada and around the world, significant financial barriers exist for those who need assistance to resolve a dispute, particularly when they are in conflict with their financial services provider. The complexity of products, complexity of regulation and other informational barriers are compounded by limited resources, especially for lower- and middle-income households. These factors combine to create very real barriers to access to justice that disproportionately impact lower- and middle-income families.

A key finding of our research is that OBSI's services are more likely to be accessed by lower- and middle-income Canadians, and that the cases brought forward to us by these consumers are as likely to be resolved in their favour, and for as much financial compensation, as cases brought forward by those from wealthier households.

The need for an ombudsman service for Canadian financial consumers who live in lower- and middle-income households is real and pressing. When disputes arise, the court system is time consuming and expensive. The Ontario Ministry of the Attorney General estimates that litigation, for as little as a three-day trial, will cost $38,200 on average.[4]

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Other alternatives are scarcely better: the Canadian Mediation Association estimates that the cost of a mediator is $150 to $750 per hour.[5] Arbitration fees, according to the Canadian Arbitration Association, tend to cost more, ranging from $250 to $800 per hour.[6]

Additionally, Canadians frequently require expert advice to help them assess whether they have grounds for a complaint or if a financial services provider has breached any applicable laws or regulations. Financial products and services, investment options and considerations, and the laws and rules that regulate the entire sector are enormously complex and beyond what an average consumer can be expected to fully understand. Yet, for consumers to maintain their confidence in the system overall, they must reasonably expect that if things go wrong, help will be available to them.

Despite the challenges of access to justice, Canadians are more dependent than ever on financial service providers to help them manage their financial affairs and prepare for retirement. Every year, fewer Canadians have access to the benefits of a defined benefit pension plan. Just over one-third of paid workers are members of a registered pension plan.[7] Therefore, the responsibility for effective investment and retirement planning is falling on the shoulders of consumers.

Statistics Canada data outlined on page 7 of this report shows that 35% of the Canadian population reports an annual household income of less than $60,000.[8] Given the growing complexity of financial products and the growing need for financial services advice and assistance for Canadians, it is more important than ever that these Canadians are aware of their rights and have access to ombudsman services when necessary.

Barriers to access justice faced by lower- and middle-income Canadians

Financial barriers to access to justice

Most OBSI recommended settlement amounts are too small to justify legal proceedings or other formal alternative dispute resolution services. Even OBSI's recommendation limit of $350,000 is far less than can realistically be pursued through the courts. Notably, however, the amount of compensation we recommend to consumers is usually much lower than this limit. In 2019, in those cases where we found that financial compensation was warranted, the average amount of compensation we recommended to consumers was $2,425 for banking complaints and $14,291 for investment complaints.

While these amounts are much lower than could efficiently be handled through the legal system or formal alternative systems, they are often of critical importance to the impacted consumers and adequate means of redress is vital to their trust in the financial services system.

Financial consumers, especially those of more limited means, are usually keenly aware of the cost barriers and information barriers that they must overcome when they find themselves in a dispute with a financial services firm. In the absence of significant economic resources, they face a strong disincentive for pursuing a legal case against a financial firm, which will likely have extensive resources to support their defense.

Legal Aid is not a viable alternative to help consumers who find themselves in a dispute with their financial services firm, because it generally will only cover all or partial expenses for specific legal problems, such as criminal charges, some family court matters, and some immigration and mental health proceedings.

Information barriers to access to justice

Financial contracts, account agreements, and disclosure documentation usually contain terms and conditions and other complexities that not all consumers fully understand. In many cases, consumers are uncertain about what they have agreed to and the responsibilities they have assumed, and when disputes arise, they require the assistance of an independent professional to help them understand whether they have been treated fairly.

In our experience, it is common for consumers to misunderstand the terms and conditions of their financial products and services. For example, consumers are often unaware of steep mortgage prepayment penalties or the fee arrangements contemplated in their agreement with their financial advisor.

The rules and laws that regulate the financial services sector and that apply when a problem arises are very complex and understood by very few consumers. Consumers are rarely well positioned to evaluate whether a financial service firm has complied with the laws and regulations that apply to it.

Consumers who believe that they may have a complaint about a banking or investment product or service are often unaware of their rights and unable to assess whether compensation for any losses they have incurred is legitimate and reasonable. They may not know whether they should question a firm's actions or accept a firm's explanations.

Procedural barriers to access to justice

There are also systemic issues at play. In a recent review of bank procedures for handling consumer complaints, the Financial Consumer Agency of Canada (FCAC) surveyed Canadians and found that many consumers may abandon their complaints altogether if they are not resolved to their satisfaction by frontline staff.

The FCAC cited two main reasons: the lack of information available to consumers about how to escalate their complaints and the fact that consumers must navigate banks' complex and multi-step complaint handling protocols to escalate their complaint beyond the first point of contact.

According to the FCAC, more than 90% of consumers with an unresolved complaint at the first level did not escalate their complaint, even when they were dissatisfied with their bank's response to their problem – an important indication of a process that is not straightforward or consumer friendly.

Additionally, public awareness of the availability of ombudsman services is low. Even when services like OBSI are available and accessible to consumers, people may not be aware that they exist.

According to a survey conducted for the FCAC, 15% of Canadians are aware of OBSI's free national public service while 5% recognized ADRBO, the organization that resolves retail bank complaints for Royal Bank, TD Canada Trust, Scotiabank and National Bank. Only 4% of Canadians had heard of both.

OBSI surveys of consumers who use our service indicate that only about half of consumers report that they heard about us from their bank, firm or advisor, despite firms' regulatory obligation to provide an OBSI referral to customers when they provide a final response to a consumer's complaint. Most complainants who use our service say that they relied on their own sources of information and personal connections to find us.

Recommendations to improve access to justice for lower- and middle-income Canadian financial services consumers

Overcoming financial barriers to justice

Support for an effective financial ombudsman service

There are a number of measures that can support the confidence of lower- and middle-income consumers in the financial services sector. One of the most important is establishing an effective and accessible financial ombudsman service, such as OBSI, and ensuring its services are available to consumers at no cost.

The G20 High Level Principles on Financial Consumer Protection, identified that, in particular, low-income and less experienced consumers often face particular challenges in the financial services marketplace.

The principles, endorsed by G20 finance ministers and central bank governors, identified the importance of access to complaint handling and redress mechanisms that are "accessible, affordable, independent, fair, accountable, timely and efficient" for financial services consumers. Alternative dispute resolution is one of the ten core principles designed by G20 members to assist the effort to enhance financial consumer protection.

Overcoming informational barriers to access to justice

Plain language, consumer-focused communication

Firms and regulators should help consumers understand their financial products and their obligations by using plain language and intuitive design in their marketing, disclosure and contractual agreements. For example, to facilitate better understanding and reduce consumer confusion, contracts could include FAQs or highlighted sections to clearly explain the penalties that consumers will face if they do not meet certain terms of the agreement.

Improved tools could be developed to assist consumers in understanding the consequences of their agreement to everyday transactions such as mortgage prepayment penalties, their RESP withdrawal categories, or the limitations on credit card chargebacks. Clearer disclosures could also help consumers appreciate the far-reaching consequences of a breach of certain contractual prohibitions, such as sharing of a PIN, relative to other requirements and prohibitions in the same contract.

Financial programs that are marketed to lower-income consumers should be subject to clearer disclosure and greater scrutiny

One of the challenges for lower- and middle-income Canadian households is saving money, as a greater proportion of their income is allocated to basic family needs and expenses. While there are government programs designed to help Canadians save, such as Registered Education Savings Plans (RESP), Registered Retirement Savings Plans (RRSP) and Tax-Free Savings Accounts (TFSA), these plans may not be advantageous or appropriate for consumers from lower-income households. Individualized advice is necessary and the pros and cons for consumers in different circumstances should be clearly disclosed.

Another example is group RESPs, which require a single lump sum or regular contributions over a predetermined length of time. Consumers who choose such investments must be able to afford the regular contributions over a potentially long period of time. If payments are missed, their savings could be compromised, and steep costs or pay-out restrictions may follow. Consumers purchasing such products should be provided with extra guidance to make good decisions and minimize any confusion they may have about such investments. Industry leaders and regulators should carefully consider the behavioural effects of conflicted sales incentive models.

Access to financial knowledge is at the heart of financial well-being

The financial services industry has a joint role to play in helping all consumers make informed and effective financial decisions.

Firms have a particular responsibility to ensure that their clients are aware of the nature of their financial products and services before contracts are signed. The more often firms educate their clients, the more informed and satisfied their clients will be with fewer opportunities for misunderstandings and complaints.

There are several resources available to help Canadians manage their personal finances effectively and improve their financial knowledge. These organizations and their programs offer guidance to the public and may provide a financial subject matter expert to answer questions. Some examples include:

- "It pays to know," a FCAC program that helps Canadians take charge of their finances;
- "Get Smarter About Money," the Ontario Securities Commission (OSC) program that provides investing basics;
- FAIR Canada, an organization that advocates on behalf of the Canadian investor;
- Prosper Canada, a national charity dedicated to the financial empowerment of Canadians; and
- Investor Protection Clinic at York University's Osgoode Hall Law School, the first clinic of its kind in Canada that offers free legal advice to people who believe that their investments were mishandled and cannot afford a lawyer.

When access to financial knowledge grows, the financial well-being of consumers is significantly improved.

Overcoming procedural barriers to access to justice

Advisors must know and understand the needs of the consumer

Investment firms' advisors are obligated to know their client and understand their products and only recommend investments to clients that are suitable for them. According to our case data since 2015, the number one issue for investment-related complaints has been the suitability of a client's investments. We have observed scenarios where advisors treat the Know Your Client (KYC) process as merely a regulatory requirement rather than an important step toward ensuring beneficial outcomes for investors. When an advisor is truly aware of their client's financial circumstances, level of investment knowledge and experience, investment timeframe (or investment time horizon), financial goals and risk tolerance then suitability complaints are more likely to be avoided.

Boosting awareness of complaint-handling options uncomplicates system

Firms could do more to ensure that their internal complaint handling procedures are clear, accessible and helpful to consumers. The options available for escalating customer complaints further should also be clearly presented from the outset. Greater clarity and prominence on firms' websites would be a helpful start. Firms and banks also have an important role to play in ensuring that consumers understand that they have access to fair, free, independent financial ombudsman services. This information can and should be included in brochures, websites, letters and educational materials that are provided to consumers, as well as in employee training materials. Freely sharing information about fair and accessible dispute resolution services encourages consumer trust and confidence in the financial services provided.

Case studies

Consumers overlook the prepayment terms in their mortgage agreement and incur thousands of dollars in unexpected penalties

Consumer Profile

Consumer: Mr. and Mrs. Z

Annual household income:

Middle income

Employment status: Employed

Complaint:

Mortgage prepayment penalty

Purchase of new home results in paying off existing mortgage early

In July 2016, Mr. and Mrs. Z purchased a home and obtained a five-year mortgage for approximately $430,000 from their bank. They had been customers with the bank for over 40 years. During that time, they had held a number of mortgages.

In June 2018 – not quite two years into their five-year mortgage agreement – Mr. and Mrs. Z sold their home and paid the mortgage loan in full. However, to their surprise, the bank charged them a prepayment penalty of $3,000 – an amount equal to three months' interest. Mr. and Mrs. Z had never been charged a prepayment penalty before.

They contacted the bank to complain that its terms regarding prepayment penalties had not been properly disclosed. They wanted the bank to reimburse them for the penalty because they felt it was unfair – they were valued customers of the bank and the bank could now re-lend the money from their mortgage at a higher interest rate. Mr. Z admitted to not reading through his mortgage documents, but he still felt that the bank should reimburse him. Mr. and Mrs. Z also said that, while they were willing to pay an administrative fee, it should only be $500.

Bank points to mortgage documents

The bank told Mr. and Mrs. Z that the annual mortgage statements that had been sent to them clearly detailed the prepayment options and penalties. As a result, the bank refused to reimburse the amount of the penalty because it had provided the appropriate disclosures and mortgage documents.

Unsatisfied with the bank's response, Mr. and Mrs. Z came to OBSI to review their case.

Our findings

During our investigation, we found that the bank was within its rights to charge Mr. and Mrs. Z the $3,000 prepayment penalty because:

- the penalty and how it would be calculated were clearly disclosed in Mr. and Mrs. Z's mortgage documents and met regulatory requirements
- by signing the mortgage documents, Mr. Z agreed to be bound by the terms of the mortgage agreement
- the bank was under no legal or regulatory obligation to reimburse any fees or charges because Mr. and Mrs. Z did not read the agreement, and were therefore unaware of the conditions they had agreed to
- there were no other circumstances to support Mr. and Mrs. Z's claims that the $3,000 prepayment penalty charged to their mortgage should be reimbursed

Based on the findings of our investigation, we found no basis for recommending compensation to Mr. and Mrs. Z.

Key Lesson

Before signing a mortgage agreement, consumers should take the time to read through their mortgage documents.

Information about prepayment penalties is normally written in plain language and found in the mortgage agreement. Paying off a mortgage early – for example, by selling a house before the term of the mortgage ends – can result in thousands of dollars in penalties, and sometimes consumers are not aware of this until it's too late. Not all prepayment penalties are calculated the same way – how the penalty is calculated varies among different lenders and different types of mortgages. It is the consumer's responsibility to understand the terms and conditions of the mortgage agreement they sign.

What is a mortgage prepayment penalty?

A mortgage prepayment penalty is an extra fee that lenders usually charge if you do not pay your mortgage according to the schedule that is set out in the mortgage agreement.

For most mortgages, prepayment penalties will apply when you:

- pay more than your regular mortgage payment,
- pay off your mortgage in full before the end of your term,
- transfer your mortgage to another lender before the end of your term,
- borrow against your home equity, or
- break your mortgage agreement in other ways.

However, some borrowers have a portable mortgage and will not incur a penalty when they transfer their mortgage balance to a new property with the same lender. This would typically apply if you purchased a new property before the end of your mortgage term.

Prepayment penalties are usually the higher of an amount equal to three months' interest on what you still owe on the mortgage loan or the interest rate differential (IRD). The IRD is the difference between what the lender expects to make from you in interest over the remaining term of your mortgage, compared to what it would make at its current posted rates by lending to someone else, plus administrative fees and charges. The amount of the IRD can be very high, especially for larger mortgages when interest rates are lower than when the mortgage started.

Advisor had little knowledge of investors' financial circumstances

Consumer Profile

Consumer: Mr. and Mrs. N

Annual household income:

Lower income

Employment status: Retired

Complaint: Unsuitable investments

New advisor recommends borrowing to invest for retired couple in financial difficulty

Mr. and Mrs. N were experiencing financial difficulty and having trouble paying their expenses. In 2005, their son introduced them to his advisor, hoping the advisor could provide advice on how his parents could manage their finances. The introduction took place over the phone because the advisor worked in another province.

Regardless of having never met Mr. and Mrs. N, the advisor recommended that they borrow money to invest and generate new income. Based on his advice, in March 2006, Mr. and Mrs. N:

- Took out a $300,000 mortgage on their $540,000 home and property.
- Invested $250,000 of the mortgage loan in mutual funds.
- Borrowed an additional $500,000 from two separate investment loans of $250,000 each.

In total, Mr. and Mrs. N invested $750,000 of borrowed funds, using the $250,000 they got from their mortgage as collateral for their second and third investment loans. The interest-only loan payments totaled about $5,522 monthly or $66,263 annually.

The advisor’s strategy involved taking cash withdrawals from the mutual funds to pay the loan payments, and using the excess funds, which he expected would be $1,000 per month, to help Mr. and Mrs. N pay their household expenses.

Couple asked to pay more to cover loans as investments lost value

In 2008, as a result of the market volatility, margin calls were issued on the two investment loans. This meant that Mr. and Mrs. N were obligated to provide additional money or investments to offset the drop in equity in their investment account. When Mr. and Mrs. N's son learned of his parents' financial situation, he complained to the firm. Because the firm did not resolve the complaint within a timely manner, he escalated the complaint to OBSI.

Our findings

During our investigation, we found no evidence that the advisor gathered or assessed information about Mr. and Mrs. N's financial circumstances before he recommended the leverage ("borrow-to-invest") strategy. Instead, we found that several key factors had been overlooked.

The loan payments represented 321% of Mr. and Mrs. N's income. Aside from their home and property, they had no other assets and owed about $5,000 in credit card debt. They simply had no way to make the loan payments or meet the obligation of a margin call.

Neither Mr. nor Mrs. N had any investment experience before being introduced to the advisor. We found that they had no understanding of investments or investing in general and no understanding of their investment strategy or its risks – including losing their home and opening themselves to complete financial ruin – despite having signed a disclosure document.

We concluded that Mr. and Mrs. N:

- Were in no position to risk their home or their minimal income and they could not afford to make loan payments of any amount.
- Had never been in the position to have limited their losses given their complete lack of understanding about their advisor's investment strategy.
- Did not understand that there was a problem until late 2008 when they stopped receiving the $1,000 monthly income they were told to expect.

The firm argued that Mr. and Mrs. N's son understood the advisor's strategy and was advising his parents, however, that was not supported by the evidence. We noted that it was not the son's responsibility, but rather the advisor's, to assess the suitability of a leverage strategy recommendation.

The outcome

We calculated that Mr. and Mrs. N had incurred investment losses and interest costs on the loans and mortgage totaling $227,440. Based on our findings, the firm offered $220,000 to settle Mr. and Mrs. N's dispute. Mr. and Mrs. N accepted the firm's offer and their dispute was resolved.

This case study was originally published on our website.
For the full version, click here.

Key Lesson

Borrowing money to invest – or leveraging – is not an appropriate strategy for many investors. There are significant risks involved and issues to consider before considering borrowing to invest. While gains can be magnified by this strategy, so too can losses. Regardless of whether you make or lose money on your investments, the loans will have to be paid back. Consumers who are conservative investors or retired should be especially cautious and fully understand the risks they are taking. Advisors should be equally careful about recommending a strategy to borrow to invest.

Consumers are not responsible for the cost of administrative errors

Consumer Profile

Consumer: Mr. D

Annual household income: Lower income

Employment status: Unemployed

Complaint: Service issue

Student loan administrative error leads to repayment problem

In 2004, Mr. D took on federal and provincial student loans through OSAP (Ontario Student Assistance Program) and returned to school. He intended to complete his studies by April 2005. Based on Mr. D's enrollment, his loan repayments were scheduled to start in November 2005, six-months after his graduation.

Shortly after beginning his studies, Mr. D experienced personal issues that caused him to leave his school program. The bank that held Mr. D's loans was notified of this change to his enrollment status by the provincial government.

Under the terms of Mr. D's loans, the change to his enrollment status should have caused his loan repayments to begin. However, the bank did not update its records and Mr. D's loan repayment remained scheduled to start in November 2005.

Incorrect interest charges and collection agency issues follow

Mr. D paid his loans between 2005 and 2016, but in September 2016, he experienced financial difficulty and applied for the Repayment Assistance Program. As part of the application process, the bank recognized the error that had occurred in 2004 and made several changes to Mr. D's file, including updating his end-of-study date, closing his original loans, and creating new accounts for both of his loans.

When the bank adjusted the loans in 2016, they incorrectly changed Mr. D's end-of-study date to April 2005, which added over $1,000 in interest to his outstanding loan amounts. Due to Mr. D's financial difficulty, the loans were now in collections. The change in Mr. D's account numbers and the bank's decision to use a new collection agency created further confusion.

The new collection agency began contacting Mr. D to request repayment on the loan accounts that had been closed. It was difficult for everyone involved to understand what was owed and to whom. These issues caused Mr. D considerable distress and he refused to make payments until they were resolved.

Our findings

During our investigation, we confirmed the bank's administrative errors. We also determined that it was unfair for the bank to retroactively add $1,008 in additional interest charges to Mr. D's loan after repeatedly telling him over the years that the amount he owed was the amount calculated based on an end-of-study date of November 2005.

We found that the bank had made errors while attempting to correct the end-of-study date and did not communicate the new account numbers to Mr. D clearly and directly.

Mr. D's attempts to understand and resolve the issue with the bank and its agents for over a year had unnecessarily caused him undue stress and frustration.

The bank acknowledged their administrative errors, apologized for Mr. D's inconvenience and offered a goodwill gesture of $1,000.

The outcome

We recommended that the bank increase its compensation offer from $1,000 to $2,008 to compensate Mr. D for the extra interest he was charged on his loans as well as take into account his stress and inconvenience. The bank agreed and Mr. D's dispute was resolved.

Key Lesson

All borrowers are responsible for ensuring that they review and understand their loan instructions for repayment and follow them. If consumers have complaints about their loans, refusing to make a payment is never a good way to fix the problem. Financial consumers, however, should be able to rely on the loan balances clearly and repeatedly communicated to them by their financial service providers.

Why does the non-repayment period for a Canada student loan matter?

For Canada student loans, students have a six-month grace period before they must start repaying the loan. The non-repayment period starts when the program is complete or switched to part-time study, or the student is no longer enrolled. During this time, no interest accumulates on a Canada student loan. Loan payments begin six months later. Provincial student loan requirements vary among provinces.

Retiree seeks compensation for financial advisor's alleged lack of service and poor advice

Consumer Profile

Consumer: Mr. O

Annual household income:

Lower income

Employment status: Retired

Complaint:

Unsuitable investments; Service issue

Allegations of unsuitable or poor performing investments, misrepresentation and lack of service

Mr. O and his wife were retired and held several mutual funds in their investment accounts at ABC Firm between 2014 and 2019. During that time, their financial advisor was Ms. L. In June 2019, Mr. O expressed several concerns to ABC Firm about the investment advice and service he had received from Ms. L throughout his relationship with the firm. He alleged that:

- the investments she recommended for purchase had either been unsuitable or underperformed, leading to financial losses of about $25,000 over five years
- the fund fact sheets provided to him were either misleading or not for the mutual funds he held
- Ms. L misled him about the performance of his portfolio by hiding the Gains/Losses figures from the portfolio performance reports
- Ms. L did not comply with his requests or demonstrate a commitment to helping him achieve his financial goals and spent little time monitoring his accounts
- the level of service that Ms. L provided was inadequate in relation to the fees he paid to ABC Firm.

Mr. O asked ABC Firm to review his concerns and reimburse him for $25,000 – the full amount of his financial losses – to resolve the matter.

Firm finds no evidence of financial harm

ABC Firm did a thorough review of Mr. O's accounts to address his concerns, including a close look at account documentation and account records over the five-year period he had been a client. They also reviewed Ms. L's notes and comments regarding Mr. O's accounts, and took into consideration her email correspondence with Mr. O.

The firm told Mr. O that their investigation found there was no evidence to suggest that Ms. L had made unsuitable investment recommendations, misrepresented the information in his portfolio performance reports, ignored his concern about management fees or provided poor service.

Unsatisfied with the results of ABC Firm's investigation, Mr. O brought his complaint to OBSI.

Our findings

During our investigation, we reviewed ABC Firm's documentation as it related to Mr. O's concerns. We also interviewed Ms. L about her handling of Mr. O's accounts. We found that:

- Mr. O's file documentation showed that he was comfortable with a conservative growth strategy and Ms. L had invested him in mutual funds that were suitable;
- all transactions on Mr. O's accounts were reviewed and explained to Mr. O in advance, including those meant to replace underperforming investments;
- Ms. L provided advice based on Mr. O's need for tax efficiency and a conservative investment strategy and that he benefited from a net gain of about $14,000;
- it was not possible for Ms. L to omit information or otherwise alter reports about Mr. O's portfolio performance because the reports were created using an internal system;
- after Ms. L had provided Mr. O with the fund fact sheets for his mutual funds, the fund managers switched the fund to series E1 or E2 automatically for Mr. O's benefit – a change that was outside of Ms. L's control;
- Ms. L specifically recommended that Mr. O switch the type of mutual funds he held to reduce the fees associated with his investments.

We concluded that there was no evidence of Ms. L misrepresenting investments to Mr. O nor did we find that there were occasions when Ms. L did not comply with Mr. O's requests. Ms. L had communicated with Mr. O regularly and ensured that his financial plan was updated on an annual basis.

The outcome

We explained the findings of our investigation fully to Mr O, and did not recommend compensation.

Key Lesson

Financial advisors are responsible for providing sound investment advice to match the financial needs and goals of their clients. They determine what is best for a client by meeting with them to discuss the "big" picture: a current look at their financial situation, risk tolerance and investment strategy. In exchange for a fee, advisors recommend investments for their clients, carry out trades for them and monitor their account performance.

Advisors are required to document their clients' information according to "know-your-client" rules and should keep a consistent record of all client conversations. These requirements are in place to benefit the investor. However, no advisor can guarantee positive investment returns because all investments, even suitable investments, have a risk of loss. Different kinds of investments have different risks, but there is always a risk that the value of an investment today will be lower in the future.

What is Know Your Client (KYC)?

In the investment industry, KYC is the process and documentation to ensure that an investment advisor knows the important financial and personal details about their client. The KYC helps to support a mutual understanding of a client's situation, such as their risk tolerance, life stage and financial knowledge. The KYC is beneficial to both the consumer and the advisor. When done correctly, it provides a foundation for creating an appropriate investment plan. It is both good practice and a regulatory requirement for advisors to regularly revisit KYC with their clients, ensuring that personal details are updated if circumstances have changed and that investment plans are still aligned with client needs.

Endnotes

1 Statistics Canada. Table 11-10-0237-01. Distribution of market, total and after-tax income by economic family type, Canada, provinces and selected census metropolitan areas, May 6, 2020.

2 Statistics Canada. Table 17-10-0005-01. Population estimates on July 1st, by age and sex, May 6, 2020.

3 Statistics Canada. Table 17-10-0060-01. Population estimates as of July 1st, by marital status or legal status, age and sex, May 15, 2020.

4 Ontario Ministry of the Attorney General. Chapter 11.1 Cost and Value of Justice, June 15, 2020.

5 Canadian Mediation Association. Fees, June 15, 2020.

6 Canadian Arbitration Association. Fees, June 15, 2020.

7 Statistics Canada. Pension plans in Canada, as of January 1, 2018, August 5, 2020.

8 Statistics Canada. Table 11-10-0237-01. Distribution of market, total and after-tax income by economic family type, Canada, provinces and selected census metropolitan areas, May 6, 2020.