November 21, 2024

Mark Wright
Director, Communications and Stakeholder Relations
Ombudsman for Banking Services and Investments
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Toronto, ON M5H 3R3
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Re: OBSI Consultation on Loss Calculation for Complaints Involving Unsuitably Sold Illiquid Exempt Market Securities – Request for Public Comment

Dear Mr. Wright,

The Federation of Independent Dealers ("Federation") is pleased to provide comments on the Ombudsman for Banking Services and Investments ("OBSI") consultation on loss calculation for complaints involving unsuitably sold illiquid exempt market securities. Since 1996, the Federation has been Canada's dedicated voice for mutual fund dealers, representing CIRO member dealerships with over a hundred billion in assets under administration and tens of thousands of licensed advisors serving millions of Canadians.

General Comments

Risk Index and Benchmarking

We note that the Simplified Example (pp. 7) uses the S&P TSX Composite Index as a benchmark for medium-risk growth portfolios but does not apply a comparable approach to high-risk securities. We recommend using appropriate medium-high or high-risk indices, such as the MSCI TR World Index, to ensure consistent evaluation across all risk levels. This approach will better assess whether complainants have experienced outsized losses compared to similar risk securities and will align with the KYC profiles of investors with high-risk tolerances.

Transparency and Disclosure

The indices and calculations used in decisions should be disclosed to firms involved in complaints to ensure transparency and fairness.

Over-fitting and Additional Factors

We caution against over-fitting the back-test model when determining compensation. Historical outlier events, such as interest rate spikes, should be considered. Additionally, OBSI should evaluate factors like liquidity/redemption restrictions and heavily weigh contemporaneous KYC against historical risk ratings in suitability assessments.

OBSI must bear in mind that the effect of any loss calculation methodology should not be to provide a de facto backstop or performance guarantee for exempt securities. While we all would seek to find risk-free investments, it's important that the resolution process does not inadvertently create such an expectation.

KYC Redetermination

We reiterate our position that redetermining KYC is problematic due to unreliable memories and financial incentives for clients to disclaim former KYC documentation. A limitation period should be implemented, given the regular provision and continuous availability of investment details and related information.

Responses to Consultation Questions

1. Fairness of Zero Value Assignment

Assigning a zero value to unsuitable illiquid exempt market securities and requiring investors to return these securities to firms is operationally costly and potentially an additional burden. Many dealerships would prefer not to receive valueless securities. Implementing a limitation period for claiming 'unsuitable' securities could mitigate this issue.

2. Exceptional Situations and Additional Considerations

a. Exceptional Situations

For flow-through shares, the tax benefit should be a mitigating factor in loss calculations. Firms should not be directed to take back securities years later if a liquidity event does not occur. Appointing expensive auditors to assign valuations can be costly. In cases where accounts transfer with locked-up real estate, determining responsibility between the new and relinquishing dealer is complex.

b. Additional Considerations

OBSI can improve fairness by:
- Extending decisions until securities can be valued.
- Holding securities in escrow until a value can be determined.
- Seeking authority to require investors to return securities to the original salesperson or firm.

For unsuitable illiquid investments transferred to a new dealership, the dealer who sold or recommended the security should take it back, or the second dealer should have the option to decide which dealer receives the security. OBSI should involve advisors in the process and support dealers in recovering compensation sums from advisors.

We appreciate the opportunity to provide these comments and look forward to continued dialogue with OBSI.

Respectfully,

Matthew T. Latimer
Executive Director
Federation of Independent Dealers
Fédération des Courtiers Indépendants