

November 21, 2024

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Re: OBSI consultation on loss calculation for complaints involving unsuitably sold illiquid exempt market securities

FAIR Canada is pleased to provide comments in response to the above-referenced consultation.

FAIR Canada is a national, independent, non-profit organization known for balanced and thoughtful commentary on public policy matters. Our work includes advancing the rights of investors and financial consumers in Canada through:

- Informed policy submissions to governments and regulators
- Relevant research focused on retail investors
- Public outreach, collaboration, and education
- Proactive identification of emerging issues.¹

A. General Comments

FAIR Canada supports OBSI's standard loss calculation methodology (Methodology) and its adjustments when dealing with illiquid exempt market securities (illiquid EMS). We also agree with the Methodology's overall objective—to determine a reasonable estimate of the investor's financial position if the advisor had not given unsuitable investment advice.

Successive independent reviews have carefully reviewed and affirmed that OBSI's Methodology is first-rate, fair, transparent, efficient and neutral. The most recent review found that it brings high efficiency, consistency and fairness to the complaints process. OBSI's approach to illiquid EMS is consistent with those in comparable jurisdictions, including the United Kingdom and New Zealand.

¹ Visit www.faircanada.ca for more information.

Lastly, OBSI has been transparent with stakeholders about how the Methodology works and is applied in various scenarios. It has consistently been open to hearing from stakeholders about any areas of concern with the Methodology, including inviting suggestions for improvement. Despite this, some dealers, particularly exempt market dealers (EMDs), continue to object to how the Methodology deals with illiquid EMS.

In the first section of this letter, we respond to the specific consultation questions. In the second part, we discuss the need for EMDs to strengthen their compliance processes and meet the regulatory expectations to their clients. After all, the best way to avoid needing the Methodology is to prevent or reduce suitability complaints. Finally, we urge the Joint Regulators Committee (JRC) to formally endorse the Methodology.

B. Responses to Consultation Questions

1. OBSI's Approach to Illiquid EMS is Fair and Reasonable

The first question asks whether OBSI's approach of assigning a zero value to unsuitable, illiquid EMS and requiring the investor to return the securities to the firm is fair and reasonable. If not, are there any alternative approaches it should consider?

We believe OBSI's approach is fair and reasonable. As OBSI makes clear, it first works with the firm to determine the fair value of any unsuitable, illiquid EMS. After giving the firm an opportunity to provide a fair value, if one cannot be determined, OBSI assigns a zero value to the security and recommends transferring ownership from the client to the firm. This approach ensures the firm benefits from any remaining value in the security and avoids the potential for double recovery for the client.

FAIR Canada supports this approach. OBSI does not dictate the value of the illiquid EMS; it invites the firm to propose a fair market value. Moreover, if the firm believes the security has value, the transfer of ownership ensures the firm benefits from any future value in the product it advised the client to buy. The firm can maximize its returns by holding the illiquid EMS until its value increases and aligns with the firm's expectations.

We also appreciate that OBSI employs Chartered Financial Analysts (CFA) (or those in the process of obtaining a CFA) to conduct the loss calculations. OBSI shares its calculations with firms, allowing them to question any points they disagree with before making its final recommendation. These practices make OBSI's use of the Methodology transparent, fair, and robust.

i. It is Patently Unfair for Clients to Bear the Risks of Unsuitable Advice

Occasionally, firms have told OBSI that receiving securities from investors as part of a settlement is unacceptable. As OBSI rightly pointed out in the consultation:

While we appreciate that receiving and holding illiquid exempt market securities may be unusual or difficult for some firms, we must also consider that holding the illiquid exempt market security may also be difficult for the investor for [sic] to whom it was unsuitably sold.

We wholeheartedly agree with OBSI. Why should EMDs' interests take precedence over those of their clients? It would be grossly unfair for retail investors to bear the burden and risk of holding an illiquid security that a dealer or its representative unsuitably recommended. This is particularly true because, as our research shows, investors rely heavily on their advice when making investment decisions.²

We believe OBSI's approach is consistent with the obligation to prioritize the client's interests. Firms are also better equipped than investors to manage the risks of illiquid EMS. Stated differently, if an EMD felt strongly that an illiquid EMS was a good investment for its client, why would it be so opposed to owning it?

Allowing firms to evade accountability in these situations erodes confidence in our investor protection framework and the capital markets. That loss of confidence raises the cost of capital for everyone.

2. Exceptions to Approach to Illiquid EMS and Improving Outcomes

The second question asks whether there are exceptional situations or specific circumstances where OBSI should not use its approach to illiquid EMS.

We are not aware of any situations that should cause OBSI to deviate from its approach. However, if an unexpected, exceptional circumstance arises, we support adjusting OBSI's approach to achieve a fair outcome.

In response to whether there are other considerations or steps OBSI should take, we encourage OBSI to continue meeting with industry stakeholders, particularly EMDs, to explain and respond to their questions about the Methodology. We hope these consultations will help address and stem further misinformation or misunderstanding about the Methodology.

C. EMDs Must Improve Suitability Determinations

² FAIR Canada [Investor Survey](#), December 2022, p. 8.

It is worth remembering that the Methodology only becomes relevant if the firm cannot resolve a suitability complaint and OBSI determines it is valid after doing an independent and neutral review. EMDs have every opportunity to try to resolve these types of complaints themselves during these processes. They can also avoid suitability complaints by better meeting fundamental obligations critical to investor protection: the know-your-client (KYC), know-your-product (KYP), and suitability responsibilities.

OBSI data on suitability cases and a recent Ontario Securities Commission report³ highlight how some dealers may not take these responsibilities seriously. For example, the OSC report found deficiencies in several key areas, including inadequate collection and documentation of KYC information. These deficiencies were common to at least 40% of the firms in the sample.⁴

OBSI statistics show that suitability complaints are a persistent concern, particularly among EMDs. Since its creation in 2002, OBSI has received more complaints about suitability than any other issue.⁵ According to OBSI's most recent annual report, suitability was the leading investment issue in 2023, increasing by 154% compared to 2022.⁶ Suitability disputes represented 27% of all investment cases, up from 15% the previous year.⁷

While suitability is the top issue among all OBSI investment firms, it is exceptionally high among EMDs, which suggests widespread shortcomings in their compliance processes and client communications. According to OBSI data, between November 1, 2016, and July 31, 2024:

- Of the 50 cases OBSI opened against EMDs, 28 (56%) involved suitability issues.
- Of the 1833 cases opened against investment dealers, only 427 (23%) involved suitability issues.
- Suitability cases represented 27% of all cases opened for portfolio managers and 24% for mutual fund dealers.

Although we do not have data showing the outcomes of these cases, it is concerning that most cases against EMDs involved suitability and that the proportion of these complaints against EMDs was double that of other dealers.

This data underscores the need for many EMDs to enhance their policies and procedures for assessing suitability. Although strengthening compliance will not eliminate all

³ OSC Staff Notice 33-755, Compliance and Registrant Regulation Branch, [Summary Report for Dealers, Advisers and Investment Fund Managers](#), July 27, 2023. The report discussed a compliance sweep of firms with assets under management of at least \$25 million and limited compliance staff. The sweep included firms registered as either an investment fund manager, portfolio manager, EMD or a combination of these categories.

⁴ Ibid, p. 19-20.

⁵ Poonam Puri and Dina Milivojevic, [Independent Evaluation of the OBSI Investments Mandate](#), June 13, 2022, p. 52 [2022 review].

⁶ OBSI [Annual Report 2023](#), p. 41.

⁷ Ibid.

complaints, living up to regulatory expectations and treating clients fairly, honestly and in good faith will go a long way toward reducing them.

D. JRC Should Support the Methodology to Enhance Acceptance

Despite ongoing objections from some EMDs, they have repeatedly failed to offer a viable alternative to OBSI’s Methodology. We also understand that about half of OBSI cases involving illiquid EMS involve CIRO members, who appear more accepting of the Methodology.

This suggests that EMDs’ criticisms have less to do with the Methodology and more with their concerns about the consequences of recommending unsuitable products. Given the numerous reviews of the Methodology and the consistent, favourable findings, we urge the JRC to endorse it. This recommendation is consistent with the 2022 review of OBSI, which concluded that securities regulators should approve the Methodology to signal their support.⁸

Thank you for considering our comments on this important issue. We welcome any further opportunities to advance efforts that improve investor outcomes. We intend to post our submission on the FAIR Canada website and have no concerns with OBSI publishing it on its website. We would be pleased to discuss our submission with you. Please contact Jean-Paul Bureaud, Executive Director, at jp.bureaud@faircanada.ca or Tasmin Waley, Policy Counsel, at tasmin.waley@faircanada.ca.

Sincerely,



Jean-Paul Bureaud
President, CEO and Executive Director
FAIR Canada | Canadian Foundation for Advancement of Investor Rights

⁸ 2022 review, *supra* note 5, p. 58.