Via Email

July 9, 2012

Tyler Fleming
Director, Stakeholder Relations and Communications
Ombudsman for Banking Services and Investments
401 Bay St., Suite 1505, P.O. Box 5
Toronto, ON M5H 2Y4

Dear Mr. Fleming:

Re: Proposed Changes to OBSI's Suitability and Loss Assessment Process

This comment letter is being submitted on behalf of the following entities within RBC: RBC Dominion Securities Inc., RBC Direct Investing Inc., Royal Mutual Funds Inc. and Phillips, Hager & North Investment Funds Ltd. We are writing in response to the Ombudsman for Banking Services and Investment's ("OBSI") request for comment on the proposed changes to its Suitability and Loss Assessment Process published on May 10, 2012 ("Revised Consultation Paper").

General Comments

We acknowledge that OBSI is taking steps to address one of the strategic reforms recommended under the 2011 Independent Review Report of OBSI ("2011 Review Report") conducted by The Navigator Company ("auditor"). To ensure that OBSI fulfils its mandate of acting as an independent and impartial arbiter of complaints that does not act as an advocate for any party, any proposed change to OBSI's suitability and loss assessment process must be critically examined.

Further to our comment letter dated July 25, 2011, we continue to experience that while OBSI's suitability and loss assessment process, as outlined in the Revised Consultation Paper, generally appears to be reasonable and acceptable in nature, it is not consistently followed in practice.

Proposed Changes

1. ***Use common indices as performance benchmarks in most suitable performance comparisons.***

At OBSI's information session held on June 14, 2012, OBSI staff presented that the use of indices as performance benchmarks by OBSI would improve consistency, predictability and efficiency of its loss assessment process. The proposed change includes utilizing a narrow list of common indices which would be applied by OBSI consistently for cases of participating firms, including member firms of Mutual Fund Dealer Association ("MFDA") and Investment Industry Regulatory Organization of Canada ("IIROC").

We reiterate that indices are not appropriate performance benchmarks in many cases. The importance of identifying the differences between an investor's portfolio and index benchmarks is highlighted in Canadian Securities Administrators' recent proposed amendments to the Companion Policy of National Instrument 31-103 ("NI 31-103") regarding the provision of benchmark information to clients: "Benchmarks need to be explained to clients in terms they will understand, including factors that should be considered by the client when comparing their investment returns to benchmark returns. For example, a registrant

could discuss the differences between the composition of a client's portfolio that reflects the investment strategy they have agreed upon and the composition of an index benchmark, so that a comparison between them is fair and not misleading."

In practice, the use of indices as benchmarks confuses suitability with performance - securities that are suitable for an investor may not always perform as well as the index benchmark. It also presents the issue of selection bias and assumes the investor would have purchased the securities within the index, which may not reflect the investor's actual investing history. OBSI should be aware that the securities within an index benchmark may not be suitable for the investor at the relevant times and index benchmarks are not assessed or adjusted to reflect the asset allocation that is suitable for a given investor.

Our concern is augmented by OBSI's proposal to utilize a narrow list of total return common indices, some of which may be over-concentrated (e.g. S&P TSX Composite). Consistent with OBSI's stated understanding that "an advisor's responsibility is to recommend suitable investments, not to guarantee performance", we believe that investors' portfolios should be measured against the general market conditions. As such, if indices would be used as performance benchmarks, we suggest that OBSI should use the average performance of three to four comparable indices where available.

OBSI must recognize that a one-size-fits-all approach may not be appropriate, especially where cases involve complex investments and fact scenarios. It should be open to considering other reasonable methods of determining whether an investor suffered financial harm and whether compensation is appropriate in the specific circumstances. As an alternative approach to improve the efficiency of OBSI's current process, we recommend that OBSI may wish to establish initially whether, in a specific case, the participating firm's assessment of investment performance was reasonable; if so, we suggest that OBSI should then maintain the participating firm's standard of assessment through the loss calculation process.

2. ***Take fees and trading costs into account in all cases when making suitable performance comparisons.***

OBSI should specify the types of fees and trading costs it will take into consideration. This should include commissions, back-end or deferred fees, redemption fees, switch fees as well as the management expense ratio as agreed between the participating firm and the investor.

3. ***As a general rule, add interest on compensable losses only if an Investigation Report (a final report where we recommend compensation) is issued, but not add interest on facilitated settlements. Generally, interest on recommended compensation would be calculated from the date the investor complained to their firm, and is intended to compensate the investor for not having access to the compensation during lengthy delays in resolving the complaint.***

We support the objective of the proposed change, which is to allow investors to be compensated for not having access to the recommended compensation during lengthy delays in resolving the complaint. The OBSI Code of Practice indicates that, 80% of the time, decisions on complaints are reached within 180 days of OBSI receiving the files. That being said, the 2011 Review Report points out that both investors and industry expressed considerable concern over the length of time OBSI is taking to achieve resolution. This is substantiated in OBSI's 2011 Annual Report where it is detailed that OBSI fails to meet its own standard of 180 days in 73.5% of the investment cases. In light of these findings, we are of the view that participating firms should not be required to pay interest in respect of delays caused by OBSI or the investor and suggest that OBSI identify the party responsible for such delays in the investigation report.

Further, coupled with the determination of compensable losses based on suitable performance comparison, OBSI is effectively penalizing the participating firms by requiring firms to provide clients with a premium in addition to a guaranteed investment performance. To ensure fairness to all parties to a case, interest on compensable losses should only apply in instances where notional portfolio approach is not used.

4. ***Implement a self-imposed limitation period of six years from the time when we believe the investor knew or ought to have known there was a problem with their investments.***

In the 2011 Review Report, the auditors found that there were a number of files where OBSI had investigated matters that originated as far back as the 1990's. This is concerning as cases should be reviewed when the evidence is not faded, lost or otherwise absent due to the passage of time and should be brought in as timely as possible to the alleged action in question. Thus, we agree that a limitation period should be imposed.

While OBSI reasoned that it derived a 6-year limitation period pursuant to the recommendation of the 2011 Review Report, we submit that OBSI's limitation period should take into account the laws and regulations that apply to the participating firms. First, statutory limitation periods vary across Canada; for instance, the general limitation period is 2 years in a number of provinces including Ontario, Alberta, Saskatchewan and New Brunswick. Second, NI 31-103 requires registered firms to keep records for 7 years from the date the record is created; registered firms may not be able to produce evidence required for the cases past the applicable record retention period. Therefore, we recommend that OBSI should impose a limitation period that is consistent with the statutory limitation period applicable to the investor.

The factors that OBSI would consider to ascertain when an investor "knew or ought to have known there was a problem with their investments" should be clarified. In particular, the test should take into account investor responsibilities and the level of knowledge and engagement of the investor.

5. ***Provide firms with working versions of our loss calculation spreadsheets during our investigation.***

The proposed change is positive and provides greater transparency to OBSI's processes. We request that the loss calculation spreadsheets should be provided in a format that would allow participating firms to review the sources of data, equations and assumptions involved in the calculations.

In cases where OBSI recommends compensation, the loss calculation should demonstrate the apportionment of financial harm between the participating firm and the investor, where applicable, taking into consideration the investor's responsibility to mitigate losses and contributory negligence.

Moreover, with the goal of enhancing transparency and consistent with Recommendation 23 from the 2007 Independent Review Report, we request that OBSI publish on its website de-personalized versions of all investigation reports and decisions made by OBSI.

Outstanding Issues

We would like to provide further comments on certain outstanding issues where we continue to have significant concerns:

Know-Your-Client ("KYC") Determination

We reiterate our concerns with OBSI's practice of retroactively re-assessing KYC information as it disregards the in-depth discussions that took place between the investor and the advisor at the relevant time(s) to ascertain such information as well as the significance of the account documentation and other legal documents that were received and acknowledged by the investor. In particular, OBSI's reassessment of KYC information should not be based on its interviews with investors regarding their current perspective and feelings about a past investment that resulted in losses to the investors.

In the Revised Consultation Paper, OBSI states that its process of considering evidence in addition to the KYC information to confirm an investor's KYC information is comparable to the process used by branch managers, compliance officers, regulators and the courts. If so, OBSI's process should take into account the guidance under the Companion Policy to NI 31-103 which clarifies that investors are expected to

promptly provide their advisors with full and accurate information that could reasonably result in a change to the types of investments appropriate for them. Where advisors have fulfilled their KYC obligations, OBSI's process of re-assessing KYC information should consider only information that was available to the advisor at the time the relevant suitability assessment was made. If OBSI concludes that the KYC information on record for an investor did not in fact reflect the investor's actual circumstances at the relevant times, it ought to clearly articulate the basis of such conclusion.

OBSI also needs to recognize that if securities regulators have not determined that there is a suitability issue, OBSI, being neither a court nor a regulator, should not override the findings of the securities regulators or courts.

Determining Investment Characteristics and Risks – Security Risk Rating

OBSI indicated that, as part of its determination of investment characteristics and risks, it initially rates all securities on a five-point scale. If the participating firm uses a three-point scale or other scale, OBSI would re-evaluate the securities to determine where they fit in the participating firm's scale based its original analysis.

We caution that OBSI's attempts to re-evaluate securities may lead to inconsistent results. This approach also overlooks the fact that participating firms who are members of IIROC or MFDA are required to follow the rules and guidelines of the self-regulatory organization ("SRO"). When dealing with an IIROC or a MFDA member firm, OBSI should risk-rate the security in question in accordance with the SRO's risk rating scale and applicable guidance.

Making a Suitability Determination – Portfolio Approach

The Revised Consultation Paper states that, as part of the suitability determination, OBSI may consider the investor's investments in the context of their whole portfolio. We note that ascertaining an investor's "whole portfolio" may be a challenging exercise since an investor may have multiple accounts with the firm in question, may have accounts with other firms and/or may hold other forms of investments.

Consequently, we request that OBSI (i) outline what constitutes an investor's "whole portfolio"; (ii) specify how OBSI would decide whether to conduct suitability assessment on a whole portfolio basis; if this decision is based solely on whether "the advisor had a reasonable plan and explained that plan to the client", a clarification on what constitutes a "reasonable plan"; and (iii) provide case studies of portfolio-basis suitability determination and the related loss calculation.

Suitability Performance Comparison – Duty of Care vs. Fiduciary Duty

While OBSI comments that it "typically need not consider whether the relationship between the investor, advisor and firm is fiduciary in nature", the distinction between duty of care and fiduciary duty is clearly recognized by both regulatory and legal principles. Specifically, in an Ontario Superior Court decision, it was clarified that "the duty on behalf of a broker will vary from that of an order taker to that of a fiduciary depending on the specifics of the relationship. This is what has been referred to as the 'continuum' or the 'spectrum'.[1]" Under a standard of duty of care, "so long as a broker applies the skill and knowledge relied upon and advises fully, honestly and in good faith, the broker has discharged his obligation and is not responsible if the transaction proves unfavourable.[2]"

Similarly, we suggest that OBSI should recognize the distinction between these two standards and that the test for whether advisors have fulfilled their duty of care or fiduciary duty should not be uniformly applied. This distinction is of particular importance when it comes to apportioning responsibilities for losses.

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[1] See *Young Estate v. RBC Dominion Securities (RBC) and Houghton* [2008] O.J. No. 5418.

[2] See above.

Appeal Mechanism

As highlighted in the Revised Consultation Paper, the 2011 Review Report observed that OBSI's decision-making in investment complaints is consistent with comparable external dispute resolution schemes in other countries.

It should be noted that ombudsmen in comparable jurisdictions offer an appeals mechanism (for example, the Australian Financial Ombudsman Service). Currently, OBSI's final recourse for non-compliance is to make public any refusal by a firm to accept OBSI's recommendation. In this regard, the 2011 Review Report commented that "the effectiveness of this 'weapon' is only of utility where there is widespread goodwill and cooperation and being 'named' has a significant reputational cost." In line with the auditor's recommendation, we urge OSBI to establish an appeals mechanism for its decisions. This would provide industry and investors with assurance that OBSI is prepared to have its decisions tested.

Closing Remarks

We appreciate the opportunity to provide comments on OBSI's suitability and loss assessment process and see this consultation as being pre-mature until such time as the oversight, governance and transparency issues of the OBSI are meaningfully addressed. It continues to concern us that OBSI has put forward in the Revised Consultation Paper a process that, in our experience, has not been consistently followed.

We would be pleased to discuss our comments further with you. If you have questions or require additional information, please do not hesitate to contact the undersigned.

Sincerely,

Russell Purre
Chief Compliance Officer, RBC Dominion Securities Inc. (Retail)

cc. Ann David, Chief Compliance Officer, Royal Mutual Funds Inc.
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