Wednesday, August-07-13

Tyler Fleming Director,
Stakeholder Relations and Communications
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ON M5H 2Y4

Dear Mr Fleming

Regarding: Consultation on Proposed Changes ~~backward stepping compromises~~ to OBSI's Terms of Reference

I am pleased to provide the following comments on the above noted consultation. Before I deal specifically with the consultation itself, I would like to make some important points regarding issues that I feel put the consultation into its necessary context:

1. The first point is regard to the extremely important observations made in the 2011 Navigator independent review: many of the concerns raised in that report are relevant when interpreting the consultation document. I expand on this point later in my letter and reference a number of extracts in Appendix A.

2. The second is the conflict between the regulation of the transaction and the regulation of advice: this is a conflict which has been raging between Canadian regulators and the industry since at least the birth of the Fair Dealing model. Retail advisory services are essentially regulated as transaction points, yet regulators have long since recognized that advice is the central component of most of these advisory services. Those who wish to retain the limited responsibility and minimum standards of transaction distribution would like to see responsibility for the transaction remain firmly weighted towards the investor. This is so even though most service representations imply a higher standard, and many institutions have publicly stated that they already operate under a "best interests' standard".

   It is the "war" over the definition of minimum standards and responsibility that the OBSI has unfortunately waded into. I believe that OBSI does not apply a best interests' standard in its assessment of cases. I do however believe that the OBSI is straying from the interpretation that distributors would like to see to one more reflective of the actual contract, albeit within the constraints of current regulation, where that contract can be discerned from available records.

   It is possible that this grey area is causing consternation, for one reason or another, within the regulators over the OBSI's role, because it is definitely, though unjustifiably, an issue with the industry. Although I have no proof, it is possible that this issue may well have influenced, to some extent, the proposed removal of the mandate to address and investigate systemic issues.

3. The third is funding: we know that many of the problems at OBSI stem from lack of funding, and it is quite possible that this one of the reasons for the two most important changes recommended in this consultation. I am of course referring to the abandonment of segregated fund cases and the systemic issue review responsibility. With the CSA proposal for a wider membership of the OBSI, funding constraints may also have had an important say in these two changes to the Terms of Reference. The question therefore, is, why has the funding issue not been addressed by any relevant body?

4. The fourth is the profound lack of robust consumer involvement in financial services regulation and the influence that industry has over regulation and the regulatory review process. I am sure that with greater consumer influence in the process we would not be seeing the proposed terms

of reference. The Navigator report discussed weak consumer representation as one of the critical components missing from a strong and vibrant ombudsman.

The 2011 Navigator Report:

I would like to highlight some key phrases from the noted report:

> *"an industry-funded ombudsman scheme, in particular one without binding powers over its members, can only operate with the support of its constituent stakeholders. Absent a clear regulatory signal to the contrary, industry's continued criticism and pressure may ultimately leave OBSI with nowhere to go but to make a series of backward-stepping compromises…. ."*

> *"its funding has not kept pace with the workload and industry compliance has deteriorated with firms walking away, threatening to walk away, using more aggressive negotiating tactics and in some cases outright refusing to comply with recommendations". The impact of all the problems was "magnified because OBSI lacks the structural support of compulsory membership, binding powers over its participating firms and strong regulatory engagement".*

The above are two of the most important excerpts from the 2011 Navigator independent review. The current consultation proposals represent a number of backward steps that could well be interpreted as compromises in the context of the Navigator report. The report also made a number of recommendations and warned that "*Selectively implementing these recommendations risks exacerbating the current state of 'imbalance'*". A great many of these recommendations have not been implemented, and those that have, have either yet to be finalized or lack the weight of the original recommendations.

Comments on the Consultation

The consultation is light on explanation of the rationale behind many of the critically important recommendations, but it does give some guidance as to where they came from. Greater transparency of such arguments and influence would be greatly appreciated and would illuminate the public comment process.

> *"There are different **rationales for the various proposed changes**. Some are **required by the Financial Consumer Agency of Canada (FCAC)** as part of their application process for external complaint bodies for the banking sector. Others are intended to **improve the efficiency of our process**. Some revisions have been **proposed over the years by various stakeholders** and OBSI agrees they have merit. Finally, **many changes are merely housekeeping in nature**."*

Also I note the following from the CSA's NOTICE AND REQUEST FOR COMMENT ON PROPOSED AMENDMENTS TO NATIONAL INSTRUMENT 31-103 (Dispute Resolution Service)

> *"The CSA has also been working with OBSI to review its processes ….. We are considering the role we should play in overseeing OBSI with respect to its terms of reference. Work is also being done with OBSI to ensure that it will have the capacity to provide effective services for an expanded base of registered firms if the Proposed Amendments are adopted."*

I would strongly suggest that it is in the public's interest to have a written record of these deliberations and their resulting decisions. Without this it is unclear to what extent each stakeholder has influenced the two key changes to the Terms of Reference.

Regarding segregated funds:

> *OBSI's mandate is limited to investigating complaints about products and services in the banking sector and those that fall under the jurisdiction of securities regulators. **This does not include***

> ***entities whose main business is the provision of insurance products or services****. The definition of a "Participating Firm" is being modified to make this clear, as well as incorporate the affiliates concept. The greatest consequence of this change will be that OBSI will refer the investigation and analysis of segregated funds to the Ombudservice for Life and Health Insurance (OLHI) even if they form a part of a larger portfolio that is the subject of a complaint to OBSI.*

I have highlighted some relevant text. Many investors acquire segregated fund investments from entities whose main business is not only, or even wholly, the provision of insurance products or services, but investment advice and a wide range of securities/product recommendations. Insurance may well be a product amongst many products.

Separating out the analysis of segregated funds from a "strategy", account or portfolio of assets, would not be in the advisor's, the investor's or the public's best interests.

While I disagree that insurance business should be held accountable to different standards, there is a clear rationale for pure insurance activities to be assessed differently from investment activities even though the advice should have some of the same central drivers.

For advisors who can only provide insurance advice, and who recommend an insurance investment product, then it would make sense for that advice to be assessed by those with insurance technical expertise, but this could just as easily be satisfied (given the appropriate resources) within OBSI. The insurance technical aspects of segregated fund investments are not complex.

Irrespective, where the insurance advice is predominantly of an investment nature, the standards and procedures for the assessment of suitability and accountability should be the same as that of a standard investment suitability assessment. Moreover, where a segregated fund sits within a wider body of assets, those assets should be considered as one and assessed as such.

Separating out the segregated fund from a wider portfolio for assessment by two separate Ombudsman, operating under possibly two different sets of standards, is nonsensical. It is virtually impossible to objectively assess the validity of the advice concerning the whole when a large or significant part of that whole is excluded.

Therefore, where an "advisor"/adviser has multiple registrations, and a segregated fund is recommended alongside non insurance investment products and securities recommended by that advisor/firm, then the segregated fund recommendations should be assessed alongside all other investments.

Where an "advisor"/firm only has an insurance registration, and has not recommended the purchase or sale of other securities and products for the investor, then this could well be assessed by the insurance ombudsman but only with the above provisos. Even here, providing the expertise exists within OBSI, there is no reason why the complaint should be transferred to the insurance Ombudsman save for outdated, bureaucratic regulatory demarcation.

But, even if a stand alone segregated fund investment were transferred to the insurance Ombudsman, the case would need to be assessed under assessment procedures common to both. Situations where one advisor recommends a portfolio of non insurance products be sold, with the proceeds invested by an insurance registered "advisor" should be caught and advice assessed by the current Ombudsman.

I can understand why when investment recommendations are limited to segregated funds and the advisor is likewise limited to an insurance license, that there is a rationale, albeit disagreeable, for having segregated investments assessed by the insurance ombudsman, but this is the only instance. And, again, there should be provisos.

Allowing segregated investments to be assessed separately from the wider investment context is a retrograde step and is not in the public interest. It is also in the public's interest to know which of "**the rationales**" for the noted change is responsible for this proposed change.

For more information on the investment issues arising from a separate analysis of segregated funds please see my relevant post in my Depth Dynamics blog on this topic.

Insurance Ombudsman

A read through the most recent Independent Review of the OLHI does not imbue me with confidence in the ability of the OLHI to properly deal with segregated fund cases. I note a number of relevant excerpts from this report:

> *"I do however have a concern that **too few complaints are being raised to the OmbudService Officers for a more thorough review and recommendations**…..after reviewing 104 files I have concluded that a dozen or more could have been raised to the OmbudService Officer level, for more in-depth inquiry and analysis…..I found a number of cases which I felt might have been unfair to the complainant by not being raised to the OmbudService Officer level.".*
>
> ***"The pursuit of fairness in complaint resolution may require OLHI, as well as the Insurer, to have access to specific** legal, medical, **financial** and other **advice**. **All of the foregoing are readily available to the insurer, but not always to the complainant and not to OLHI as matters now stand.** One of the needs as related to me by some of the frontline counsellors at OLHI is that they wished that they had available to them the right to consult legal, medical and financial professionals in cases when they need such advice."*
>
> *"What **OLHI needs is additional funding for access to specialized** legal, medical and financial **advice**, and perhaps at times the advice of other specialists. **Complainants can rarely supply OLHI with the specialized advice that it needs in order to make the playing field more level between the consumer and the insurer."**.*
>
> "*Since OLHI has been in existence there have only been six references to a Senior Adjudicative Officer. An increase in the number of such references would increase OLHI's effectiveness and stature as a provider of dispute resolution services."*
>
> *"Although there is an acknowledged "gap" in the industry pertaining to the inability to obtain compensation from independent agents, it is not a problem within OLHI's capacity to solve. A solution would be best found through a process involving regulators, independent agents, and the insurers."*

Even if segregated fund complaints were transferred to the OLHI it would appear that the OLHI is not currently set up to deal with the investment issues associated with segregated fund complaints – it lacks process, it lacks funding and its lacks the necessary expertise. In this respect alone it would seem to be more practical and pragmatic for segregated fund issues to remain with OBSI.

Regarding systematic issues:

The ability of the Ombudsman to investigate systemic issues is of critical importance where a) the opportunity for redress through the regulators is limited or non existent, b) where the structures and procedures for dealing with systemic issues of the type likely to be addressed by the Ombudsman, in a timely manner, may be undeveloped or non existent, and c) where it is reasonable that there are material risks to investors.

The OBSI is in a perfect position to initiate systemic issue investigations. Not only should this benefit the investors and clients of firms, but it should also be protective of the necessary confidence in the financial

system and its regulation. While an ombudsman does not define regulation nor fine a firm, it does have innate public interest responsibilities.

The recommendation and the explanation for the recommendation to remove systematic issues from OBSI's mandate for investment cases outside the banking remit is not sufficient to justify the removal of the mandate. It is in the public interest for these reasons to be disclosed and this would include why regulators are supportive of the decision.

> *In developing regulations concerning banking dispute resolution that were finalized in April 2013, the Department of Finance adopted a new policy direction:* ***any potential systemic issues identified in the investigation of an individual complaint should be referred by external complaint-handling bodies such as OBSI to the FCAC for investigation****. As a result, OBSI is removing the systemic issue investigative powers from our Terms of Reference (former Section 11), which also necessitates a change to the definitions section.*
>
> ***This change*** *to the Terms of Reference* ***eliminates OBSI's ability to investigate systemic issues on the investment side of our mandate as well****. OBSI's Board believes that there should be one policy on systemic issues for the entire organization, and* ***the decision by the Department of Finance has necessitated this policy change.*** *The Board understands that* ***securities regulators are supportive of this position.***

If indeed the regulators (CSA? IIROC? MFDA? Or others) are supportive of this move it is incumbent on them to demonstrate how systemic issues are to be dealt with under current regulation.

I suspect that the decision to remove systemic issues from the OBSI mandate is a function of one or more of the following:

a. **cost** - the 2011 Navigator report pointed out the OBSI's funding pressures, which would lead one to conclude that there was a lack of sufficient resources to fund systemic investigations.

b. **industry pressure** - the 2011 Navigator report was particularly concerned about industry pressure with respect to the continuing viability of the OBSI. It is likely that industry pressure will have increased with respect to CSA plans to widen the membership. Who knows how this pressure has manifested itself - we do know that some institutions have asked for other EDRs to be made available for investment complaints as well as banking complaints[1].

c. **regulatory constraints, weaknesses of the SRO structure and the limitations of regulation of the transaction** - in other words, the decision to remove systemic issues from OBSI's mandate may have more to do with the defects of the present system than the potential public interest merits of its retention. i.e., the current foundation is not strong enough to support a systemic issue mandate.

Oddly enough, I note that the "*OLHI has a protocol for identifying and processing systemic complaints that is supported by the industry and incorporated into its Terms of Reference*[2]". Is this going to be removed too?

Regarding self imposed limitation period:

No disagreement here, although a rationale for the 6 year period should be provided.

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[1] http://www.osc.gov.on.ca/documents/en/Securities-Category3-Comments/com_20130215_31-103_agnewd.pdf

[2] http://www.olhi.ca/downloads/pdf/Independent%20-eview-Report-OLHI.pdf

Regarding compensation limit

I can see a need for a compensation limit, but I think this limit needs to be argued and reason provided for the limit itself. There may well be cases which would fall under the OBSI purview but where the scale of the losses might not be. I would certainly appreciate more insight into the rationale behind the current limit, because it should certainly not be a figure drawn at random.

I presume also that the Ombudsman provides a guide as to what it considers to be the level of compensation required where this exceeds the limit it is able to recommend. From what I understand in my interpretation of the consultation document, there is nothing stopping a customer from accepting the OBSI maximum and taking other avenues to attempt to claim the balance.

Regarding escalation process:

The 2011 Navigator report provided recommendations that would have dealt more effectively with this issue and I ask why there is no mention of bringing in binding decisions. Again, I strenuously recommend that reasons for not following up on this and other recommendations made should be disclosed as a matter of public interest.

Regarding independent reviews

I can see many reasons why it would be fortuitous to extend the timeframe for independent reviews from 3 to 5 years, in this case. I have no personal preference between 3 or 5 years, or insight that would provide such, save that in instances where the mandate of the OBSI is about to undergo significant change, that an independent review is requested in some shape or form. I think a 5 year review time frame should be adequate for most time frames. I would very much like to see an authoritative independent review of the current proposed changes especially since they appear to be at odds with the main recommendations of prior independent reviews.

Summary & Conclusion

In its 2011 report, Navigator stated that "*the regulatory and government stakeholder 'leg' had yet to assert itself vigorously enough to provide OBSI with the support it will need to survive*". Well, it appears that the two have asserted themselves, but not as one would have expected. Banks have been allowed to decide on which EDR scheme they should send their complaining customers to, OBSI is in the process of having a key and universally acknowledged critical component of its mandate removed, and few of the necessary reforms recommended in the 2011 report have been implemented.

We may well have "peace in our time", who knows, but at what cost. Unfortunately we have the proof and the pudding.

Andrew Teasdale, CFA, BA Hons Econ

NB, from the Navigator report*: "there is an agenda calculated to permanently weaken OBSI….Nor is it clear to us that many in industry think of OBSI as having a sufficient public interest role, such that consumers should be entitled to have a voice in the governance of the organisation."*

Appendix A – 2011 Navigator Report Excerpts & commentary

http://www.obsi.ca/images/Documents/Ind_Rev/independent_review_of_obsi_2011.pdf

Let us take a step back in time to the 2011 Navigator report:

It stated that OBSI faced "*significant challenges*", that the "*sustained criticism of its investment complaints methodology"* was without substantive basis*, that "Timeliness"* had "*dropped significantly"*, but "*mostly as a result of the surge in volume*", the "*complexity of complaints, industry resistance and the drop in real levels of funding.*" According to the report *"its funding has not kept pace with the workload and industry compliance has deteriorated with firms walking away, threatening to walk away, using more aggressive negotiating tactics and in some cases outright refusing to comply with recommendations*". There were also "*fractures amongst the Board*".

The impact of all the problems was "*magnified because OBSI lacks the structural support of compulsory membership, binding powers over its participating firms and strong regulatory engagement*".

It also pointed out the absence of factors that would ordinarily act "***as a 'dampener"***: "*organised, effective consumer pressure on the political process"*, "*an authoritative cross-sector regulatory presence*" and "*senior executive-level, broad strategic industry perspective and leadership*"

Its "*recommended strategic reforms*" were "*aimed at addressing the structural weaknesses of OBSI's voluntary authority; improving the presence of the consumer voice; strengthening regulator engagement with OBSI's mission; establishing 'safety-valve' mechanisms for resolving issues of great contention between industry and OBSI and strengthening confidence in the governance of the OBSI*."

A great many of these recommendations have either not been followed up (binding powers, consumer representation), while it is unclear what is happening to others (regulatory oversight of funding/budget decisions, independently chaired advisory panel), and clear movement in some (compulsory membership) have been countered by the introduction by the Ministry of Finance of competing independent EDR options. There also appears to be greater friction between the Ombudsman and industry with the many naming and shaming incidents and it is also unclear as to whether the investment loss calculation methodology has finally and unequivocally been accepted by industry.

In truth, there has been little publicly available comment by both regulators and the Ombudsman's board on the Navigator recommendations, which must be set against Navigator's comments in its report; "*the regulatory and government stakeholder 'leg' had yet to assert itself vigorously enough to provide OBSI with the support it will need to survive*".

The board has actually stopped publishing the content of its board meetings, apparently because they are now in competition with competing banking EDR schemes. It is frustratingly difficult trying to work out what is actually happening. The present TOR consultation document is itself short on a valid rationale for some of the key changes proposed.

As Navigator stated in its review, "*Selectively implementing these recommendations risks exacerbating the current state of 'imbalance*'.

The report further stated that "*there is an agenda calculated to permanently weaken OBSI….Nor is it clear to us that many in industry think of OBSI as having a sufficient public interest role, such that consumers should be entitled to have a voice in the governance of the organisation.*"

Other comments in the report clearly highlight the problems of advice in the industry that have again only been touched upon by the CSA "*criticisms that OBSI is failing to act consistently with Court decisions, that OBSI is going beyond regulatory standards when assessing an investment firm's approach to financial advice, that OBSI is applying hindsight, that OBSI is failing to assign adequate responsibility to the investor….etc*."

The presently proposed terms of reference represents a series of "*backward stepping compromises*", a phrase taken from the Navigator report; "*an industry-funded ombudsman scheme, in particular one without binding powers over its members, can only operate with the support of its constituent stakeholders. Absent a clear regulatory signal to the contrary, industry's continued criticism and pressure may ultimately leave OBSI with nowhere to go but to make a series of backward-stepping compromises…. .*"

We think that the principle underlying reason is that industry are very uncomfortable and resistant to the evolving public interest role for OBSI.

"Systematic issues: Neither OBSI's Terms of Reference nor its Policy and Procedures Manual specifically contemplate the possibility of issues that are systemic across a sector…This is an area that has become part of EDR scheme practice in other parts of the world - albeit not without some resistance from industry and allegations of scope-creep. This is a seemingly inevitable and difficult part of the evolution of EDR schemes given the differences in expectations of external stakeholders. At one end of the spectrum – a systemic investigation is a natural extension of an investigation of a single matter. It is logical and importantly is exactly what consumers and the community would expect. We often hear from consumers during our interviews "if it happened to me, it must have happened to lots of other people - will the scheme investigate that?""

"Once an EDR scheme has identified a system or practice that is problematic in one firm, the principles that underpinned that finding must inevitably similarly (not slavishly) apply if an equivalent set of circumstances arises in another firm. It is a fundamental fairness obligation on the scheme - to both consumer and participating firms."

Appendix B – Systemic Issues

The following is taken from the Australian Financial Ombudsman Service:

*…FOS is obliged to identify, resolve and report on systemic issues and serious misconduct**. A systemic issue is….an issue that will have an effect on people beyond the parties to a dispute**. Serious misconduct is defined as conduct that may be fraudulent or grossly negligent or may involve wilful breaches of applicable laws or obligations under the Terms of Reference. By dealing effectively with systemic issues and serious misconduct, **FOS can raise industry standards and help consumers to obtain fair compensation for financial losses**.*

FOS Systemic Issues Process

1. Identification - While FOS is handling a dispute, we consider whether the dispute raises any issues that might be systemic.

2. Referral - Once a possible systemic issue has been identified, we refer it to the relevant financial services provider (FSP). We will detail the issue, ask for further information, and invite the FSP to formally respond.

3. Assessment - We then assess the FSP's response and determine whether the issue is definitely systemic. Investigations are carried out by FOS's systemic issues staff, in consultation with the relevant Ombudsman. If we decide that the issue is not in fact systemic, then the matter is concluded. If we decide that it is a systemic issue, then we will manage its resolution in conjunction with the FSP.

4. Resolution - FOS will work with the FSP to resolve the systemic issue. Resolution of the issue will require the FSP, where appropriate, to: identify all affected customers; compensate the affected customers fairly for any financial loss, and implement a strategy to prevent the problem from recurring.

5. Reporting - FOS reports to ASIC quarterly on systemic issues. FOS only identifies an FSP in a report to ASIC if the FSP has not dealt with a definite systemic issue to the satisfaction of the relevant Ombudsman.

Note also the following excerpt from "Resolving disputes between consumers and financial businesses: Fundamentals for a financial ombudsman (For the World Bank January 2012)

In addition to investigating individual complaints, the Ombudsman must have the right to deal with systemic issues or commence an own motion investigation

And the following excerpt from the 2011 Navigator report:

"Neither OBSI's Terms of Reference or its Policy and Procedures Manual specifically contemplate the possibility of issues that are systemic across a sector…This is an area that has become part of EDR scheme practice in other parts of the world - albeit not without some resistance from industry and allegations of scope-creep. This is a seemingly inevitable and difficult part of the evolution of EDR schemes given the differences in expectations of external stakeholders. At one end of the spectrum – a systemic investigation is a natural extension of an investigation of a single matter. It is logical and importantly is exactly what consumers and the community would expect. We often hear from consumers during our interviews "if it happened to me, it must have happened to lots of other people - will the scheme investigate that?"

REMARKS TO THE HOUSE OF COMMONS STANDING COMMITTEE ON FINANCE - Delivered by Douglas Melville, Ombudsman and CEO– "We also serve as an early-warning system, which allows firms

to correct problems at low-cost and before they are litigated, while also providing regulators and public policy makers with unique data to inform their decision-making. Now, all that is at risk."