

October 3, 2024

Comments on OBSI illiquid Security loss calculation method consultation

Ombudsman for Banking Services and Investments (OBSI)
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Dear Sir/Madam

I appreciate the opportunity to provide comments on this consultation Paper. This consultation would have been unnecessary if OBSI had taken up the Battell Independent Review Report suggestion to periodically submit decision letters for independent third party review. If the consultation had provided historical statistics related to Exempt Market Dealer (EMD) complaints (number, main issues, refusals etc.) it would have scoped the issue to aid commenters.

Per the 2023 OBSI Annual report there were just 2 closed cases involving EMDs; neither were found in favour of the complainant. [Per the OBSI 2022 Annual Report there were zero closed cases. In 2021 there were 6 cases closed with none in favour of the complainant.]

Although I support the methodology in principle, I am surprised so few cases result in complainant compensation. Anonymized posting of complaint files would provide the visibility to better understand the outcomes.

As regulators expand the number of retail investors who can be sold exempt securities , the need for this consultation is clear. I am providing my input as a concerned individual investor in support of the proposed loss calculation methodology. For most Canadians OBSI is the last stop for complainants given the high cost, time consumption and stress of litigation in Canada.

NOTE: 283 out of 1312 (21.5%) OBSI investment dealer Participating Firms are EMDs.

EMDs are regulated just like other investment Dealers

Provincial regulators regulate EMD Dealers, a distributor of illiquid securities.

Exempt Market Dealers (EMD) must follow the same "Know Your Client" (KYC) and "Know Your Product" (KYP) procedures and carry the same "Suitability" obligations as other registered dealers (e.g. investment dealers, mutual fund dealers and scholarship plan dealers). These requirements ensure that each client's personal, financial and investment profile is understood and confirmed prior to any trading

activity. EMDs must also ensure that any security they recommend is suitable for a particular client by considering the particular investment product as well as each individual client's investment goals and profile. Source: <https://www.pcmacanada.com/page/Thecapitalmarkets>

These rules come into play in the complaint handling process. [The Dealer is clearly accountable for any exempt market securities recommendations notwithstanding any actions by the investor or disclosures provided to the investor.](#) If the security is unsuitable, it should not be recommended or sold to the client.

Regulators have confidence in OBSI

In a show of confidence in OBSI, Saskatchewan's Bill 150 has demonstrated investor protection leadership by giving OBSI a binding decision mandate with a higher dollar compensation limit. Based on statements from the Ontario Securities Commission, Canada's largest securities regulator, it too will support a binding mandate for OBSI.

OBSI and unsuitability

How does the Ombudsman service deem a product is unsuitable? The obvious approach is to relate the transaction to the KYC (and eligibility). [Marketing materials should also be reviewed.](#) The key KYC parameters are investor financials, investor goals/objectives, investor knowledge, risk profile (which includes risk capacity) and time horizon. Before accepting the recorded KYC information, OBSI validates the information and ensures that any inconsistencies are reconciled. An unsuitable investment also involves the sale of an exempt product to an investor that does not qualify for the purchase of exempt securities. The EMD is responsible for diligently validating investor information provided to ensure ineligible clients are not sold exempt products.

For investment advice to be determined as unsuitable it must be inappropriate for the client, inconsistent with KYC and / or the security was misrepresented at the point of sale. OBSI have established how to proceed with a complaint- the basic process involves a review of the facts, documents, account statements, etc and timelines related to the sales transaction. I assume promotional materials and ads are part of the review.

When OBSI declare an investment is unsuitable it means that the recommendation to buy the exempt security was not in accordance with securities laws. It is the investment advice that is unsuitable for the client, based on KYC and other factors. The exempt security itself may or may not have value.

Once OBSI determines that a recommendation is unsuitable, the next step is to determine the losses resulting from the unsuitable sale of the exempt market security.

I support the use of the investments clients would have purchased had there been suitable advice in the suitability performance opportunity assessments where there is clear evidence of what the complainant would have purchased, rather than using indexes. Where an index is used in a loss calculation estimation, it should be adjusted for fees and expenses.

I caution that any application of “investor responsibility” or mitigation principles to the loss calculation methodology must take into consideration the asymmetry of experience and knowledge between the client and the advisor/EMD. Further, I suggest that if investors are required to mitigate their losses, EMDs/advisors should also have an obligation to pro-actively assist clients in mitigating losses.

In the case of an illiquid security, OBSI propose setting its valuation as zero (if no value can be determined) and calculating a suitable comparator to calculate what the value would be if the money had been invested suitably. In effect, the transaction is reversed with the EM Dealer taking back the security and paying compensation to the investor based on what OBSI estimate a suitable investment would have returned. This makes sense – to my knowledge the industry has not put forth a fairer way to resolve the dispute.

The Financial Ombudsman service (UK) agrees with OBSI’s approach. See the section dealing with illiquid or suspended securities <https://www.financial-ombudsman.org.uk/businesses/resolving-complaint/understanding-compensation/compensation-investment-complaints>. The FOS uses the same loss compensation calculation model as OBSI. The UK FOS is internationally recognized as a leading financial ombudsman service. AFCA, the Australian Complaints Authority also provides investor compensation for opportunity losses due to mis-selling using a similar approach.

Some additional thoughts

I would like to also suggest adding some additional oversight provisions on OBSI that would not allow a problem like the exempt product loss calculation issue to fester for years without resolution. It should not have required an audit report to prompt executive action.

- **Publish anonymized cases on the OBSI website for transparency of decision making. This would be most appropriate when OBSI acquire a binding decision mandate.**
- Periodically submit selected case decisions to an independent third party assessor and make the assessment result public by posting on the OBSI website.
- OBSI should report all cases to the applicable regulator/ JRC where there is concrete evidence that the EMD has not demonstrated due diligence in assessing the eligibility of the investor to purchase exempt securities. This

process would assist in reducing the number of client complaints and is a valuable ombudsman service.

- Establish an independent Financial Consumer Committee that would act as the voice of the financial consumer to executives and the Board of Directors.

In a recent article lawyer Ellen Bessner stated “ *Gone are the days when you simply marked the trade ticket “unsolicited” and executed what the client instructed, even if unsuitable. That will not cut it in court or with the regulator.*” This suggests that OBSI should not be unduly swayed by EMD’s that defend their case by citing signed client risk acknowledgments.https://www.investmentexecutive.com/inside-track/_ellen-bessner/dont-go-down-with-your-clients-ship/

EM Industry want to retain the “ombudsman” nomenclature for internal complaint assessors

According to the PCMA, the lobbyist for EMDs, letter to the CSA on an OBSI binding decision mandate, it supports the use of the use of the term “ombudsman” for internal complaint handlers. This nomenclature could deceive complainants and steer them away from OBSI and OBSI’s proposed loss calculation methodology for complaints. Banking regulators have prohibited the use of the term “ombudsman”; accordingly, all the major banks have already ceased using the term “ombudsman” in client communications.

I urge the CSA not to permit this practice as it would undermine OBSI and all the fine work it has done to obtain fairness in complaint handling.

Summation

Based on the available information, the OBSI EMD loss calculation methodology does not appear to be is a major problem. Multiple independent reviewers have consistently said the OBSI process is fair and reasonable. I could not find any evidence the industry has a better alternative proposal other than to vacate OBSI or lower the compensation limit because of “special” E&O considerations. Treating the transaction as a refund for the sale of a defective transaction and making complainants whole is fair and is essential for effective investor protection.

As the exempt market expands and more Canadians can participate in the exempt market, the need for a demonstrably fair loss calculation methodology is essential. In my opinion ,the OBSI approach is logical, fair and reasonable.

It is fine to post this letter on the OBSI website.

Sincerely,

Arthur Ross -retail investor

DOCUMENTS and ARTICLES

SUMMARY OF KEY CAPITAL RAISING PROSPECTUS EXEMPTIONS IN ONTARIO

https://www.osc.ca/sites/default/files/pdfs/irps/ni_20160128_45-106_key-capital-prospectus-exemptions.pdf

Review of Enforcement Issues Associated with Prospectus Exemptions in

Canada: University of Calgary School of Public Policy

<https://journalhosting.ucalgary.ca/index.php/sppp/article/view/42936/30776>

Firm Refusals: Becksley Capital Inc. | OBSI

<https://www.obsi.ca/en/news-publications/firm-refusals/>

The AFCA Approach to calculating loss in financial advice complaints

<https://www.afca.org.au/media/402/download>

Valuing illiquid stocks

https://web.archive.org/web/20131126131814id_/http://www.u.arizona.edu:80/~gjiang/Valuing%20illiquid%20stock.pdf

Buyer beware with exempt securities - The Globe and Mail

<https://www.theglobeandmail.com/globe-investor/globe-wealth/buyer-beware-with-exempt-securities/article37406342/>

OSC finds significant deficiencies at exempt market dealers | Fasken

<https://www.fasken.com/en/knowledge/2015/10/osc-finds-significant-deficiencies-at-exempt-market-dealers>

PCMA comment letter to CSA on OBSI binding decision mandate

<https://fairandbalancedregs.com/wp-content/uploads/2024/03/PCMA-Comment-Letter-CSA-Proposed-Amendments-to-Certain-Complaint-Handling-Provisions-of-NI-31-103-and-31-103CP-1.pdf>