Kenmar Associates
Investor protection and education

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Mandatory OBSI Participation by IIROC and MFDA Member Firms

Kenmar Associates have been actively tracking OBSI ever since it became the Ombuds service for investments in 2002. We have issued Reports on its decisions, its Annual Report(s) , its operations, its Terms of Reference and its governance . We have acted as Intervenors or supported complainants in other ways. We have issued a Guide for retail investors on how to deal with OBSI . Thus ,we feel well qualified to comment on the current issue.

A May 24 article in the Toronto Star " Brokers battle with ombudsman" http://www.moneyville.ca/article/996371--roseman-ombudsman-can-t-resolve-dispute-with-members-over-compensation says it all. Canada's large investment firms are fighting with the Ombudsman for Banking Services and Investments (OBSI). The article says they think OBSI's decisions are too favourable to

investors and too costly for industry members. They want to work with other complaint mediators just as the RBC's banking group did in 2008. According to the article, five investment dealers – TD, Manulife, Investors Group , Macquarie Group and RBC – met with you to seek exemption from mandatory participation in OBSI . [strangely Luc Papineau and Terry Peacock of TD are on the OBSI Board despite TD's desire to depart the OBSI fold]

While we were not invited to this meeting and have been unable to secure a meeting of our own , we take this opportunity to provide our viewpoint. The article says that you have denied their request, but asked OBSI to explain and justify the method used to calculate investment losses via a public consultation. The Consultation Paper has been released and we will comment on it. Our comments here are laser focused on the retention of OBSI as the sole Ombud service for handling MFDA and IIROC member Complaints. Clearly,the industry is exploiting a defect in of National Instrument NI 31-103 [para 13.16] as the rationale to move to an independent dispute resolution service framework of their choice .This most definitely would not be in the public interest .

Many of the controversial points involving OBSI are rooted in the structure of OBSI itself and the influence of the industry which created it. While OBSI is viewed by many with suspicion due to a perceived pro-industry bias in recommendations , weak governance , excessive cycle times, and 100 % industry financing , it remains in many cases ,the only viable option available for aggrieved investors to gain some measure of restitution. Legal remedies are unaffordable for the vast majority for most complaints submitted to OBSI . They are simply not large enough to justify costly and time consuming litigation but large enough to adversely impact the lives of Canadians. In Q1,2011 OBSI made recommendations for monetary compensation or facilitated monetary settlements totaling $792,280, representing 29% of all closed case files. 17% of banking services case files and a whopping 41% of investment case files ended with a recommendation for monetary compensation or facilitated monetary settlement. An additional three case files (2% of closed case files) ended with a non-monetary recommendation or facilitated settlement .

Compensation	Total	Average	Median
Overall	**$792,280**	**$14,672**	**$7,569**
Banking Services	$103,037	$6,869	$1,000
Investments	$689,243	$17,673	$9,078

In fiscal 2010, OBSI recommended compensation in 78 banking case files and in 177 investment case files, with an astonishing 100 % of recommendations being accepted by the firms involved. Complainants received compensation from their financial institution in just 20% of banking cases and 38% (177 of 468) of investment cases, representing a total of only $3,788,896 for all of Canada [this is less than the tiny OBSI annual operating budget of$7, 335,746] . Just 5 cases were settled for greater than $100,000 . About 63 % of total OBSI costs were related to investments. Among IIROC firms, TD Waterhouse Canada was the subject of the most cases (72 vs. 46 in 2009), while BMO-related firms (BMO InvestorLine Inc., BMO Nesbitt Burns Inc. and BMO Nesbitt Burns) were the focus of 26 cases. Ironically, both firms are on the Board of Directors. On the MFDA side, Investors Group Financial Services Inc. was the subject of 24 cases, followed by World-Source Financial Management with 10. These results indicate that the numbers involved are very small . So small, in fact that we believe they represent only a small fraction of prevailing investor abuse .In any event ,it appears that a mountain is being made of a molehill by a few firms.

OBSI is generally recognized as the nation's banking and investment Ombudsman. The Ombudsman can serve as a bulwark of financial consumer democracy in troubled times, protecting citizens and helping industry, regulators and government to improve in the face of a tough economy and fiscal constraint. See http://www.gouvernance.ca/publications/09-06.pdf for a review of the Ombudsman as a producer of better governance.

Here are our main reasons for retaining OBSi as the sole Ombuds service approved by the CSA:

- OBSI provides a one-stop point of entry for complaint resolution. Distressed investors require simplicity in working their way through the convoluted financial services industry complaint handling process.
- OBSI are constrained by the FRAMEWORK worked out by regulators and must comply with its specifications.
- Every 3 years OBSi is subjected to third party review providing some assurance the service is functioning properly and keeping up with Best Practices around the world. The last time such a review was conducted it resulted in 24 recommendations and this cogent remark*" The final difference that we will note is our observation that Canada's financial services environment has noticeably lower levels of formal consumer protection by comparison with other parts of the developed world – including Australia.* " The next report is expected in September

- By its nature, OBSI has a treasure trove complaint database entrusted to it. This database can be mined to help develop better practices in the financial services industry , not just assess complaints. Prevention will reduce complaints and make Canada a safer place to invest.
- OBSI's cross Canada complaint database can be used to identify systemic issues at the national , regional or dealer level. It could , if used properly, provide an insight into long term industry issues. For example , OBSI have identified the NAAF/KYC system deficiencies as a root cause of investor complaints and a key factor in complicating the analysis of complaints.
- OBSI is much more transparent than any for- profit dispute resolution services.
- Permitting MFDA/IIROC dealers to retain multiple dispute resolution service providers of their choice would lead to confusion and inconsistencies in the processes and methodology used in resolving investor complaints.
- Eliminating the requirement for member firms to participate in the OBSI would create an alternative complaint handling network laced with conflicts-of- interest with little oversight by regulators . Retail investors would be at a huge disadvantage under such a regime. We expect that the for-profits would be more motivated to retain business than be fair to complainants. This would further weaken investor protection in Canada .
- A for-profit Ombuds service paid for directly by dealers would never be trusted by investors

If the CSA permit dealers to pick their own Ombuds services , it is reasonable to postulate that many will seek greener pastures, thus weakening OBSI. No doubt the banks would quickly follow . The contagion could spread to the OLHI . The end result could set back investor protection at least a decade. To allow this would be nothing short of regulatory malpractice.

These points makes it essential that mandatory use of OBSI be preserved .The cost of litigation is simply too much for most Canadians to bear especially after they've lost a money. Internationally, other Ombuds services are an Agency of Government established by legislation as is the case in the UK, Australia ,NZ and elsewhere . By all accounts these are working very well. e.g.

UK Financial Ombudsman Service (FOS) attacks banks handling of investment complaints http://www.moneymarketing.co.uk/investments/fos-attacks-banks-handling-of-investment-complaints/1031252.article In Canada, the banks and dealers are attacking OBSI. Latest FOS Annual Review at

http://www.financial-ombudsman.org.uk/publications/ar11/ar11.pdf (152 pages) See page 40 esp. Read also page 104 How Consumers feel about complaining.

OBSI has already been irreparably damaged by the public disagreement. Of course the real problem to be `` fixed`` is the abuse sales Reps are inflicting on Main Street. OBSI is only the symptom of the problem. The KYC system is broken and suitability standards are weak and ill-defined. Investment Policy Statements would help but they are not required by regulators and hence ,infrequently used. We note also that, in most cases, sales Reps owe no fiduciary duty to clients . These systemic regulatory deficiencies are the root cause of the majority of complaints .

OBSI does have serious governance issues and excessive cycle times but their job is made more difficult by working within a weak regulatory foundation. Based on our experiences, complainant satisfaction is not high but has been improving steadily these past few years. Long cycle time, unrealistic mitigation criteria, perceived interviewer hostility and undue acceptance of dealer assertions top the list of areas for improvement.

Because of all the negative publicity and hostility , OBSI will never be the same again. Intimidation and threats now hang over their head- funding formulas and budgets will be real battles.- loss calculations will be a persistent irritant-more cases will end up in Court or dropped by worn out investors Investors will now not accept that OBSI is independent [if they ever did]. OBSI has been emasculated and permanently impaired . We recommend that the CSA engage with OBSI to stabilize it and rebuild staff and investor confidence. This will require ,at a minimum, changes to NI31-103 and the FRAMEWORK The CSA / OSC should sit down with the investor advocacy community and discuss this Category #1 issue face to face . After all, investor protection is JOB #1.Without an independent OBSI, investors will have to get involved with costly , lengthy and frustrating civil litigation or just grin and bear the losses.

We add parenthetically that a compensation calculation that *makes people whole* from an industry that holds itself out as a trusted source of advice must include opportunity costs. The abuses we see are truly disturbing . It is supported by false and misleading representations by the industry as to the roles, titles, and compensation of those they employ as "advisors".Further information regarding the misrepresentative marketing practices that are considered standard operating procedure by the industry can be found at http://www.investorvoice.ca with particular attention to the MARKARIAN vs CIBC WORLD MARKETS discussion of false and misleading sales practices by a Quebec Superior Court Judge.

http://investorvoice.ca/Cases/Investor/ ... _index.htm Lofty slogans complete the inducement to trust the industry. Investors are lured into a relationship that is unfriendly , if not hostile, to them. They , especially seniors and retirees , are defenseless in this scenario. That is why loss calculations employing notional portfolios play a crucial role.

OBSI should explain their methodology in more detail but the general concept of compensating opportunity losses is correct. If it were any other way , restitution would be limited to the loss incurred - for a senior or retiree especially, that could mean several critical years of potential earnings would be lost forever. It would mean that RRSP's/RRIF's could not be repaired. It would also mean that reckless behaviour would not carry much financial risk for industry participants .We think of unsuitable investment recommendations as unauthorized trades and therefore the loss calculation should include opportunity costs. OBSI is not a regulator -it cannot fine wrongdoers , order disgorgement or assign punitive damages. so opportunity costs are the only available route for fair compensation for demonstrably defective advice . THE UK Ombuds service routinely uses notional portfolios to assess restitution.

As a general observation , industry participants and OBSI should publicly clarify which items of loss are subject to compensation and which are not- for example :

1. Actual investment losses due to unsuitable investments or other causes
2. Excessive fees paid
3. Early redemption penalties to exit unsuitable investments
4. Interest charges for *unnecessary* margin or loans
5. *Excessive* sales commissions
6. Undue income tax liabilities as a result of churning or unsuitable investments
7. The costs associated with preparing the claim/complaint
8. Opportunity costs /losses
9. Costs incurred such as interest on loans directly necessitated by the unsuitable investments/transactions
10. Interest expenses

OBSI does explain how it deals with non-financial loss (industry Ombuds do not) . https://www.obsi.ca//images/document/up-NFL_Approach_Sept_07_Fin.pdf The amounts however are very small (under $1000) and deserve upgrading given that they may involve loss of reputation, damage to credit ratings and loss of privacy.

In conclusion, Kenmar Associates supports continued mandatory OBSI participation for MFDA an IIROC dealers .We urge securities regulators to protect investors by resisting any attempt to dismantle OBSI. We urge the CSA, IIROC, and the MFDA not to buckle under to intense industry pressures to revise Section 24.A.1 of MFDA By-law No. 1 and IIROC Rule 37.2 and to remove the definitive requirement for dealers to participate in the OBSI complaint assessment process.

In fact ,we urge regulatory reforms to strengthen the accountability and independence of OBSI in the public interest. Further , the financial services industry should be asked to explain why the number of OBSI complaints is so high and growing . They should be asked to reveal their loss calculation methods and justify them. They should be asked to justify why they do not compensate for " opportunity losses". They should be asked to correct obvious deficiencies in their investor protection protocols.

We understand that OBSI currently has about 15 cases in which there's a stalemate and the firm refuses to follow its recommendation. According to OBSI's Terms of Reference they should be publicly revealing the names of the firms that refused to accept their recommendations. That hasn't happened, further weakening OBSI's claim of independence. The faster this invented problem is resolved, the faster these citizens can get on with their lives.

We would welcome an opportunity to meet with you and discuss this critical issue.

Should you wish to disclose or post this letter on websites , permission is granted.

Sincerely,

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