INVESTMENT INDUSTRY ASSOCIATION OF CANADA
ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÉRES

Susan Copland, B.Comm, LLB.
Director

Tyler Fleming
Director, Stakeholder Relations and Communications
Suite 1505 - 401 Bay St.
PO Box 5
Toronto, ON M5H 2Y4

July 9, 2012

Dear Mr. Fleming:

Re: Proposed Changes to OBSI Suitability and Loss Assessment Process

The IIAC appreciates the opportunity to comment on the current proposal respecting changes to OBSI's Suitability and Loss Assessment Process (the "Process").

We applaud OBSI for its efforts to engage with its stakeholders to improve OBSI's loss calculation methodology.

Our comments on the proposed changes to Process are as below. We also have input on certain matters discussed in the May 10, 2012 Notice, which follows our feedback on the specific questions regarding the loss calculation Process.

Our responses to the specific questions relating to the Process are as follows:

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

In the case where OBSI is conducting suitable performance comparisons, we generally support the use of common indices as one of the performance benchmarks, as they can increase the consistency, predictability and efficiency of the loss calculation process. It is however, critical that fees and trading costs be factored into the index performance as proposed. This will help ensure that any assessment of loss will more accurately reflect the actual performance and return on an investor's portfolio.

Further, clarification is required as to which indices will be used in which circumstances, and if OBSI staff will be provided with guidance on particular

indices to be used in specific fact scenarios. It was unclear in the IIROC/OBSI conference call on June 18, 2012 whether there will be some flexibility in applying the proposed common indices included in the powerpoint presentation.

In order to ensure investors' portfolios are measured against the general market conditions rather than only the best performing indices, we recommend that where possible, staff use the average performance of 3-4 comparable indices. We also recommend that OBSI consider using the performance of funds in the same family of funds if they exist and are relevant.

We also note there may be issues when situations arise involving complaints over sector concentration will be dealt with when the securities in question, comprise part of the index. For example, Materials & Energy stocks comprise approx 48% of the TSX/S&P Composite Index. These types of issues must factor into OBSI's procedures.

As discussed in the IIROC/OBSI conference call on June 18, 2012, using an index as a performance benchmark in situations where there are only isolated securities within a portfolio that are "not suitable" can lead to unfair results. This approach ignores the balancing effect of a portfolio approach and potentially substitutes it with a methodology that substitutes the lower performing or risky securities within a portfolio with more "suitable", higher performing stocks. This does not reflect the process or results of portfolio investing, as it removes the risk balancing inherent in a portfolio approach, and holds the advisor to an impossibly high standard. As such, we recommend that the indices only be used when most or all of the clients' portfolio is deemed "unsuitable".

As we have stated in our previous submissions, it is important to recognize that using one loss calculation methodology in all cases may not be appropriate. For instance, the notional portfolio/index approach may not be appropriate in some suitability disputes where the securities are not properly risk rated or circumstances where the client is actively involved in the investment decision making process.

Taking this into account, we request clarification as to the general circumstances under which OBSI staff will use indices as a basis for loss calculation, and the factors that OBSI will consider when considering common indices in different case scenarios. We believe OBSI should only undertake such a calculation if and when the methodology used by the dealer in its calculation of the loss is unreasonable. We seek confirmation that OBSI will remain open to other loss calculation approaches that may be proposed by stakeholders as long as they are reasonable.

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

As stated above, in order to provide a fair and accurate assessment of loss, it is critical that fees and trading costs be factored into calculations when assessing investment performance.

It would be appropriate for OBSI to specify the fees and trading costs that will be taken into account. These should include back-end or deferred fees, redemption fees, switch fees, and trailer fees. In addition to fees and trading costs, the suitable performance comparison should also take into account commissions (including front-end sales or load commissions) and MER.

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.**

Given that the loss calculation methodology using the notional portfolio takes into account market performance over time, adding interest to the compensation recommendation provides additional compensation beyond what the market would have provided, effectively double counting compensation. This strikes us as punitive. Adding interest to market based compensation effectively takes all risks out of investing and would unjustly enrich the complainant at the expense of the firm. We seek confirmation of the assertion of OBSI staff at the June 18 meeting, that interest will not be assessed in a way that results in double counting in respect of compensation where a model portfolio is used.

In addition, the length of time taken to process a complaint is often well out of the control of the firm. If matters take longer than OBSI's published performance objectives to resolve, a clear analysis as to where delays occurred is warranted. Although we do not support adding interest to losses measured by the notional portfolio and/or index approach, if such compensation is foreseen, it should be demonstrated that the firm is responsible for the delays and was not acting in good faith in its causing such delays.

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.**

We have concerns with, and seek clarification on a number of points in respect of this recommendation. It is important that it is well understood what criteria OBSI will use to determine when the investor knew or ought to have known that there was a problem with their investments. This issue is related to client responsibility and their duty to mitigate their losses. In the interest of fairness, clients bear a reasonable amount of responsibility for their actions or inactions in dealing with their advisor and managing their investments, when they are provided with information and have indicated agreement with their advisor's recommendations. In applying the "knew or ought to have known" test, we believe it is important to consider the level of knowledge and engagement of the client.

In our view, the six year term appears to be an unreasonably long time to provide to clients to file a complaint once they know or ought to have known that there is a problem. It is difficult to imagine a scenario where it is reasonable for a person

to wait six years to register a complaint once they are aware of a problem. The six year time frame also makes it difficult to provide the requisite information to investigators, as in time, staff turns over and memories become less accurate. In addition, IIROC has a seven year retention requirement for many documents, which may result in difficulties in providing full documentation of the case.

It is unclear whether the six year time period applies to the length of time that OBSI can look back in respect of "unsuitable investments". Once a complaint has been made, is there a limit on the number of years that OBSI can go back and investigate in respect of the investment in question?

Our concern is that this effectively opens up firms to claims from clients over an unreasonable time frame, both in respect of the time clients have to voice their concern and the length of time OBSI can go back in history to establish fault and award compensation.

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

We support this recommendation, and believe it could be helpful in discussions regarding loss calculation. We note, however, that in order to be useful, information as to how values in the spreadsheet are calculated must be transparent. In practice, this means that the columns in the spreadsheet must be "unlocked" so that the input into the cells is apparent.

It is important that the person producing the loss calculation spreadsheet understands all of the facts of the case and is not merely inputting data. The unlocked values in the spreadsheet will help the stakeholders understand the assumptions and information on which the calculation is based.

Other Issues

KYC Determination

At the June 18, 2012 meeting it was noted that OBSI processes are such that staff will review the KYC form with a view to making a determination whether it is accurate, whether or not the KYC form is in dispute. The KYC information is contained in a client account agreement between a firm and its client, of which under the new CRM requirements, the firm is required to provide to the client a copy. The investment advisor and the firm use the KYC information in their compliance procedures to supervise the suitability of a portfolio for a client, based upon the KYC information, risk objectives and risk tolerance. It is inappropriate that the OBSI process would void those fundamentals, particularly where the client did not dispute the information in the KYC in their initial complaint.

We are concerned that this "KYC Determination" is done without the benefit of a process to assess credibility, such as face to face interviews, or testimony under oath with an opportunity to cross examine.

Determining Investment Characteristics and Risk

We agree that there is a problem that results when attempting to reconcile the MFDA five-point risk rating scale with the IIROC three-point scale. We are concerned that this results in inconsistent ratings, for instance where an investment shows as a medium-high risk on the MFDA scale is translated to a high risk investment for IIROC investors. Suitability determinations made in such circumstances must be closely examined to ensure the risk rating that OBSI is applying is properly considered.

Disclosure Doesn't Validate an Unsuitable Recommendation

We would appreciate further clarification as to OBSI's approach in respect of how investor knowledge and responsibility may factor into the disclosure issue. For instance, if an advisor provides a full explanation of the risks to a knowledgeable investor, would this be reflected in the apportionment of losses due to an acknowledgment of some client responsibility?

Making a Suitability Determination

With the introduction of enhanced suitability requirements under IIROC's Client Relationship Model (CRM) in September 2012, we believe that OBSI's approach to suitability assessments should be adjusted to be closely aligned to regulatory standards. The CRM mandates a number of steps and considerations that advisors **must** take into account in determining client suitability. IIROC has spent significant time and effort over the past several years to ensure these requirements serve and protect clients' interests. As such, for OBSI to apply different and / or additional standards places an unfair and excessive burden on advisors in their dealings with their clients.

We are also concerned with suitability determinations made in situations involving estate executors and those with a power of attorney over client affairs. Given that in both cases, the client is effectively out of communication, there are significant problems in determining why decisions were made, particularly in cases involving long term relationships where no complaints were raised by the actual investor when they were able to speak for themselves.

Client Responsibility

As we have noted above, it is important that client knowledge and responsibility be taken into account when assessing losses and the apportionment of client responsibilities should be demonstrated in the loss calculations. The dispute resolution process must fairly take into account the fact that investors bear some responsibility to understand and direct their financial decisions, and that advisors cannot be held 100% to account for failure of such individuals to ensure that they understand the information provided to them, or mitigate losses for decisions that were made about their portfolio, once they are aware that they are not consistent with their understanding or expectations.

It should be clear that it is the responsibility of the client to divest themselves of unsuitable investments once they are aware of them and they should not be compensated for losses if they continue to hold the "unsuitable" investment when they were aware that it was not suitable for them. It should be disclosed to the firm whether the client continues to hold the investment that is the subject of the dispute, or if it has

been sold, what the proceeds were. In either case, the compensation recommendation should take into account the investors' subsequent actions. If the investor continued to hold an investment they believed to be unsuitable, the advisor should not be responsible for losses subsequent to the point they became, or should have became aware that such investment was unsuitable. Where the investment was sold, proceeds from the sale should be factored into the loss calculation.

We support OBSI's role as an impartial dispute resolution service that recommends reasonable compensation for client losses, but it should not promote abdication of responsibility by investors.

OBSI should be clear, and provide explanation in respect of the allocation of client responsibility in each case for which compensation is recommended. It is important to recognize the situations in which clients are, and are not held accountable for their participation in decisions that result in compensation recommendations.

Thank you for considering our feedback on these issues. We believe it is critical to address the issues articulated by OBSI's stakeholder groups in order to ensure that such an important dispute resolution forum is supported by, and has the confidence of the industry and consumers alike. If you have any questions, or require further input, we would be pleased to meet with you.

Yours sincerely,

Susan Copland