By email

November 21, 2024

Ombudsman for Banking Services and Investments
20 Queen Street West, Suite 2400, P.O. Box 8
Toronto, ON M5H 3R3

Attention: Mark Wright
Director, Communications and Stakeholder Relations

Dear Mr. Wright:

Re: OBSI consultation on loss calculation for complaints involving unsuitably sold illiquid exempt market securities

Portfolio Strategies Corporation ("PSC") is a Calgary-based dealer, member of the Canadian Investment Regulatory Organization, registered mutual fund dealer and exempt market dealer in British Columbia, Alberta, Saskatchewan, Manitoba, Ontario, Quebec, New Brunswick, Nova Scotia, Newfoundland and Labrador, and the Northwest Territories, and investment fund manager in Alberta and Ontario.

We are pleased to have the opportunity to provide our comments and responses with respect to the questions contained in the request for public comment.

**Opening Comments:**

While we have noticed improvements in the quality of OBSI investigations and recommendations over the last few years we still have some concerns with the knowledge levels and experience of OBSI investigation staff, or lack thereof. Member firms and their advisers work with clients face to face on a regular basis, ask questions about their objectives, investment knowledge, time horizon, etc., in an attempt to truly know their client so they can make sound recommendations based on those responses. OBSI seems to take everything clients say at "face value", where clients change their story from what they told the CSA or an SRO, despite written evidence or signed forms to the contrary, in a snapshot of time, and never truly know the client as we do; worse, some OBSI investigators ignore the written evidence and decide for themselves what they think should be the objectives, investment knowledge, or time horizon. This now means that Members and advisers can't necessarily rely on what clients tell them in signed documents, which seems blatantly unfair. When we raise this issue with OBSI investigators we are told that they "use their own fairness principles" which are not defined anywhere. This seems to contradict this request for comment on page 2 where OBSI states "We use the law and industry regulations as guides to determining fair outcomes, but we are not bound by precedent or specific case law." Member firms understand the law and industry regulations for the most part, but it is difficult for firms to follow undefined "fairness" principles in place of written, signed documents over long periods of time.

Members are at a large disadvantage when we don't know what those principles are, or how they should be applied when meeting with clients.

Some OBSI investigation recommendations are easy to understand and fair, and we believe that most, if not all recommendations are followed by member firms according to OBSI's own statistics. Then there are more complex cases, with a lot of moving parts, and cherry-picked alternative investments by OBSI like lower risk government bond funds, GICs etc. that OBSI feels the client should have been invested in for the period of the complaint – even though the client said they wanted to grow their capital and did not require income. Some of

the OBSI loss calculation spreadsheets are difficult to follow and not always clear, even for industry veterans or experienced Member compliance staff.

We have been involved in OBSI investigations of other Members when OBSI wants to look at current account statements, KYC forms etc. to determine if any changes took place after the client left the previous firm. When we talk to the client to get their permission to release their file to OBSI for such an investigation, they often express gratitude for the service the new firm has supplied in restructuring their portfolio to match their objectives. Imagine our surprise to hear from OBSI that our previously satisfied client now wants to file a complaint against the second Member, likely written or coached by OBSI to make such a complaint. This demonstrates obvious bias against the investment industry and assisting clients to file new, follow up complaints, is outside of OBSI's stated mandate, in our opinion.

Furthermore, there are concerns with the loss calculation example provided in this request for comment as it appears to be rather simplistic and may not be indicative of an account's suitability as it does not consider the time frame of the client. A fairer and more relatable approach to the assessment would be to include products, benchmarks, that relate to the client's time horizon. In this example, the client appears to be a growth investor and is now questioning the suitability after a short time frame. This is unclear. Additionally, the asset allocation appears unsuitable; however, was this suitable at the time of initial purchase?

OBSI's approach to considering the suitability may be questionable:

- The investments were approved at the time of purchase as a complete portfolio, which may imply they were suitable at that time. In other words, their risk rating may have increased during this time, which may not have been considered in this example;
- The time horizon is not stated, and the client is questioning her account after three years. Was the client not receiving advice during this time?; and
- The consultation says that OBSI considers the suitability either at the portfolio level or at the individual security level. This is the first that we are hearing about this. In practice, the portfolio is constructed first, and then individual securities are selected to ensure the portfolio is suitable based on the client's stated risk tolerance, investment objectives and time horizon.

Structurally, when providing advice to clients, their KYC is determined and agreed upon first. Then the portfolio is constructed based on suitable products that both the client and adviser decide upon. This is very much a top-down approach rather than what is suggested in the consultation.

**Please see our responses below in regard to the OBSI consultation on loss calculation for complaints involving unsuitably sold illiquid exempt market securities – request for public comment.**

1. *For loss calculations involving unsuitable illiquid exempt market securities for which no ending value can be determined, is OBSI's approach of assigning a value of zero and requiring the investor to return the unsuitable illiquid exempt market securities to the firm fair and reasonable? If no, are there any alternative approaches that we should consider?*

   **Response:**

   For cases where a loss calculation involves unsuitable illiquid exempt market securities and an ending value cannot be determined, OBSI's current approach of assigning a value of zero and requiring the investor to return the securities to the firm is a significant point of contention.

   While we understand the logic behind assigning a value of zero – given that these securities are often difficult to price or have no liquid market – we believe there are alternative perspectives worth evaluating:

Fairness to the Investor: If an unsuitable illiquid investment has been sold to a client and has been transferred to a new member, where that dealer has provided proper advice to the client on the security, disposition of the security, etc., the original dealer which sold the product to the client should take it back as they were 100% responsible. In other words, the new firm should not be required to take those assets on their books. We feel that the original firm should buy them back at the current market value or the original purchase price. This however becomes rather difficult when the issuer is inactive or is defunct, and no certificates could be issued representing where the assets are being held.

This approach ensures that investors are not left holding unsuitable investments that may have little to no practical value. It also helps reinforce accountability for firms that improperly sell such securities. However, assigning a zero value may not fully capture scenarios where residual or potential value exists but is indeterminable.

Alternative Approaches:

*Lack of appropriate benchmarks:* One of the challenges for member firms is the difficulty in accurately valuing illiquid exempt market securities, particularly when there is limited market information or reliable benchmarks available. We note that an appropriate high-risk index such as the MSCI Global Private Capital Closed-End Fund Index isn't used to determine whether the high-risk securities lost value against a comparable basket of securities, which is equivalent to the method used for evaluating medium-risk and lower-risk securities. This would allow a reasonable evaluation of gains and losses across the full spectrum of investment products. It would also improve the quality of investigations where a complainant who, for example had an 80% high-risk KYC profile yet they are still claiming unsuitability within the portfolio. Using a medium-risk index or a GIC at historically high rates, would not be indicative of the client's stated risk tolerance, investment objectives and time horizon. In most cases, clients had not owned GICs previously due to low returns, so OBSI's regular use of GICs as proxies for returns is not at all realistic or reasonable.

An alternative could involve a more nuanced estimation method, such as consulting third-party valuation experts. This may provide a fairer reflection of potential residual value, ensuring outcomes that are equitable for both parties.

*Name and shame the Advisor:* Another far more effective system would be if OBSI "named and shamed" the adviser responsible for the unsuitable trades in the first place. Regulators tell the public to run searches on their financial adviser for registration and disciplinary history. A "bad actor", or repeat offender, will never be found out under the current OBSI processes because the adviser is never "named or shamed". Further, Members will never find out either because there is nowhere for Members to search so they can avoid hiring such "bad actors". If OBSI and the CSA truly want to speed up the settlements with investors, and get more members at the table for agreed settlements, then they have to involve the 'adviser who made the unsuitable recommendations.'

There is also great unfairness in how OBSI publishes Member names on their website in advance of conducting an investigation. Members are effectively "guilty until proven innocent" based on OBSI's current processes. Many client complaints are dismissed as unfounded, but the damage has already been done when members are "named and shamed" without receiving due process.

2. *If we maintain our general approach of assigning a value of zero to unsuitable illiquid exempt market securities when a value cannot be determined and requiring investors to return these securities to firms as part of any settlement:*

    a. *are there exceptional situations or specific circumstances where such an approach should not be used?*

    **Response:**
    There may be exceptional cases where applying a zero value would be inappropriate:

    Partially Recoverable Assets: If an illiquid security has undergone partial liquidation or demonstrates some capacity for future recovery, even if uncertain, assigning a zero value may not accurately reflect its status.

    Evidence of Market Value: In cases where external information, such as recent transactions or third-party appraisals, indicates some potential value, a zero-value approach might overlook critical data.

    Special Circumstances: For securities tied to ongoing projects or ventures that have a reasonable expectation of generating future returns, alternative valuation methods might be more suitable. In addition, how should a registered plan be treated, such as an RSP or a RIF? There would be tax consequences – contributions, tax receipts, etc. – that the client may have benefited from. Some clients may hold these illiquid investments in a RIF, with no other holdings. All other holdings may have been withdrawn that could have been used to satisfy the RIF payment requirements. In such cases, a measure of last resort would be to de-register those holdings as the RIF payment. A fulsome review of the client's situation would alleviate some of these concerns. It's not as simple as the question suggests.

    b. *are there any other considerations or steps that we should take in the recommendation and settlement process that would improve the fairness of outcomes for consumers and/or firms in cases where illiquid exempt market securities have been unsuitably sold?*

    **Response:**

    Enhanced Disclosure: Ensure that firms provide comprehensive documentation of any attempted sale, transfer, or appraisal of the security during the resolution process to validate that no market value could be determined.

    Third-Party Audits: Engage independent auditors or appraisers to perform valuations where possible, offering an unbiased view of any potential worth that could inform a fair settlement.

    Graduated Returns: For cases involving securities that show potential for future returns but are currently illiquid, a mechanism for an earn out basis, such as future contingent payments based on eventual outcomes, could provide a balanced approach.

    Firm Accountability: Ensure that firms engaging in the initial sale of such unsuitable investments face clear, enforceable obligations to rectify the situation in a way that discourages future occurrences. In other words, the adviser and the original firm who sold the product should be held responsible.

    Special Circumstances: There may be situations where an unapproved off-book product was invested in by a client through a rogue adviser without the member firm's knowledge. The client may have knowingly pursued "off-book" above average returns, only to complain when

the investment does not work out. OBSI should not readily accept the complainant's view or feeling about being misled without reviewing all of the evidence.

**Conclusion:**
OBSI's current methodology of assigning a zero value is a practical approach to ensure fair treatment in many cases where no value can be determined. However, considering exceptions, finding an appropriate third-party benchmark (using a GIC as a base case is unreasonable), engaging third-party experts for valuation (in a worst case scenario), naming and shaming the adviser, the selling firm's accountability, and reviewing all the facts, could contribute to more equitable resolutions. Ensuring that outcomes are as fair as possible for both consumers and firms will bolster trust in the oversight process and encourage responsible practices in the exempt market sector.

At the end of the day, clients should be expected to continue to hold investments rightfully sold to them based on an accurate KYC. OBSI should not be permitted to fabricate a new KYC after they receive a complaint, then retroactively apply it to support their recommendation.

Thank you for the opportunity to provide our comments. We trust that these points will contribute to OBSI's ongoing efforts to refine its approach and maintain fairness and transparency in the resolution of complex cases involving exempt market securities. Please contact Mark Kent or Zachary Cohen with any questions you may have.

Yours truly,

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