Walton
Investing on Solid Ground®

February 14, 2013

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Nova Scotia Securities Commission
New Brunswick Securities Commission
Superintendant of Securities, Department of Justice and Public Safety, Prince Edward Island
Office of the Superintendent of Securities, Newfoundland and Labrador
Superintendant of Securities, Yukon
Superintendant of Securities, Northwest Territories
Superintendant of Securities, Nunavut

Dear Sir or Madam:

Re: CSA Notice and Request for Comment (the "Request for Comment") on Proposed Amendments to National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* ("NI 31-103") and to Companion Policy 31-103CP *Registration Requirements, Exemptions and Ongoing Registrant Obligations* – Dispute Resolution Service (the "Proposed Amendments")

This letter is provided by Walton Capital Management Inc. ("**Walton**") in response to the Request for Comment by the Canadian Securities Administrators (the "**CSA**") on the Proposed Amendments.

Walton is registered as an exempt market dealer (an "**EMD**") under NI 31-103 in all provinces in Canada. Walton currently has 75 dealing representatives and offers for sale prospectus-exempt real estate investments manufactured by entities in the Walton Group of Companies to qualified investors resident in Canada. These investments include pre-development and development land securities products.

Walton's parent corporation, Walton Global Investments Ltd. ("**Walton Global**"), previously owned a Canadian mutual fund dealer which it sold in 2010. As a result, Walton Global has experience working with the Ombudsmen for Banking Services and Investments ("**OBSI**") in relation to clients of the mutual fund dealer.

Walton has a number of concerns with the Proposed Amendments as detailed below. Walton proposes that, other than as discussed below, the wording of Section 13.16 of NI 31-103 remain as it is currently worded and that the temporary relief provided for under Section 16.16 be allowed to run out on September 28, 2014 or earlier.

1. **Avoiding a competition for dispute resolution services is not necessarily in the best interests of the capital markets** – The CSA indicates in the Request for Comment that one reason for mandating the use of only one dispute resolution service is that "[t]here would be no perception that competition for business from registered firms might influence the recommendations of for-profit dispute

resolution service providers". In addition to securities commissions and various SROs providing regulatory oversight, there are, of course, two very important participants in the making of an investment: the investor and the dealer providing the investment service. There needs to be a reasonable balance between the interests of all participants in order for the capital markets to operate in a mutually beneficial manner.

Providing a monopoly to one entity for the provision of dispute resolution services could very easily cause an imbalance among the interests of these participants. Given that it is proposed that the securities regulators choose the one entity to be granted the monopoly, the perception, and potentially the resulting reality, could be that this one entity may err on the side of providing compensation to investors in order to continue to be maintained by the regulators as the sole service provider. This perception, and potential reality, is just as damaging to the reputation of the capital markets as the perception raised by the CSA as indicated above.

It might be argued that this will not be the case with a "not-for-profit" entity. However, just like for-profit entities, not-for-profits must fund the retention of employees and infrastructure in order to carry out their services. They too have a vested interest in keeping employees and infrastructure in place. A monopoly, whether for a not-for-profit or for a for-profit dispute resolution service provider, is not in the best interests of the capital markets.

2. **The CSA's concern that a common dispute resolution service provider would reduce investor confusion as to who to contact is unfounded** – The Request for Comment states that a common dispute resolution service provider would reduce investor confusion as to whom to contact when complaints are not resolved at the dealer level. This concern is unfounded. It could be easily addressed by having dealers advise clients whom to contact in these circumstances. For example, when the EMD issues a substantive written response to a client in connection with a complaint, the response should include the contact details of the EMD's dispute resolution service provider in case the client wishes to take further steps.

3. **OBSI currently has a significant backlog of complaints that it is handling** – Walton understands, based on its discussions with other registered dealers, that OBSI is currently experiencing a backlog of complaints that it is handling and that OBSI is taking approximately 6 months to prepare its initial investigation report. The additional workload that will arise as a result of the Proposed Amendments can only add further pressure to this situation.

   We understand that, in the circumstances where OBSI recommends awards or compensation to clients, OBSI usually also includes an interest component in the award or compensation. A significant delay in the time it takes OBSI to complete the dispute resolution process will directly result in higher costs to EMDs in the form of higher interest amounts awarded against the EMDs. Alternatively, if OBSI waives interest because of its own delays, the result will be increased losses suffered by clients.

   A system that takes a significantly long period of time to resolve disputes is not beneficial for either EMDs or their clients and does not promote certainty or efficiency for the capital markets. Permitting EMDs the discretion to choose service providers for dispute resolution will promote a reasonably swift resolution to complaints raised by clients.

4. **OBSI's use of its so-called "'Name and Shame' requirements" is inappropriate in a system where the use of OBSI is mandatory** - Section 27 of OBSI's Terms of Reference state that:

"In the case of an individual Complaint, if a Participating Firm does not accept the recommendation of the Ombudsman, the Ombudsman shall make public the name of the Participating Firm, the recommendation and the circumstances of the case in a manner considered appropriate by the Ombudsman."

We note that, on its website, OBSI itself refers to this provision as the "so-called 'name and shame' requirements". In the Request for Comment, the CSA proposes to make the use of OBSI mandatory as a dispute resolution service for all EMDs and indicates that the OBSI only makes recommendations that are non-binding. Yet, OBSI is required to publicly "name and shame" dealers who do not follow their recommendations. We note that the requirement set out in OBSI's mandate to name dealers that do not follow their recommendations is not mentioned in the Request for Comment.

In our discussions with other registered dealers, we have determined that many dealers are so concerned with their name being disclosed by OBSI in this manner and its impact on regulators and SROs that they have accepted OBSI recommendations that they believe to be unfounded, unfair and/or disproportionate to the complaint made. Such circumstances are not conducive to the fair and efficient operation of the capital markets.

The power, and indeed, the requirement, that OBSI has to "name and shame" dealers who do not follow its recommendations is inappropriate and procedurally unfair in a system where (i) OBSI's use is mandatory, (ii) OBSI is not required to follow normal legal rules in making its recommendations (see item 5 below), and (iii) its recommendations are stated to be "non-binding".

If the CSA determines to mandate the use of OBSI for EMDs as provided in the Proposed Amendments, then Walton recommends that the CSA specifically provide in its amendments that the "name and shame" requirement in Section 27 of OBSI's Terms of Reference will not be applicable.

5. **There is a concern that OBSI's methodologies ignore legal principles and result in uncertainty in dispute resolution** – The CSA states in the Request for Comments that "OBSI conducts its dispute resolution activities in an informal, non-legalistic manner". Walton understands the benefit of a more informal process in the context of dispute resolution. Indeed, all dispute resolution service providers available in the Canadian marketplace utilize processes that are more informal than resolution through the courts.

   However, discussions with other registered dealers and Walton Global's experiences indicate that OBSI may ignore applicable legal principles resulting in significant uncertainty as to the claims brought to OBSI. For example:

   (a) OBSI issued a paper dated November 2, 2012 (the "**OBSI November 2012 Paper**") wherein it indicated that OBSI is "not subject to statutory limitation periods" in its process and indicates, as an apparent reason for doing so, that "[a]n Ombudsmen's role is to investigate complaints with a view to resolving them in a manner that is fair and reasonable in all circumstances".[1] We fail to see how ignoring the limitations periods for claims that would be applicable in a court proceeding is "fair and reasonable" to the dealer involved, especially in the circumstance where it is the client that decides whether to seek relief in the courts or through OBSI. We are aware of a situation where a client's claim was statute barred because the statutory limitation period had long since

[1] "Approved Changes to OBSI's Suitability and Loss Assessment Process, and Summary of Public Comments" – November 2, 2012, page 9.

run out and, in addition, the relevant regulatory authority had made a determination that there was no dealer liability. Notwithstanding this, OBSI recommended a significant award to that client. The dealer involved felt compelled to pay the award because of OBSI's "name and shame" requirement (see item 4 above). In these circumstances, the errors and omissions insurer for the dealer denied coverage. As a result, the dealer had to fund the award itself without the benefit of insurance.

Limitation periods are a crucial part of modern legal systems. The purposes for limitation periods include that (i) over time, evidence can be corrupted or disappear, which leads to unfairness for potential defendants if claims are allowed to be brought after significantly long periods of time, and (ii) providing certainty to potential defendants that claims must be made within mandated time periods, is beneficial to society. The limitation periods applicable in Canada have developed over centuries, are fair to both plaintiffs and defendants, have been mandated by government and interpreted by the courts. The ability of OBSI to ignore these rules leads to significant uncertainty for dealers and unfairness as indicated in (i) and (ii) above.

In addition, as noted earlier, OBSI usually includes an interest component in the award or as part of compensation. These interest costs and the potential loss of insurance coverage compounds the impact on EMDs of OBSI refusing to abide by applicable statutory limitation periods.

(b) In the OBSI November 2012 Paper, OBSI indicated that, in the context of "suitability" complaints, it has determined that it will use certain indices for suitability performance comparisons in determining awards for claims.[2] The use of this approach will not be appropriate for assessing awards in the context of most claims in the exempt market. Exempt market securities typically have trading restrictions and do not typically trade over secondary markets. When clients utilize EMDs, they usually do so with the intent to acquire securities that are primarily illiquid and have no trading market. Also, in many instances, exempt market securities are structured in a manner that is significantly different than the securities that are comprised in the indices suggested by OBSI. For example, many exempt market securities have specific tax features that are different from the securities comprised in the indices.

The approach to assessing damages and awards in the context of dispute resolution for exempt securities should be the approach utilized by courts rather than relying on indices that may not be relevant to exempt securities. To base awards on anything other than applicable legal principles will bring uncertainty and unfairness to EMDs and their clients.

One of the fundamental principles in the application of "procedural fairness" as it relates to administrative and regulatory processes is the concept of "certainty". If all participants in the process cannot rely on the consistent application of legally defensible principles, the whole system can be called into question.

If the CSA insists on mandating the use of only one dispute resolution service for all EMDs, and, as it indicates in the Request for Comment, that its "goal is to ensure the independence of dispute resolution services and consistency in expectations and outcomes", then it is crucial that the CSA demonstrate to the market that its choice is wholly appropriate for these purposes and that all legitimate concerns are investigated and properly addressed.

[2] See Note 1 above, page 4.

6. **The Proposed Amendments are not based on experience with the operation of Section 13.16 of NI 31-103** – As noted in the Request for Comment, at the time NI 31-103 came into force in 2009, Section 16.16 provided a two-year transition period for the requirements in Section 13.16. This was eventually extended for a further year. Then, effective September 28, 2012, the CSA granted further relief until the earlier of September 28, 2014 and the coming into effect of any amendments to Section 13.16.

   The CSA did not indicate, at any time in this process, that it might implement an amendment mandating the use of OBSI as the sole dispute resolution service available to EMDs under Section 13.16. This was the case notwithstanding that, at the time of the coming into force of NI 31-103, both the MFDA and IIROC either mandated the use of OBSI or were proposing this to their members. In fact, in response to its Request for Comments dated February 29, 2008, the CSA indicated that "[a] commenter is of the view that the OBSI should be specifically included in the proposed Rule as part of the complaint process". The CSA's simple response was "We do not agree".

   We believe that it is inappropriate for the CSA to mandate the use of one dispute resolution service when the process that was originally put in place has not yet been implemented and tried. There is no evidence to suggest that the original process is unsatisfactory or yields an unjust result in the context of EMDs.

7. **CSA does not provide adequate information on increase in costs** – Under the heading "Anticipated costs and benefits" in the Request for Comment, the CSA does not provide any analysis as to the increased costs to the capital markets as a result of the Proposed Amendments, other than to indicate that "[w]e note that section 13.16 of NI 31-103 requires registered firms to bear the costs of an independent dispute resolution or mediation service ..." and "[w]e believe the benefits of mandating a common dispute resolution service provider outweigh the potential for any incrementally higher costs to registrants." This does not constitute adequate analysis for the purpose of justifying mandating the use of one service provider. We request that, if the CSA continues to propose mandating the use of OBSI, it undertake further study of the quantitative increase in costs to EMDs of the Proposed Rule and publish the results of that study. For example, OBSI observes on its website that it is able to provide its services in 170 languages. While impressive, one wonders whether it is appropriate to have all dealers bear those types of additional costs, rather than those who need those special services.

   Granting a monopoly to an organization in circumstances such as these, where the costs are absorbed only by Canadian registered dealers, could very easily result in significantly higher costs and fees than in the circumstances where there is a "competition" by a number of entities that are able to provide the service.

   To be clear, Walton agrees that the costs of these services should be absorbed by EMDs. However, there should be appropriate checks and balances on the fees charged for those services. Granting a monopoly to one organization provides little incentive for cost efficiency and will remove the most important check and balance.

Based on the above reasons, Walton is of the view that mandating OBSI as the common service provider, or mandating any common service provider, for all registered dealers and advisers in respect of their dispute resolution obligations under NI 31-103 will not be in the best interests of investors or EMDs. Other than as indicated below, we recommend that the wording of Section 13.16 remain as it currently is

worded and that the temporary relief provided for under Section 16.16 be allowed to run out on September 28, 2014 or earlier.

On page 3 of the Request for Comment, the CSA sets out two issues for specific comment relating to the time within which complaints must be brought by clients to OBSI. As indicated above, Walton recommends that OBSI not be mandated as the sole dispute resolution service provider. However, in the context of when complaints must be brought by clients to the dispute resolution service providers chosen by EMDs, we recommend that, for the reasons discussed in item 5(a) above, a specific deadline by which claims must be brought should be included in NI 31-103. However, "within 6 years of the date when the client knew or reasonably ought to have known of the trading or advising activity" is much longer than the applicable statutory limitation period in most provinces. For the reasons discussed in item 5(a) above (including the concern regarding loss of insurance coverage), we recommend that the time limitations track those required under applicable Canadian law, for example, in the case of an Alberta trade, the earlier of (i) 2 years from the date when the client knew or reasonably ought to have known of the trading or advising activity, and (ii) 10 years from the date of the trading or advising activity.

We would be happy to discuss our comments with you. Please do not hesitate to contact us if you have any questions.

Yours truly,

WALTON CAPITAL MANAGEMENT INC.

Mark Mckenna
President

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