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To: Member Commissions of the Canadian Securities Administrators (CSA):

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Financial Services Commission
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
New Brunswick Securities Commission
Registrar of Securities, Prince Edward Island
Nova Scotia Securities Commission
Superintendent of Securities, Newfoundland and Labrador
Registrar of Securities, Northwest Territories
Registrar of Securities, Yukon Territory
Registrar of Securities, Nunavut

c/o John Stevenson, Secretary
Ontario Securities Commission
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By email to: *jstevenson@osc.gov.on.ca*

Anne-Marie Beaudoin, Directrice du secrétariat
Autorité des marchés financiers
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Montreal, PQ H4Z 1G3
By email to: *consultation-en-cours@lautorite.qc.ca*

Re: Canadian Securities Administrators (CSA) National Instrument 31-103 Registration Requirements (the Rule) and proposed Companion Policy 31-103 Registration Requirements (the Companion Policy)

Thank you for the opportunity to comment on NI 31-103.

¶1. The focus of my remarks will be sections 5.29 – 5.31 in the Rule on **Complaint Handling** and section 5.12 in the Companion Policy on **Client Complaints**. I will also refer to relevant passages in the Notice and Request for Comments (the Notice).

¶2. **Background.** In August 2004, I made a submission to the Ontario Securities Commission in response to its Request for Comments on its Fair Dealing Model Concept Paper. Currently these comments are posted at www.osc.gov.on.ca/Regulation/Rulemaking/Current/Part3/Comments/33-901/com_20040809_33-901_pjreeve.pdf and www.sipa.ca/library/Documents/OSC-FDM-Reeve_040809.pdf. In this submission, I apply the principles of fair dealing to complaint handling at financial service providers. My conclusion is that investors are exposed to harm in the context of these dealings. Subsequently, I made submissions on this topic to the Senate of Canada and federal Department of Finance.

Notice & Request for Comments: Division 7: Complaint Handling

¶3. The Notice observes that the requirement for firms to implement policies and procedures to address client complaints is a new requirement in most CSA jurisdictions. It notes further that *"This requirement is in response to comments received from investors about the need for responsive complaint handling processes"* (Notice, p. 14). In view of this, a requirement is introduced in the current Rule that investment firms should internally review client complaints as per 5.29 and 5.31.

¶4. The Notice also states that the CSA reviewed *"the nature and scope of the market problems or risks"* in considering the addition or modification of registration requirements (p. 6).

Problems re: introduction of a requirement for an internal complaint process

¶5. **Alleged investor "need".** The source of the above investor "comments" is not identified. The proposal of a regulatory requirement on the basis of such indeterminate comments is questionable. More precisely, investors with complaints are not in need of an adversarial complaint process, conducted by a party that is inevitably affected by conflict of interest (see ¶¶11-12 below). Investors do not need a complaint review process where they are inevitably disadvantaged by an imbalance in knowledge, power, and possibly other vulnerabilities (¶¶12-13). In view of this, the introduction of a requirement that firms should internally review client complaints cannot be justified in terms of investor needs.

¶6. **Absence of risk assessment.** There is no evidence that the CSA Member Commissions have considered or conducted an assessment of the risk of harm to investor interests in connection with the internal review of client complaints by investment firms.

¶7. The Notice states that the purpose of the registration requirements is to *"provide protection to investors from unfair, improper or fraudulent practices"* (p. 6). No such protection is provided by the proposed requirement. On the contrary, the requirement that firms should deal internally with client complaints and that investors should have to go through the internal complaint process before being able to access independent adjudication, exposes the investor to significant risks.

OBSI Statistics: 50% of decisions by investment industry overturned

¶8. Case-based statistics in the last two Annual Reports of the Ombudsman for Banking Services and Investments (2005 and 2006) give some indication of the risk faced by investors in the context of firms' internal complaint process.

¶9. In 2005, the OBSI recommended compensation in **50% of investment cases**. In 2006, OBSI recommended compensation in **51% of investment cases.** Regarding the 2005 figure, feedback from the OBSI indicates that in most cases, the client's complaint had **previously been denied** by the firm, i.e. with no offer of compensation. In some cases, the client would have been through two levels of internal review: first with the Compliance Department and then with the firm's internal Ombudsman.

¶10. The OBSI statistics shed light on the reliability of the **internal complaint process** at investment firms. According to these results (and the OBSI is an industry-funded organization), investors have only a **50% chance** of receiving a fair decision. A 50% rate of overturn suggests that internal decisions by firms are **unreliable.** Should clients accept these decisions? Judging by the outcome of OBSI reviews, the investor may as well flip a coin.

Further comments on proposed complaint handling requirement

¶11. **Conflict of interest.** The Rule obligates firms to manage conflict of interest. Clearly, the internal compliant process is inherently affected by conflict of interest. Firms are making judgments about their own dealings in circumstances where there is a financial incentive to act in their own interests, i.e. deny meritorious complaints or offer inadequate compensation. The 50% overturn rate of firms' decisions by the OBSI is evidence of this conflict of interest. The NI 31-103 requirement that firms should deal internally with client complaints exposes investors to the risk of harm arising from this conflict of interest. Investors should not be put in the position of having to **rely** on firms to self-manage conflict of interest in the complaint process. How would the client assess whether the firm is fulfilling its obligation? The client should not have to monitor this.

¶12. **Adversarial nature of the complaint process.** Regulatory insiders are aware that the internal complaint process is 'adversarial'. Yet, it is not identified as such to the client—either by firms or by the regulators. The complaint review process is presented as a dispute resolution 'service' or this is implied. The firm may even refer to it as an independent and impartial investigation. These representations do not alert the client to the adversarial nature of the complaint process and the need to protect their interests. Not being informed, the client may rely inappropriately on the firm's decision.

¶13. **Vulnerability of clients.** The proposed requirement that firms should deal with complaints internally in the first instance does not take into account the vulnerability of the client in this process. Clearly, there is a significant **imbalance in power** in a context where the client has direct dealings with the firm. Advantage could be taken of the client, especially seniors and those with disabilities or language problems.

This vulnerability is further amplified by an **asymmetry in knowledge.** It has been acknowledged that there is a relatively low level of financial literacy among Canadians. If this is problematic at the investment level, it is even more problematic in the complaint process, where the investor is not in a position to make an independent judgment about the fairness and accuracy of the firm's decision.

¶14. **Suitability.** The above vulnerabilities are even greater where the issue regards investment suitability. In 2005, the OBSI reported that 48% of complaint issues related to suitability and 49% in 2006. The client may only know that they have lost money. Assessment of suitability involves a relatively complex analysis that must take into account several factors (age, net worth, investment objective, timeline to retirement, risk level of investments, etc.). Clients should not be put in the position of having to rely on firms to conduct an objective and impartial review of suitability issues. The fact that most investors are unable to assess this for themselves, puts them at considerable risk in the internal complaint process where this is an issue.

¶15. **Current SRO oversight of the internal complaint process.** Provincial statutory regulators have delegated investor protection to self-regulatory organizations such as the Investment Dealers Association (IDA) and Mutual Fund Dealers Association of Canada (MFDA). SROs currently have oversight of internal complaint handling by their member firms. Fair dealing is not a new requirement. Firms already are required to conduct business in a manner that is fair, honest, and in good faith. What evidence is there that firms have been resolving client complaints fairly? In view of the OBSI results of the past two years, as well as other data, and the above risks and vulnerabilities, I have to question whether investors can rely on SROs to ensure fair dealing in the internal complaint process of their member firms.

¶16. In the final analysis, it is the investor, including seniors, who are exposed to risk in the internal complaint process. In the event that a meritorious complaint is decided unfairly by a firm and is accepted by the client, who may be a trusting senior, the harm suffered is unrecoverable financial loss and perhaps a diminished quality of life for years to come.

Summary

¶17. The proposed registration requirement that firms should deal internally with client complaints is introduced on the basis of a reference to unidentified investor comments. This is an inadequate basis for introducing a regulatory requirement for a complaint process that is questionable in the above respects.

¶18. The proposed requirement overlooks existing problems. A 50% overturn rate of firms' decisions by the OBSI indicates that the internal complaint process is unreliable.

¶19. There is evident **conflict of interest** on the part of firms and **multiple vulnerabilities** on the part of investors in the internal complaint process. This amounts to significant **risk of harm** to investors with meritorious complaints. This risk is amplified in the case of suitability and other complex issues where the uninformed client is put in the position of essentially having to guess whether the firm's decision is accurate and fair. Going through such a process serves no purpose that relates to investor protection, which is the stated aim of the Rule.

¶20. **The purpose of the National Instrument 31-103 Registration Requirements is to protect investors. This purpose is not served by the proposed requirement that firms should deal internally with client complaints.**

¶21. As long as the current system remains in place, investors going through the internal complaint process should be cautioned that the process is adversarial and should be advised to seek an outside opinion on the merit of their complaint.

Thank you for the opportunity to address the proposed Rule.

Yours truly,

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