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Independent Evaluator

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RE: Request for Comment on the Independent Evaluation of the Ombudsman for Banking Services and Investments (OBSI) with respect to Investment-Related Complaints

OVERVIEW

The Portfolio Management Association of Canada (**PMAC**)¹ represents over [300 investment management firms](#) from across Canada registered with the various members of the Canadian Securities Administrators (**CSA**) as Portfolio Managers (**PMs**). PMAC's membership is comprised of firms of varying sizes and models, ranging from one-person firms to international and bank-owned firms, including more traditional models and online advisers, and manage total assets in excess of \$2.9 trillion, with a mix of both institutional and private client assets.

PMAC appreciates the opportunity to have participated in various consultations and in-person discussions regarding the OBSI's mandate and operations, as well as to provide our feedback on this independent evaluation of OBSI's investment-related mandate (**Consultation**) through our meeting on January 12, 2022 and this written response.

Registered PMs have discretionary authority over investments they manage for their clients and have a duty to act in the best interests of their clients, also referred to as the fiduciary duty. PMAC strongly believes that this fiduciary duty is of utmost importance to investors, that its existence increases confidence in the capital markets and that it informs the way that PM firms operate their business and service their clients.

PMAC is supportive of securities regulation that promotes safeguarding the rights of Canadian investors and that avoids or minimizes retail investor dissatisfaction. We believe that OBSI plays a valuable role in Canada's capital markets and we support this important function.

We also note with appreciation OBSI senior staff's demonstrated receptiveness to stakeholder feedback on issues such as the representation and reporting of complaints in Annual Reports, and their commitment to enhancing OBSI staff's knowledge and understanding of discretionary asset management.

Important context to note for our comments is that the number of open complaint cases by the PM sector has consistently been between 3-5% of total investment-related complaints, and often, 2% or less of PM firms have had any interaction with OBSI, other than billing. Given that the small sample size of PMs that have had any experience with OBSI resolving complaints is

¹ For more information about PMAC and our mandate, please visit our website at pmac.org.

insufficient for PMAC to comment on service, our feedback and recommendations are focused on fees and reporting.

KEY RECOMMENDATIONS

PMAC's key recommendations are as follows:

1. **Overhaul the fee model for PMs** – The total revenue collected from the PM sector to process the consistently small volume of complaints is extremely high. The current method of allocating a portion of the total OBSI budget based on complaint volume results in a cost per complaint that is excessive. Ideally, fees should correlate to the risk of the OBSI participant (firms with more frequent complaints would pay higher fees). The current model results in the PM sector paying a disproportionately high amount of OBSI's costs in relation to the services provided to PMs. We recommend the fee setting model be completely overhauled to allocate fees relative to service volume more fairly and benchmark the cost per complaint to be more in line with what is reasonable in the private dispute resolution service market. The current proportional fee allocation model does not achieve fee fairness.
2. **Improve fee and cost allocation transparency** by expressly setting out the proportion of OBSI's costs divided amongst industry sectors, relative to each industry sector's average share of cases opened.
3. **Ensure appropriate characterization of complaints** to provide fair dispute resolution as well as accurate complaint reporting and fee allocation. Where more than one OBSI participating firm has a relationship with the investor, ensure that the firm whose conduct resulted in the complaint is the named party.
4. **Clarify that OBSI's mandate does not extend to non-individual clients** by engaging the Canadian Securities Administrators (**CSA**) to amend National Instrument 31-103 – *Registration Requirements, Exemptions and Ongoing Registrant Obligations (NI 31-103)*.
5. **Permit PMs and their clients to use dispute resolution services other than OBSI** – PM clients are typically sophisticated and high-net-worth individuals with significant assets, who may prefer to use a dispute resolution service other than OBSI. The main gap in services with OBSI is the availability of qualified mediation specialists.² This approach to dispute resolution may be more suitable for sophisticated high net worth clients and there are external providers of this service. Other providers may offer more efficient processes or more specialized expertise that would be better suited to these sophisticated investors.

Additional detail on our key recommendations as well as other comments are set out below.

² Mediation is a recognized dispute resolution mechanism for resolving commercial disputes – see for example, *Commercial Mediation Act* (Ontario) (the Act), 2010, S.O. 2010, c. 16, Sched. 3, s. 3 “commercial dispute” means a dispute between parties relating to matters of a commercial nature, whether contractual or not, such as a dispute related to... investment, financing, banking, insurance...” The Act sets out a framework for dispute resolution that would work for sophisticated investors, who would be in a position to select their own mediator.

CONSULTATION QUESTIONS

PMAC is responding to certain of the consultation topics and questions and, where applicable, we have cross-referenced the consultation topic and question below.

2. Independence and Standard of Fairness

With respect to the specific consultation questions in this section, as we explained during our January 12th meeting, PM firms do not have sufficient collective experience with OBSI to allow us to opine on the impartiality, objectiveness and consistency of decisions rendered by OBSI.

However, PMAC members continue to voice concern around the classification and categorization of certain complaints. Members are troubled by certain instances of OBSI characterizing and adjudicating complaints that arise from the custodial side of the client relationship as PM complaints. For instance, we are aware of a case where an investor used a PM's platform to upload transfer instructions to a custodian (an IIROC dealer member). There was an error in the brokerage transfer performed by the custodian which resulted in the custodian liquidating a position the investor wanted to keep. Despite the PM's involvement in this transaction being limited to having provided the client with the digital platform to upload transfer instructions to the custodian, OBSI treated the complaint as a PM complaint. This is in spite of OBSI acknowledging that the investor was also a client of the custodian on whose side the error occurred. We believe that instances such as this can confuse investors, unfairly penalize the individual PM and skew the already-small number of complaints categorized as PM complaints, thus increasing the fees paid by all PMs for OBSI services. We urge careful consideration of which OBSI participating firm is responsible for each client's complaint, to seek resolution of the complaint with the correct party and to categorize the complaints accordingly.

3. Processes to perform functions on a timely and fair basis

- Question: How effective do you consider the "naming and shaming" system to be?

Given the relatively low profile of the OBSI "name and shame" system with respect to firms that refuse to pay the recommended OBSI compensation amount, PMAC suggests there may be opportunities for OBSI to: a) share findings of an investigation with the firm's principal regulator or SRO, as well as b) consider having the CSA add this information to a firm's [national registration search results](#) and/or the Disciplined List. We believe that reporting decisions involving firms to the principal regulator or SRO would provide a further incentive to firms to deal honestly, fairly and in good faith with clients, and may provide information to the regulator that would factor into its compliance review or risk rating of the firm. This information is also instructive to consumers; naming and shaming in OBSI Annual Reports and on the OBSI website is a useful start, but providing consumers with other avenues to access the information will make it more likely to come to their attention.

- Question: What powers do you think OBSI should have and, specifically, do you think OBSI should have authority to issue binding decisions?

As set out in [PMAC's response](#) to the Capital Markets Modernization Taskforce (**CMMT**) consultation, PMAC is supportive of measures that improve retail investor access to dispute resolution services and outcomes. Since OBSI is not structured to be a decision-making body, like a court of law or an administrative tribunal, were OBSI to be empowered to render binding decisions, we believe that additional procedural and administrative fairness measures would need to be implemented. We do not believe that it would be efficient or effective for this additional infrastructure to be added to OBSI. Rather, we would support an appeal process that leverages the CSA members' tribunal structures, as recommended in the CMMT report. We

believe that, without such additional measures, OBSI should not have the authority to issue binding decisions.

As noted above, our members would also support the availability and use of other dispute resolution mechanisms and alternatives to OBSI. PMAC members' clients are typically sophisticated and high-net-worth individuals with significant assets, who may prefer to use a dispute resolution service other than OBSI. Other services may offer more efficient processes or more specialized expertise that would be better suited to these sophisticated investors.

4. Fees and Costs

- Question: To what extent does OBSI have a fair, transparent and appropriate process for setting fees and allocating costs among firms that use its services?

We recommend that if the current process of setting fees and allocating costs continues, there needs to be greater transparency and reporting of the total fees collected for each registration category and the resulting cost per complaint. To improve transparency and to set appropriate fee and cost allocation amongst firms, OBSI should clearly set out how the costs of senior management, administration and overhead are divided proportionally across the various sectors according to their share of complaints.

Improved transparency regarding the exact quantum that PM firms are collectively paying on an annual basis and with respect to the allocation of these fees would allow stakeholders to better understand how the fees are used, and whether the fee structure and allocation is fair. We suggest that alternative methods, such as a system whereby firms that have multiple disputes would pay higher fees (similar to the insurance model where claims increase premiums) or allowing PMs to opt-out and/or retain other dispute resolution services that better suit their needs, would achieve greater fairness with respect to the fee allocation.

Secondly, we strongly recommend there be a complete overhaul of the current fee setting process for PMs. The total revenue collected from the PM sector to process the consistently small volume of complaints is extremely high. The current method of allocating a portion of the total OBSI budget based on complaint volume results in a cost per complaint that is excessive. The current model results in the PM sector paying a disproportionately high amount of OBSI's infrastructure costs in relation to the services provided to PMs. We recommend the fee setting model be completely overhauled to allocate fees relative to service volume more fairly and benchmark the cost per complaint to be more in line with what is reasonable in the private dispute resolution service market. The current proportional fee allocation model does not achieve fee fairness.

- Question: what, if any can OBSI do to improve the allocation of its fees and the value it provides to its participating firms?

As stated earlier, we recommend a complete overhaul of the fee setting process for PMs. We believe the revenue being collected from the PM sector to process the small volume of complaints results in a per complaint cost that is excessive as compared to the private dispute resolution service market. Recognizing OBSI's commitment to fairness and fee impact on member firms and the principle of no cross-subsidization among registrant categories, we continue to highlight the very low number of inquiries and complaints that have been reported in connection with PMs in the OBSI Annual Reports for both 2019 and 2020, which demonstrates this category of registrants is lower risk, and therefore should be paying a significantly lower cost per complaint.

According to the case statistics in the OBSI Annual Report 2020, there were 692 PMs participating in OBSI. Only 26 cases were opened in connection with PMs in 2020, representing a mere 5% of the overall total of cases opened. And, according to the case statistics in the OBSI Annual Report

2019, there were 732 PMs participating in OBSI and a total of 14 cases were opened, representing 3.6% of the overall total cases opened by OBSI that year. Given that the PM category accounts for an average of approximately 4% of the overall cases opened in the last two years³ a disproportionate share of OBSI's levies are charged to a sector that, by our analysis, generates a small fraction of OBSI's total complaint volume and costs.

PMAC has been engaged in ongoing advocacy on the fee allocation issue since OBSI was mandated as the dispute resolution mechanism under NI 31-103. Despite our support for OBSI's services, we believe the OBSI fee structure for PMs needs to be overhauled in order to more appropriately reflect the complaint volume actually represented by clients of PMs as well as to manage the sometimes-significant fluctuations in annual fees from year to year.

In addition to allocating fees more fairly among industry sectors, a new fee calculation formula should be implemented to eliminate the fluctuations in fees to be paid year to year to allow firms to budget and plan. As noted above, we believe that greater fee fairness could be achieved through allowing PM firms to select alternative dispute resolution mechanisms that might better serve their clients and/or introducing a fee calculation where firms that have multiple disputes would pay higher fees.

5. Resources

- Question: To what extent are OBSI's staff qualified, experienced and capable of devoting the required time and effort to individual investigations?

As we discussed during our meeting, we would expect that individuals tasked with handling PM complaints have adequate training with respect to the PM business model (such as a lawyer, a CFA Charter (or at minimum Level I or II CFA)), and industry experience. The individual should have a good understanding of portfolio construction, the documentation used throughout the lifespan of the PM/client relationship and the fiduciary relationship between the PM and the client.

10. Transparency

- Question: Does OBSI engage in public consultations with respect to material changes to its operations and services?

PMAC has been satisfied with OBSI's consultation process. We believe that stakeholder feedback on this Consultation (the Independent Evaluation) and on future related consultations is vital to the ongoing success of the OBSI and, in future, would encourage consultation periods that are at least 90-days in length in order to solicit a wide array of thoughtful feedback. We are appreciative of the extension of the original timeline for the current consultation.

Other

Non-individual clients, not just non-individual Permitted Clients, should be excluded from OBSI's mandate – applying for exemptive relief is a regulatory burden

PMAC firmly believes that since the OBSI's mandate does not extend to institutions, the requirement NI 31-103 for firms with non-individual non-Permitted Clients to use OBSI for dispute resolution should be changed. Although firms with non-individual non-Permitted Clients may apply to the relevant CSA jurisdiction for exemptive relief from NI 31-103, this avenue is costly, burdensome and does not further investor protection.

³ With similarly low case volumes in years extending back to at least 2015

The Permitted Client definition in section 1.1 of NI 31-103 does not capture several non-individual clients that PMAC considers to be “institutional” clients because they meet other criteria common to institutional clients. Examples of certain clients that do not meet the Permitted Client definition and the financial thresholds in NI 31-103 are:

- Health and welfare trusts (distinct entities under the *Income Tax Act* (Canada))
- Unions and union-related benefit plans
- Multi-employer benefit plans
- Some foundations and registered charities
- Some overflow pension accounts (associated with pension plans, but not pension plans themselves)
- Supplemental employee retirement plans
- Disability Plans
- First Nations trust vehicles (i.e.: for government monies) and
- Retirement Compensation Arrangements.

Including these non-Permitted Client / non-individual entities in OBSI’s dispute resolution mandate is not appropriate nor in line with OBSI’s purpose of serving as a dispute resolution mechanism for retail investors and small businesses. These entities have the means and sophistication to achieve dispute resolution in other ways. There is no policy reason to expend firm and OBSI resources on these entities.

We ask that the independent evaluator make a recommendation to revise the requirement under subsection 13.16(8) of NI 31-103 which currently reads “this section does not apply in respect of a complaint made by a permitted client that is not an individual” to say, “this section does not apply in respect of a complaint made by a non-individual client”.

We thank you again for the opportunity to participate in this Consultation. If you have any questions regarding this letter, please do not hesitate to contact Katie Walmsley (kwalmsley@pmac.org) at (416) 504-7018 or Melissa Ghislanzoni (mghislanzoni@pmac.org) at (416) 504-1118.

Yours truly,

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