TAMRIS Consultancy

Perspective on proposed changes to IDA Complaints Regulations & OBSI Terms of Reference

According to an Independent Review of the Ombudsman for Banking Services and Investments[1] "*Canada's financial services environment has noticeably lower levels of formal consumer protection by comparison with other parts of the developed world*".

This document addresses recent proposals to upgrade the Canadian retail investor complaints process from the perspective of minimum industry standards with regard to suitability. It argues that while the current proposals to upgrade the complaint process will enhance investor rights and protection in Canada it will only do so within the restrictive confines of the current regulatory framework. What is in fact needed, are higher minimum standards governing responsibility (*"fiduciary type" responsibilities extended to advisory services*) and suitability; higher standards also imply greater transparency and higher levels of disclosure.

Indeed, the document states that "implied" industry standards are far higher than those generally considered as standard in the complaints process and that the suitability process does in fact require a far higher level of responsibility for advice than that currently accepted by the regulatory bodies and financial institutions themselves. However, recent proposals to improve the complaints process are likely to open the retail engine to view and may initiate wider questions about the viability of the current regulatory structure and culture.

A significant barrier to higher standards is the de facto regulatory control of the retail financial services industry by self regulated organisations. A complaints process beholden to the current regulatory structure (*including that of the financial ombudsman OBSI*), is not going to be able to address the systematic issues that drive poor financial advice in the first place. Note that OBSI is constrained by industry minimum standards which are more or less determined by self regulated organisations. Since these standards are influenced by industry interests OBSI can hardly be considered to be truly independent of the interests of the industry.

While a greater focus on complaints and the systematic issues that underpin complaints (*that fall within minimum industry standards*) would clearly pose risks for the status quo by opening the door onto the wider issues associated with low minimum standards, a reassessment of the structure of retail financial services regulation is clearly needed if we are to deal appropriately with the real issues underpinning poor financial advice.

The document does not go into all the regulatory issues and concerns over the complaint processes. For those who are interested in wider investor advocate concerns I would recommend reading comments provided by Dr Pamela Reeve (on behalf of SIPA for the IDA complaints process) and Kenmar on the respective IDA and OBSI pages.

Brief reference is made to the British regulatory approach which, though not perfect, regulates for higher standards and provides greater protection of retail investor rights. The UK financial services industry is directly regulated (*it is not hived off to self regulatory bodies*) and its ombudsman (OFS) is given statutory authority. Minimum standards are regulated by the UK Financial Services Authority (FSA) which consults with both industry and consumer bodies[2] and hence the rules governing industry practise which the OFS

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[1] Navigator Report - http://www.obsi.ca/UI/Resources/WhatsNew.aspx

[2] Whatever the Canadian Regulators say there is no effective consultation with consumers in Canada.

refers to can be considered to have arisen from an objective and independent process. Such a process is important if an ombudsman is to be truly independent.

I would therefore also recommend that the UK FSA, Financial Services Ombudsman and UK Financial Services Consumer Panel websites are referenced in tandem with the Canadian OBSI and provincial securities regulators sites.

A central component to this document is a study of higher implied minimum industry standards. For this we have used BMO Nesbitt Burns[3] charter of client rights and client responsibilities as a reference benchmark.

The document also contrasts the BMO standards with the recent OSC "researching your investment" document which appears to imply that investors are responsible for detailed research into all the investments recommended by their advisors. This is a confusing document and at face value is an apparent volte-face from the earlier stance taken by the Fair Dealing Model, where at one point a fiduciary type responsibility was being considered for advisory based services.

OSC Fair Dealing Model Concept Paper***, "In an Advisory Relationship the client is entitled to rely on objective, expert advice from the representative".***

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[3] charter of client rights and client responsibilities

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1 Complaints & Minimum Standards

The Canadian Financial Services Industry complaints process is currently under review as noted by a) the Investment Dealers Association of Canada proposals for amendments to complaint handling requirements (by-laws 19 and 37 and policy number 2) and b) the review of the Ombudsman for Banking Services and Investments "Terms of Reference".

As discussed, this document briefly reviews these two issues within the context that effective management of retail investor complaints can only effectively be addressed within an environment of higher minimum industry standards for disclosure and suitability and the acceptance of responsibility for the suitability of recommendations made by the industry. These issues formed a significant part of the substance of the Ontario Securities Commission's "Fair Dealing Model".

Minimum standards within the Canadian Financial services industry would appear to be based on the assumption that all retail investors (*with the exception of those accepting discretionary mandates*) are initiating requests for transactions and are responsible for accepting the suitability of those transactions.

All minimum industry standards (for advisory services) appear to require is that the transaction complies with basic "know your client" rules governing suitability, even though most industry communication implies a far higher level of responsibility and standard of service[4]. Even these standards are narrowly interpreted by firms' complaint departments and self regulatory organisations. They are also the same standards on which the independent financial services ombudsman (OBSI) bases its recommendations. Note the following differing aspects of standards ranging from **standard** (Canadian compliance benchmark), **good practise** (UK Ombudsman benchmark) and **best practises** (Fair Dealing Model benchmark).

> "*…we did not identify any complaints where we felt OBSI expected a level of practice that clearly went beyond the bounds of reasonable **standard industry practice**.*" Taken from the Navigator review of OBSI.
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> OSC Fair Dealing Model Concept Paper, "*The Fair Dealing Document is based on **actual examples of best practises i**n account opening documentation*".
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> "*When we look at complaints, our approach is to decide what we believe is fair and reasonable in the circumstances of each particular case. We take into account the law, rules, codes **and good practice** that applied at the time of the event complained about.*" UK Financial Services Ombudsman[5].

Part of the problem is that regulation of the retail financial services industry has been delegated out by provincial securities organisations to powerful industry controlled self regulated bodies, the Investment Dealers Association and the Mutual Fund Dealers Association. Importantly and, as an aside, a very large segment of financial advice provided by the insurance industry, with its array of investment products, is excluded from the main retail regulatory structure.

Financial institutions will often use inadequate minimum industry standards to defend instances of bad advice and to promote sales practises that by default misrepresent the true nature of the risk and costs of products and services. This could be viewed as a systematic issue. While improvements in complaint handling will force the issue of suitability to the fore, the ability to deal appropriately with the issue will require regulations that stipulate higher standards of disclosure, responsibility and suitability.

A move to higher minimum industry standards will also predicate a move to redefining advisor responsibility to one that more appropriately reflects the reality of the actual client/advisor relationship. The current

[4] Note BMO Nesbitt Burns

[5] http://www.financial-ombudsman.org.uk/publications/pdf/guide_complaints_handlers.pdf

archaic interpretation and application of Fiduciary responsibility will need to be modernised to incorporate advisory based services where organisations actually retain considerable discretion in the suitability process. Nowadays, even many so called discretionary managers operate on a quasi discretionary and not a true fiduciary basis; the asset allocation and risk and return benchmarks are set by agreement (investment policy statements) between manager and client. Fewer and fewer client relationships are falling into what would be considered the pure definition of a fiduciary responsibility (essentially ignorant individual handing over complete responsibility for all decisions) and most advisors, whether discretionary or advisory, are operating at various levels of a fiduciary type responsibility.

The TAMRIS document, "Suitability, Minimum Standards and Fiduciary Duty" explains the complexity of the suitability process, the reality of fiduciary type responsibility and the weaknesses of current minimum industry standards while the comments on the Joint Forum of Regulators "Point of sale Documentation" expands on the issues of disclosure and responsibility.

1.1 IDA proposals for amendments to complaint handling – by-laws 19 and 37 and policy number 32

The IDA is looking to introduce rules governing the time frame in which firms must reply to a client complaint and ultimately respond to a client complaint. These new rules also dictate that substantive information must be provided to clients making a compliant. The most significant impact of these proposed rule changes is that investors will now have a right to take their complaint to the industry Ombudsman (OBSI) at a much earlier stage in the complaints process.

Firms will need to reply to a written or verbal complaint within 5 days of receipt of the complaint and must respond with a substantive reply by 90 days (understood to be a quarter year). At the present moment in time there are no time limits. While the proposed rules provide insufficient information on just what a substantive response should be, especially under the context of minimum industry standards, the overall requirement for a time limit and the ability for investors to bring complaints to the independent ombudsman at an earlier point in time should be welcome.

The proposed changes will place compliance departments under greater pressure to perform and companies' management to pay greater attention to compliance and issues giving rise to complaints. By forcing companies to give its clients the right to go to OBSI after 90 days it places greater emphasis on settling complaints early and to dealing professionally with all complaints.

Having to deal with complaints in a timely manner with the threat of a review by OBSI should make the complaints process more efficient and should ultimately impact on the supervision and standards within organisations.

Other countries around the world have taken on standards higher than those recommended by the IDA and there is no reason why current proposals should not be seen as part of a gradual process of evolution. In the UK firms have to reply to a complaint within 5 days (*there is no reason why Canadian companies be less efficient than global standards*), they should also look to provide a substantive response within 4 weeks and, if not, must conclude their response within 8 weeks (*56 days*). After eight weeks UK investors have the right to take complaints to the UK Financial Services Ombudsman. Such a timeline forces companies to deal with complaints as part of its business process and promotes the importance of more effective oversight at the advisor and process level. It is also clearly demonstrates the importance of the consumer to the financial services industry important in promoting public confidence in the retail financial market place.

While the proposed rules IDA are an important step in the enhancing investor protection (90 days as opposed to 28 days in the UK) they ignore the effectiveness of IDA oversight of industry compliance departments and the role minimum standards play in defining those processes[6]. Canadian retail financial

[6] It is worth noting that the IDA's own reporting in this area is termed Sales Compliance.

services operates as if it were primarily a transaction driven industry with brokers/investment advisors apparently free to recommend virtually any product or transaction within the confines of their registration. It would also appear, if we are to judge from comments made by the financial institutions in the comments section of the IDA and OBSI proposals, that they are very keen to keep the status quo "as is".

If an organisation has no clearly defined service structure, standards of disclosure and investment processes governing portfolio construction, planning and management then the compliance department will be unable to properly assess client complaints regarding suitability and misrepresentation. That is, there are no benchmarks against which a compliance department can easily judge deviation from a firm's let alone industry standards. Unfortunately the industry is marketing its services as if it does provide structured wealth management solutions (*including what is effectively portfolio management if not directly by nam*e) when in fact its culture, processes and structures are primarily transaction focussed.

If a client has clarity over the service they should be receiving (*transparency aided by better disclosu*re) and the organisation has a structured process for the delivery of wealth management services, then an investor will be better able to understand when they need to complain and a compliance department will have effective benchmarks to determine when advice has transgressed those standards.

As stated, the comments made in this document have a specific suitability focus. The Small Investor Protection Association's submission to the IDA prepared by Dr Pamela Reeve focuses amongst other things on the treatment of private investors in the complaint handling process. Dr Pamela Reeve is an academic who has gone through the complaint process. For a list of all submissions please not the following link.

http://ida.knotia.ca/Knowledge/View/Document.cfm?Ktype=445&linkType=toc&dbID=200712361&tocID=9&nc=512633857743&nc=846460784325

1.2 OBSI, Navigator Report & Term of Reference

Canada's financial services ombudsman OBSI[7] was set up by the financial services industry whereas other international ombudsman have been set up by statute; note the UK financial services ombudsman[8].

At present regulation of the Canadian retail financial services industry is determined by self regulated organisations as are effectively minimum standards. Therefore, the final arbiter of a complaint, the financial services ombudsman (OBSI) is constrained by these same minimum standards and logically dependent on and not independent of these industry bodies. Judging by the comments received by OBSI from the industry in response to the proposed changes to their terms of reference one could be forgiven for believing that it is also accountable to "participating members".

> If anybody wants to assess just how much the financial institutions determine minimum standards they should look at the registration reform project's committee reports on the Fair Dealing Model recommendations. TAMRIS has produced an analysis of these committee reports in *"Registration Reform Project Working Committee Paper comments".*

An independent review[9] of OBSI was conducted by the Navigator company of Australia and this review is worthwhile reading. Although this review did not address minimum industry standards per se, or the reasonableness of these standards, it did confirm that OBSI decisions follow minimum industry standards. As noted at the start of this document, the Navigator report commented on the "***noticeable lower levels of formal consumer protection***" in Canada.

> Navigator report excerpt"*…we did not identify any complaints where we felt OBSI expected a level of practice that clearly went beyond the bounds of reasonable standard industry practice. ….This is another example of an area where the more fulsome explanation*

[7] http://www.obsi.ca/default.aspx
[8] http://www.financial-ombudsman.org.uk/
[9] http://www.obsi.ca//images/document/up-3OBSI_Review___Final_Report_EN.pdf

*referred to in Section 7.5 above is needed – i.e. what elements of industry practice are seen to be the **minimum essential for fair dealing**? We have seen this done well by other ombudsman services – expressed at a level of generality – leaving the detail of how a firm achieves that standard as much as is possible to its own discretion".*

The report dealt with amongst others the lack of a mandate to deal with systematic issues, which it (Navigator) considered integral to the efficient operation of an independent ombudsman. With the ability to define minimum industry standards difficult, it would presumably be difficult to define just what is and what is not a systematic issue with respect to the provision of suitable advice. There have also been numerous other instances of systematic abuse that could well have been caught be a wider focus on systematic issues; note the sale of business income trusts via the promotion of "high yields" (which were in fact comprised of substantial returns of capital); note the mutual fund market timing scandal; note the sale of principal protected notes outside the scope of securities regulation and we could go on. Attention to systematic issues could therefore be problematic for the industry.

Navigator did not explain what it considered to be systematic issues or how an ombudsman would deal with systematic issues. If OBSI is constrained by minimum industry standards it would be limited in its ability to deal with systematic issues that arose directly from minimum industry standards. Additionally, with self regulated organisations responsible for regulation of retail financial services, it is unclear as to whether these systematic issues would receive an objective hearing. In the UK the following are a number of options the FSA would have recourse to.

In the case of the FSA, action could include:[10]

- *taking supervisory action;*
- *taking enforcement action;*
- *taking regulatory action under the Unfair Terms in Consumer Contacts Regulations;*
- *securing redress;*
- *publishing rules and/or guidance.*

It is noted that the OBSI terms of reference looks to OBSI dealing with these issues itself. It is a moot point whether OBSI should be dealing with systematic issues direct. The UK OFS refers systematic issues to the Financial Services Authority (regulator) and/or the Office of Fair Trading. It is clear that OBSI needs to address systematic issues (note the wider application issues unit of the UK Ombudsman) but what is not clear is to whom OBSI should refer notice of systematic issues. To industry controlled self regulatory organisations or statutory bodies such as the provincial securities authorities? Logic would suggest that this should be referred to the provincial regulators and not the SROs who may be tempted to deal with the issue with the interests of its industry members in mind. Although as noted in a recent Investment Executive article "*OBSI Not a Regulator*", David Agnew stated, "*If not us, Who?....The regulators have made it pretty clear that they do not want to get into the restitution game*"**.**

Since the industry is largely self regulated at the retail level, it is inconceivable that the industry would look to tighten standards on its own, enhancing consumer rights and moving from a transaction based to an advice based model with its attendant higher level of industry responsibility for making suitable recommendations.

A body (OBSI) that is set up by industry and dependent on the rule making of that industry cannot be considered truly independent or objective. In this context OBSI could be considered beholden to industry control of the regulatory process.

[10] http://www.wider-implications.info/process/what_will_be_done.htm

In the light of the above it is worthwhile noting an excerpt from OBSI's terms of reference (*pointed out by Pamela Reeve in her comments on the proposed amendments to OBSI's terms of reference*).

> "*The Ombudsman shall report to a Participating Firm information about any threat to Participating Firm staff or property of which the Ombudsman becomes aware in the course of the Ombudsman's duties*".

As noted by Dr Reeve, this quote confirms that there was no such requirement for OBSI to report in the public interest any threats to its (public interest) integrity.

While redefining OBSI's terms of reference may deal with a number of issues, a major part of the problem does not just reside in improving current complaint processes but in redefining the qualitative benchmarks or minimum standards governing suitability and responsibility. This will therefore require changing the culture, structure and regulation of the retail financial services industry. Comments on OBSI's terms of reference[11] can be found at the OBSI website and again I would recommend reading Dr Pamela Reeve's submission for a consumer advocate perspective.

One area where the industry and self regulated organisations may well express concern is the fact that reporting of systematic issues to a higher regulatory body may implicate the complaint handling process and possibly systematic issues within the SROs themselves.

1.2.1 Industry comments OBSI

It is noted that industry comment over the proposed amendments to OBSI's terms of reference recommends that the investigation of systematic issues be excluded from the proposed terms of reference. Reference is made to the UK system where the regulator and the respective regulated firms are charged with dealing with systematic issues as a matter of fact.

What industry comments failed to point out is that the UK regulation of financial services institutions is direct and that firms have a specific responsibility to deal with systematic issues. The comments also failed to point out that the UK's financial services ombudsman has a responsibility to deal with wider systematic issues both within its memorandum[12] of understanding with the FSA and the Office of Fair Trading (OFT) and with respect to the rules and regulations for dealing with issues with wider implications[13].

The Canadian Bankers Association also disputed the need for to limit the period of complaint handling for participating firms to 90 days, "*the effect may be to eliminate the opportunity for a firm to resolve its most complex complaints on a timely basis for the consumer*". The validity of such a rationale was itself strongly disputed in the Navigator report.

1.3 Conclusion complaints and minimum standards

IDA proposals to tighten complaint timelines are needed and welcomed as is the ability to take complaints to OBSI at an earlier stage. The intent to allow OBSI to address wider systematic issues is also welcome although, it is unclear just what is the best route for this process to take shape.

Unfortunately at the heart of most complaints lie the issues of suitability, responsibility and process. These have not been touched on in the current round of administrative enhancements. Until minimum industry standards are raised and industry accepts a higher level of responsibility for its advice, the heart of the matter will remain unaddressed and bodies like OBSI will be unable to deal with the larger and more important systematic issues regarding suitability. This is unlikely to happen under the current regulatory structure and culture. Change as Barak Obama would say is needed.

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[11] http://www.obsi.ca/UI/Resources/WhatsNew.aspx?csid1=31.
[12] http://www.financial-ombudsman.org.uk/about/other_bodies.html
[13] http://www.wider-implications.info/default.htm

2 A study of implied higher minimum industry standards – Example BMO Nesbitt Burns

OSC Fair Dealing Model Concept Paper, *"The investor is responsible for making the final decision on any trade. But in making these decisions, it is assumed that the investor is relying on the representative's opinions, and therefore, the representative must meet a certain standard of care. Most importantly any advice must be appropriate for the client's financial needs and objectives… A firm could be liable for investment losses if a court determined that its representative failed to meet the applicable standard of care or breached a fiduciary duty"…*

While minimum standards used to determine responsibility and suitability may mean that many meritorious complaints are turned down, it is clear that many institutions imply a far higher level of services, standards and responsibilities than that implied by minimum industry standards. It is time that minimum standards for the assessment of complaints are raised to reflect the actual implied higher standards marketed by the industry.

The following uses BMO Nesbitt Burns full service brokerage (advisory) standards as a benchmark for assessing minimum industry standards and financial institution responsibility for its "advisory clients".

2.1 The reality of the client decision process

When making decisions about who to use for investment and wealth management advice it is logical for an investor to consider the overall resources, experience and expertise of the financial institution.

It is logical because the quality of the advice and the process in which advice is delivered has a direct relationship with the resources, the experience, the systems and the expertise embodied within that organisation.

Most investors, including those with a lifetime of investment experience do not possess the necessary expertise, resources, systems or investment knowledge or the time to research, value, select, combine and manage their investments. They look to their investment advisors to fulfil this role. Indeed, the average investment advisor does not possess the resources and the expertise needed to deliver the investment solution on their own, which is why they work for a financial institution that is organised around the delivery of wealth management solutions.

This is recognised by BMO Nesbitt Burn's own marketing message and their charter of client rights and client responsibilities[14]. The importance of an organisation's resources and expertise to the ability of an advisor to deliver their services should not be underestimated.

What most investors do not always appreciate is that for advisory services it is they who are deemed to be responsible for accepting the risks of the investments and the strategies recommended. **However this responsibility is logically and fundamentally only effective within a well defined and implemented process**. This is the process which defines the suitability of an investment and it starts with taking the time to know your client, proceeds to the time and attention needed to prepare and recommend transactions that are suitable for the client's risk preferences, investment objectives and financial needs and ends with a explanation of the reason for and the risks of the recommendation.

A client that accepts an investment or strategy derived within the confines of such a process is responsible for accepting the consequences of a transaction or strategy. However, problems occur where an inappropriate and unsuitable transaction or strategy has been recommended without due care and attention to the components of the process. If the advisor has not taken the time to understand the client's financial

[14] http://www.bmonesbittburns.com/personalinvest/About/ClientExperience/default.asp

situation, has not taken the time to ensure that the securities and strategy selected are appropriate and has not taken the time to explain the risks and consequences of an investment or an investment option, then most investors (with the exception of the truly sophisticated and knowledgeable) cannot be held responsible for the consequences of poor investment decisions made by advisors.

The process which defines suitability and which manages the responsibility of the advising institution and the accepting client is not just an administrative procedure or formality. Given that there are clear conflicts of interest between the financial remuneration of advisors and institutions and the needs of the client, the process is also important in maintaining the balance of power and in allocating responsibility between the advisor and client. Subversion of due process occurs when an advisor operates outside of the boundaries of the process to deliver a self serving outcome. Organisations should not tacitly allow or encourage such subversion.

2.2 BMO Nesbitt Burns Full Service Brokerage

BMO Nesbitt Burns' Full Service Brokerage service (as of July 2007) makes the following claim on their website[15].

"Experience the full service difference by investing with a BMO Nesbitt Burns ***Investment Advisor***. You can trust in our ***expertise*** to help you build a wealth management strategy uniquely designed to achieve your wealth management objectives"

The following are the more detailed claims made about their ***investment advisors*** and their ***expertise***.

Investment Advisors

At BMO Nesbitt Burns, our Investment Advisors are *committed to gaining a thorough understanding* of your financial goals, evolving life circumstances and investment preferences to proactively address your financial interests and stay on top of your wealth management plan. Having trained and qualified according to some of the most comprehensive standards in the Canadian investment industry, they draw upon their extensive experience, expertise and one of Canada's broadest selections of wealth management solutions, *in order to ensure you develop a wealth management strategy that's appropriate for you*. You'll benefit from their insight as you work together to build a *personalized program that is tailored to your financial needs*.

Through the combined resources of BMO Nesbitt Burns and BMO Financial Group, our Investment Advisors can work with you to address all your financial needs, including estate planning, insurance and private banking. And as you move through life and your financial circumstances and goals evolve, *you can rely on our Investment Advisors to continue to be a valued resource and driving force behind your wealth management plan*.

Knowledge

Hands-on experience plus Canada's top-rated research team.

Better knowledge leads to better investment decisions.

This reality, reflected in four key ways, ultimately drives everything we do at BMO Nesbitt Burns.

To begin with, we rigorously train our Investment Advisors *to assure an understanding of available products and services and how to assemble them in planning and developing client portfolios*. Our advisors also draw

15 http://www.bmonesbittburns.com/personalinvest/default.asp

upon the best investment knowledge and market expertise including top-ranked equity research. BMO Nesbitt Burns independent mutual fund research further sets an industry standard for depth and breadth.

With global investing being a growing factor for all Canadians, we have also tapped into a network of exclusive research sources. In the U.S. – the international market of greatest interest – we have access to three of the finest research houses who collectively cover over 5,000 companies in the U.S. and abroad.

Finally, we keep our clients fully informed about their accounts through comprehensive statements. We have also invested in developing leading edge systems, providing clients with online access to account information and research on mutual funds, and Canadian and U.S. equities.

2.3 BMO Investor Rights

The following are excerpts from the (as of July 2007) BMO Nesbitt Burns' Charter of Investor Rights. While this information has only been recently produced, BMO Nesbitt Burns do state that these rights have always been implied rights.

- Work with an organization and an Investment Advisor committed to understanding your needs.
    - The investment advisory process starts with a *commitment to Knowing Our Clients*. Our Investment Advisors take the time to understand each client's unique financial situation and objectives. Based on this information, *they recommend strategies to meet your needs* and they have the *responsibility to ensure that the strategies are appropriate for you*.
- Work with an Investment Advisor who conducts him or herself with *high standards of professionalism and integrity at all times*.
    - Client interests always come first. *Professionalism and integrity mean that our Investment Advisors know you and your unique needs* and that they follow regulations designed to protect all of our clients. Moreover, our commitment to putting clients first is demonstrated by our client account management and monitoring technology and by our supervisory system.
- Access to qualified expertise to help you reach your financial goals.
    - As a full-service investment firm, BMO Nesbitt Burns is *committed to providing clients with a wide range of wealth management expertise and services*. Our Investment Advisors must complete comprehensive training and continuing education programs as their careers progress. They have *access to best of class economic and market research, sophisticated software programs, tools and strategies as well as all the wealth management expertise offered by the BMO Financial Group*.
- Clear and comprehensive information about your accounts.
    - We ensure that you are always fully informed about your investments through comprehensive account statements, provided for each quarter and for every month there is activity in your account. You also have the ability to access your account information online at any time through our online client information centre. You will be notified of important business and regulatory changes through statement bulletins and inserts or special mailings.

2.4 Importance of the suitability process

In the absence of the professional execution of a well defined suitability process, the advisor is in a position to recommend solutions that are a) inappropriate to the client's financial position and b) that mislead or take advantage of the client's own lack of knowledge and investment discipline.

One of the reasons investors need advisors is that they lack the personal discipline needed to avoid buying too much at the wrong times and selling too much at worst possible moment. Irrespective of the level of discretion in a relationship, an advisor will to lesser or greater extent, have an influence on the decisions of the client. Where the advisor does not conduct him or herself with integrity and professionalism and where security selection and strategy has veered well outside a structured suitability process, the interests of the advisor are able to take precedence over the interests of the client and subvert the true intent of the process.

The suitability process is important because it provides the necessary checks and balances required to establish responsibility (client, advisor and institution) and to maintain the balance of interests and power between advisor, client and financial institution. It is the financial institution's responsibility and not the client's to monitor its advisors and to enforce the integrity of the suitability process and its implementation.

2.5 Client implied responsibilities and expectations of service

While the valuation, selection and the development of investment strategies is complex and outside the ability of most clients to fully evaluate, most individuals are able to understand the generic risk and return profiles of different types of investments and different types of investment strategies or mix of investments.

In general the client bears a responsibility to make sure that the generic risk/return profile and investment objective selected represents the risks they are comfortable with and that they fully understand the risks as presented to them. The degree to which a client is responsible is nevertheless dependent on the communication, the illustration and the explanation of the generic risk profile and investment objective. This implied responsibility of the client does not obviate the advisor and the institution from making sure that the recommendations reflect the clients' financial needs and that the strategies are appropriate to the risk profile selected and the risks explained.

The client must accept responsibility for their decisions, but that this responsibility can only reasonably be enforced where the risk profile of the recommendations matches that implied by the generics and structure of the suitability process. The process of knowing your client, selecting appropriate products, securities and strategies and the explanation of the reason for their selection and the risks of the recommendation are all part of this generic process. The suitability process is quite rightly one of the foundations of the wealth management services' contract since it defines the responsibilities both parties accept when entering into a wealth management services contract.

BMO Nesbitt Burns quite rightly state that the charter of investor rights has always been implied in their services and the contract for services offered. If the processes that gave those rights definition were ever missing from the process in which products and securities and strategies are selected and recommended, then it would be the institution and the advisor that must bear the responsibility for their omission.

BMO Nesbitt Burns clearly advertise the importance of the expertise, the training and the resources of their advisors, since these are necessary to properly fulfil the requirements of the suitability process. When an investor selects an institution and advisor they are making a qualitative judgement as to their ability to support the processes needed to deliver the services they are agreeing to. An institution that has the necessary resources and expertise and delivers those resources and expertise in a disciplined manner is an institution that can be trusted. This is precisely the message a financial institution is sending out when it advertises its expertise and abilities.

2.6 Client Account Agreement

The risk assessment questionnaire is a critical component of the contract between the advisor and the client. It relates the clients' understanding of risk and return and their ability to accept risk, both financially and emotionally, to a portfolio, "strategy" or set of securities suitable for that risk profile.

Modern risk assessment processes are directly related to an organisation's investment processes which include the valuation (*for valuation based disciplines*), the selection, the allocation (*a mean variance optimiser for modern portfolio theory based retail focussed disciplines*) and the management of security selection over time. Whether the service is discretionary or advisory, the relationship between the risk assessment process and the final solution should be the same.

Where a risk assessment questionnaire embodied within a Client Account Agreement bears the financial institution's hallmark, a client should expect the recommended solution to match that which would be recommended by the financial institution with reasonable allowance for personalisation of strategy with respect to financial needs, types of securities selected (mutual funds or direct stocks for example) and individual holdings; for example securities instead of mutual funds, leeway for market cap, sector and market allocations by a pre defined margin +/-some pre defined percentage.

Where the risk assessment questionnaire is the only formal component of the process defining suitability, it is of fundamental importance that the securities or portfolio options and strategies recommended relate to a framework implied by the risk assessment.

2.6.1 Investment experience/knowledge

The objective of defining the clients' investment knowledge is to provide a cross reference with the risk of the strategy associated with the selected investment objective and to help the advisor guide the client in that selection.

There are a number of problems with client account agreements with respect to the recording of experience and knowledge.

One of the problems is that they often tie the level of sophistication with the amount of experience and the amount of experience of investments with the experience of strategies. Experience does not necessarily equal expertise. Also there is more often than not no explanation of their nomenclature (note the nebulous sophistication). Another word often noted with respect to experience is the word strategies; most forms provide no explanation of strategies, which can be diverse and complex and requiring of significant expertise to successfully implement.

While there is a uniformly limited explanation of what experience means, there is often no explanation whatsoever of limited, average, good or sophisticated investors. Indeed, there are often no obvious selections for clients who have had a lot of experience with investments (commons shares, bonds, mutual funds, new issues) but who have had limited experience with different strategies and do not possess the expertise needed to select investments or strategies.

The only conclusion that can be drawn from an analysis of industry risk assessment questionnaires is that they were designed to provide a "general" assessment of the client's level of experience and their ability to accept the risk profiles of investments and strategies that would eventually be selected.

The reason for the qualification of the level of investment knowledge, for those relying on their advisors for security selection and investment strategy, is to assess a client's knowledge of the generic strategies (varying allocations of investments with different risk/return profiles) and the types of securities that would be employed in a portfolio comparable to the risk profile and investment objective selected.

Given this it should also be clear that the risk assessment is not specifically intended to enforce a situation where the risk of the security selection and the overall allocation profile of a portfolio far exceeded that implied by the organisation's contractual documentation, internal processes, model portfolios and general investment expertise.

2.6.2 Risk profiles and investment objectives.

The risk assessment process relates a client's risk profile and investment objective to an appropriate investment strategy and security selection. The job of the investment advisor is to make sure that the risks of the solution selected to achieve the objective are those that the client can emotionally and financially stomach. This is a continuous requirement. It is also the client's responsibility to inform the advisor of material changes to risk profiles and financial needs; this is anything which materially impacts their ability to accept risk both emotionally and financially.

The current modus operandi of the industry is one that does not focus on education of risk and return but one which bases recommendations on the client's current understanding of risk and return. This places the onus to ensure that the risk profile and investment objective selected suits the client's financial needs on the financial services institution and their advisors. Generally speaking, the higher the level of communication and information regarding risk and the recommended portfolio and security solution, the greater the responsibility the client is taking over the investment decision.

Most risk assessment formats provide a range of risk and investment objectives from conservative income, to income, to balanced, to moderate growth to aggressive growth. Given the preceding analysis, the range of options should relate to a disciplined asset allocation and security selection process. A client's selection of an option would normally be made by reference to at least one if not two other options. The ability to make a selection by reference would be aided by information regarding risk and return as well as asset allocation of security selection.

A number of risk assessment questionnaires do not provide illustrative asset allocations or risk profiles to help the investor make a decision by reference to risk or return.

It is therefore logical that the advisor would have to guide a client through the process and his or her input would have a material influence on the final decision. In the absence of an illustration of the risk and return associated with a given risk profile and investment objective, a client would have to decide whether or not to believe the advisor's explanation of the risk/return profile of an investment strategy. This is implicit and as such a client is to lesser or greater degree dependent on the integrity of the processes that define, manage and implement suitability within an organisation. Any suasions used by the advisor to downplay risk and to enhance the return also become a liability that the organisation must shoulder.

2.6.3 Liabilities and financial position

The financial ability to bear risk depends on an investor's financial circumstances, in particular short term financial demands on their assets. While few client account agreement formats require specific information about future income and capital demands on assets, the investment objectives provided have an implied relationship to the size and timing of financial demands on investment capital.

As such, investment advisors must pay attention to future liabilities within the portfolio selection and the recommendation of portfolio strategy. Ignoring them, or failing to advise clients of the risks of a strategy which breaches the implied suitability requirement is a breach of the advisors duty to make sure that investments are suitable to clients' financial circumstances.

2.6.4 Assessment of risk profiles and investment objectives

With regard to risk assessment questionnaires, these can only realistically be intended to convey acceptance of the risk associated with a properly constructed portfolio option appropriate to the investment objective and risk profile selected. Even then, the ability to enforce such an agreement would be in doubt without a reasonable explanation of the profile and the risks associated with the options; you would not agree to buy a car without knowing the type and the colour.

It is not going to be immediately obvious to an investor whether or not the strategy they have received conflicts with the risk and return profile selected by them or sold to them. Without any reference points, it can often take 2 to 3 years for the flip side of an unsuitable solution to surface. An investor could justifiably be in the dark at the selection phase and continue to remain in the dark for years. If an advisor is not delivering his or her security and product recommendations within an appropriate framework then the risk assessment process cannot reasonably be binding on the client, even under the constraints of industry minimum standards.

The less information provided by an organisation the greater the implied responsibility for providing a structure since the client, irrespective of the advisory nature of the relationship, is forced to rely on the advisor that a structure is indeed in place; only a truly sophisticated investor would be able to discern this. This responsibility is implicit within the initial contract of which the risk assessment is a critical component.

2.6.5 Implied acceptance of strategy

The mere fact that a client has accepted the short term performance of a portfolio should not be used to imply acceptance of a strategy if a client has not been provided with the information that would have allowed them to fully understand the risks of the strategy. The risks of a strategy are not always obvious, especially during positive demand conditions for the securities held.

With no performance (relative to comparable risk benchmark), relative valuation (price of investments relative to earnings or other measures relative to the market or comparable benchmark), relative risk (standard deviation or risk adjusted return or similar measure) or comparative asset allocation analysis it is impossible for investors to discern the real risks posed by a security selection strategy.

2.6.6 The importance of client account agreements

The client account agreement and its risk assessment questionnaire is more than just a procedural nicety, since the selections made (risk profiles and investment objectives) must relate to the way securities and strategies (portfolios of securities and mix of asset classes) are structured and managed within the organisation. Properly executed client account agreements are critical to the integrity of the suitability process, as is the relationship between the risk assessment spectrum within the agreements and the investment discipline and processes of the financial institution.

Much is made in this discussion of the relationship between the risk profiles and the investment objectives noted in client account agreements and the way in which securities and strategies are formulated within an organisation. There are no doubt instances where an advisor will veer from the securities and strategies that would be provided by the organisation. Where this occurs, the financial institution in question is responsible for ensuring that the processes used by the advisor are indeed structured, disciplined and appropriate and that the risk assessment and investment objectives selected by the client can be directly related to these processes. In other words, a financial institution is assumed to have endorsed the processes and disciplines that underpin the security selection and strategies recommended by an advisor where these differ from those provided by the institution; this must be so if the advisor uses the institutions own client account agreement and risk assessment process and account opening documentation.

In the absence of well defined processes required to provide integrity and definition to the suitability process, we have ambiguity. An investment objective and a risk profile are only ambiguous if we cannot relate them to a well defined security selection and asset allocation strategy or where we cannot relate the security selection and strategy to the risk profile and investment objective. Ambiguity cannot be used to support the actions of an advisor in the absence of a well defined relationship between the investment process and the suitability of the security selection and asset allocation strategy. BMO Nesbitt Burns charter of client rights and client responsibilities confirms that the existence of such a process is integral to the proper functioning of the suitability process in Canada’s financial services industry.

2.7 Conclusion

It is clear that organisations that implement clear suitability processes should rarely suffer from client complaints from inappropriate financial advice. Such processes will provide compliance departments with clear guidelines for determining when advice has breached a firms suitability standards making settling a complaint and of providing a substantive explanation quick and easy. Clear processes which are effectively supervised and implemented will also minimise the number of complaints.

It is clear that most financial institutions imply a far higher level of standards than those currently supported by minimum industry standards. Implementing a regulatory regime which enforces the implied contractual obligations of these promises will require a change in the way the Canadian financial services industry is regulated. Firms, to varying degrees do have a fiduciary type responsibility for the advisory services they provide and should not be able to rely on low minimum transaction based standards and investor responsibility for mitigating inappropriate financial advice.

As discussed here, investor responsibility is limited to the generics of the process and where transactions and advice veer from the implied generics an organisation should be responsible for the consequences. That they are not in the current environment is clearly a systemic issue.

3 OSC Researching Your Investments

OSC Fair Dealing Model – *"Representatives and firms would take on greater responsibility for educating or informing their clients. They would be required to make available concise informational materials on the basics of investing…Before any transaction is completed, the financial services provider in an advisory relationship should provide the investor with meaningful information about the riskiness of the security, and how it would affect the investor's portfolio….communication alone is not sufficient to discharge the representatives and the firms ultimate responsibility for ensuring that each trade fits the investor's risk profile"*

The OSC provide a number of investor education documents at their checkbeforeyouinvest.ca section of their website. One of these documents is entitled "Researching Your Investments".

This document details what an individual investor needs to do if they are going to make sure their investments are suitable for them. What is worrying about this document is the depth of research a private investor is supposed to conduct to understand their investments. The investor's responsibility appears to apply whether they have an advisor or not.

There is no such similar document for investment advisors nor, apparently, any requirement which comes anywhere close to detailing what an advisor needs to do before recommending an investment. We only need to look at the point of sale disclosure documentation from the Joint Forum of Regulators to appreciate the chasm between what the industry needs to provide and apparently what investors need to know.

It is unclear just why the document is so detailed and why investors who depend on advisors need to go into their investments in such depth. Is this not the job of the institutions, the parties recommending the investments in the first place? How many investors are going to be able to research their investments in such detail in a ***check before you invest*** kind of way?

If this document is intended to convey the degree of responsibility an investor has towards the investments recommended by their advisor it also omits a) the research processes that an investor would need to follow for all other asset class and investment products and b) any information regarding portfolio construction and management. Portfolio construction, planning and management expertise is needed to allow an individual to determine how much of an investment they need within a portfolio construct, the style and discipline they are following and how to manage the allocation over time.

Is this the standard investors are meant to adhere to when accepting investment recommendations from advisors?

Ominously there is no information on the legal ramifications of the information provided in the document with respect to an investor's right to redress in the event of unsuitable investment recommendations and strategy.

Anyone who has either gone through the complaint process as an investor with a complaint or, as a professional providing input to the process, will know that the industry argues that it is the investor's responsibility to accept the recommendations and to mitigate bad investment decisions. This document raises the bar to a level which the vast majority of ordinary investors will never aspire to.

There are no documents on the check before you invest site as to the realities of the complaints process with respect to investor responsibilities and the rules and regulations governing resolution of complaints.

This document could be taken as an indication that regulation of the retail financial services industry is being even more closely aligned with the interests of the major financial brokerages as opposed to the investor.

Without confirmation as to the rights and responsibilities of investors in the light of this document, the brokerage industry and all advisors operating under anything other than discretionary authority should not be touched with a bargepole; the reason being that investment counsellors and portfolio managers are held to a much higher standard.

This document without clarification from the OSC muddies the waters with respect to minimum standards and investor rights, but most importantly it raises question marks as to the true intent of Canadian regulators towards the goal of investor protection.

It would appear that the OSC is papering over the systematic issue of low minimum industry standards enforced by self regulating organisations by reinforcing the client's responsibility for accepting transaction recommendations.

4 Conclusion

While the current proposals by the IDA and suggested amendments by OBSI to its terms of reference are steps forward, they are only steps to improve the administration of the current rules. These rules or minimum standards remain inappropriate for what is an advice driven financial services industry.

This is not a revelation; the Ontario Securities Commission apparently accepted this issue when instituting the Fair Dealing Model project. Recent OSC documentation as noted in the previous section would appear to reverse this earlier stance and cast doubt on even the current (and nebulous) low minimum standards.

Other global regulatory authorities have long ago understood the importance of retail investor protection, higher minimum standards as well an independent consumer voice. In the UK there exists an independent financial services consumer panel[16] (mandated by statute) and the regulators are themselves involved in raising standards in the industry; note the highly visible "Treating Customers Fairly"[17] initiative.

While the UK financial services market place is far from perfect and suffers from its own share of bad advice, there is greater emphasis on the suitability of and responsibility for recommendations made by the industry and a genuine and credible voice for consumers. Such is palpably lacking in Canada.

Unfortunately Canada's retail financial services woes just do not light up on the provincial or federal government radars. Canada's regulators have long since lost (or are wilfully ignoring) the plot, the self regulated organisations that effectively determine and dispense standards have no interest in raising them and the industry would rather drag their heels in an attempt to maintain the status quo. It is clear that Canada needs change at the regulatory level but it is also clear that Canada's retail financial services industry needs to retool and to move away from its transaction based model.

[16] http://www.fs-cp.org.uk/
[17] http://www.fsa.gov.uk/Pages/Doing/Regulated/tcf/index.shtml

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