

Joint CSA Staff Notice 31-351, IIROC Notice 17-0229, MFDA
Bulletin #0736-M
*Complying with requirements regarding the Ombudsman for Banking
Services and Investments*

December 7, 2017

Introduction and Purpose

This is a joint notice published by staff of the Canadian Securities Administrators (CSA) jurisdictions and staff of the Investment Industry Regulatory Organization of Canada (IIROC) and the Mutual Fund Dealers Association of Canada (MFDA) (together, **staff** or **we**).

A fair and effective independent dispute resolution service is important for investor protection in Canada and is vital to the integrity and confidence of the capital markets. We strongly support the Ombudsman for Banking Services and Investments (OBSI) in its role as the independent dispute resolution service made available to clients under National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (NI 31-103).¹

On May 1, 2014, the CSA published Staff Notice 31-338 *Guidance on Dispute Resolution Services – Client Disclosure for Registered Dealers and Advisers that are not Members of a Self-Regulatory Organization* to provide guidance to registered firms on how to meet their obligations relating to the requirement to make available an independent dispute resolution service or mediation service to clients with complaints.

We are publishing this Staff Notice (this **Notice**) to highlight concerns arising from some registered firms' complaint handling systems and some firms' participation in OBSI's services. OBSI's compensation recommendations are not decisions that are binding on firms or clients.² However, we are of the view that:

- refusals to compensate clients consistent with OBSI recommendations, or
- repeatedly settling for lower amounts than recommended by OBSI

can sometimes be a risk-based indication of problems with a firm's complaint handling practices.

¹ NI 31-103 requires all registered dealers and advisers outside Québec to offer OBSI's services to their clients. In Québec, the Autorité des marchés financiers (AMF) provides a dispute resolution service to clients residing in Québec of all registered dealers and registered advisers. Firms registered in Québec must inform clients residing in Québec of the availability of these services.

² As required by the Memorandum of Understanding (MOU) between OBSI and the CSA, OBSI underwent an independent evaluation of its investment operations and processes in accordance with its terms of reference in February 2016. One of the key concerns raised in the independent evaluator's report is that OBSI's inability to bind firms to its compensation recommendations "prevents it from fulfilling the fundamental role of an ombudsman, securing redress for all consumers who have been wronged." The CSA continues to consider, in conjunction with OBSI, options for strengthening OBSI's ability to secure redress for investors.

As part of our risk-based reviews, we will particularly take note of patterns involving these activities.

Such activities could suggest the possibility that the firm may not have:

- participated in the OBSI process in good faith,
- complied with the applicable standard of care, or
- implemented and maintained effective complaint handling procedures.

In such cases, we may make enquiries of the firm, which could lead to further actions as discussed in this Notice.

Even though the AMF has its own dispute resolution services, staff of the AMF may take the same view as staff of the other CSA jurisdictions concerning firms' complaint handling practices and firms' participation in OBSI's services.

This Notice also addresses concerns that we have identified regarding the manner in which some firms are using an internal "ombudsman" as part of their complaint handling system. In some cases, it appears that clients are not being given the clear option of using OBSI's services in the timeframes contemplated by NI 31-103 and applicable SRO rules with the effect that they are being diverted to an internal ombudsman while the time limits for submitting the complaint to OBSI or commencing a civil action continue to run.

Background

Rule requirements

Subsection 13.16(4) of NI 31-103 requires a registered firm to ensure that an independent dispute resolution or mediation service is made available at the firm's expense to resolve complaints made by clients about the trading or advising activity of the firm or its representatives. Pursuant to subsection 13.16(6) of NI 31-103, firms outside Québec must take reasonable steps to ensure that OBSI will be the service that is made available.

We expect a firm to maintain ongoing membership in OBSI (except for firms registered only in Québec), to participate in the dispute resolution process in a manner consistent with the firm's obligation to deal fairly, honestly and in good faith with its clients, and to respond to each customer complaint in a manner that a reasonable investor would consider fair and effective.

Registered firms that are members of either IIROC or the MFDA, including those registered in Québec, must comply with their Self-Regulatory Organizations' (**SROs**) requirements for member firms to be members of OBSI.

IIROC and the MFDA (together, the SROs) also expect that their respective dealer Members will participate in OBSI's services in a manner consistent with their obligations to not engage in any business conduct that is unbecoming or detrimental to the public interest. The SROs also have specific rules regarding complaint-handling. These rules include a requirement that dealer Members have written policies and procedures to ensure that complaints are dealt with

effectively, fairly and expeditiously. A firm's participation in OBSI's services is required to be conducted in accordance with these rules.

We will review firms' complaint handling systems and may make enquiries as a result.

OBSI's process

If OBSI reviews a complaint and determines that it would be fair for the registered firm to compensate a client for financial loss due to the acts or omissions of the registered firm, OBSI will issue a written recommendation to that effect to the firm, summarizing the facts of the case and the reasons for its recommendation, including a compensation amount.

OBSI can make a non-binding recommendation that a firm compensate a client, up to \$350,000, if it determines that the client has been treated unfairly, taking into account:

- the particular facts and circumstances of the case,
- the criteria of good financial services and business practice,
- relevant codes of practice or conduct,
- industry regulation and the law, and
- steps the investor took, if any, to mitigate the financial harm.

If OBSI recommends compensation to the client but the firm refuses to pay it (a **refusal case**), OBSI is required to publish a statement on its website that informs the public of its recommendation, the firm's refusal to compensate the client and the details of the complaint. Since 2012, there have been 19 refusal publications.³

CSA staff and SRO staff receive information from OBSI about complaint cases, including refusal cases, through the Joint Regulators Committee (**JRC**), which is composed of designated representatives of the CSA, IIROC and the MFDA. The JRC meets regularly with OBSI to discuss governance and operational matters, including the effectiveness of OBSI's services.

Review of complaint handling practices

The CSA and SROs are committed to ensuring that a fair and effective independent dispute resolution mechanism is available to investors. In our efforts to protect investors and ensure registrant compliance with conduct requirements, we routinely take note of public information about registered firms, including refusal cases. We also receive information that comes to us from other sources such as the JRC, which monitors data regarding closed OBSI cases and considers patterns and issues raised by them.

Staff will take note when a registered firm is involved in a refusal case or a pattern of repeatedly settling for amounts lower than OBSI recommendations. We believe that this data can provide risk-based indications of potential problems with a firm's complaint handling practices, or raise questions about whether it is participating in OBSI's services in good faith or consistently with the applicable standard of care.

³ Some of the 19 refusal publications involved more than one case relating to the same conduct. These refusals involved 25 investors and refused compensation totalling \$2,670,000 since 2012.

Depending on the facts and circumstances in each instance, we may conclude that enquiries regarding the firm's actions or compliance system are appropriate.

We may also make enquiries if a firm is involved in a disproportionate number of settlements, whether for the amount recommended by OBSI or otherwise.

Examples of potential failures

Some examples of potential failures in a firm's complaint handling practices as they relate to OBSI include the following:

- not providing a client with appropriate notification of OBSI's services within the required timeframes pursuant to subsections 13.16(2), 13.16(3), 13.16(4) and paragraph 14.2(2)(j) of NI 31-103 or the SRO rules;
- misrepresenting OBSI's services in communications with a client (for example, by implying that OBSI's services do not become immediately available to the client pursuant to the requirements through the placement and prominence given to OBSI as a complaint dispute resolution service, the language used to describe timelines to access the services of OBSI or the sequence of escalation options following receipt of the firm's decision);
- exerting pressure on a client to not use OBSI's services;⁴
- failing to establish and implement complaint handling policies and procedures regarding notification to clients of when and how the complaint can be submitted to OBSI for investigation;
- not fully cooperating or assisting OBSI with its investigation of a complaint consistent with OBSI's Terms of Reference or the SRO rules; and/or
- pressuring a client to accept any offer.

Potential regulatory responses

Staff will not assume that there is a compliance failure at every registered firm that does not comply with an OBSI recommendation by refusing to compensate a client or by settling below OBSI's recommended compensation. Staff will also not automatically commence a review in every case. But, where it appears to be warranted, staff may initiate a discussion of concerns with a firm or a more formal compliance review. The likelihood that staff would conclude that enquiries or a review is warranted will be significantly higher if a firm has shown a pattern of either refusing to compensate clients after recommendations by OBSI or settling matters at discounts from OBSI's recommendations.

Staff have a variety of regulatory responses available if, after concluding an appropriate review, we come to the view that securities laws and rules have been breached. These may include, but are not limited to:

⁴ Section 13.16 of the Companion Policy to National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*.

- recommending terms and conditions on the registration of the firm or registered individuals to mitigate risks in the area of concern; and
- initiating an enforcement investigation of the registered firm and/or registered individual relating to the issue.

Any regulatory response taken by staff will occur within the existing regulatory framework, including the right to an opportunity to be heard, where applicable.

Internal ombudsman

Section 13.15 of NI 31-103 requires firms to respond to each complaint in a manner that a reasonable investor would consider fair and effective. There are comparable requirements in IIROC and MFDA rules for their members. IIROC Rule 2500B *Client Complaint Handling* requires that the substantive response to a client complaint must be presented in a manner that is fair, clear and not misleading to the client. MFDA Rule 2.11 *Complaints* and Policy No. 3 *Complaint Handling, Supervisory Investigations and Internal Discipline* require every Member to establish written policies and procedures for dealing with complaints which ensure that such complaints are dealt with promptly and fairly.

Section 13.16 of NI 31-103 specifies that a firm must make available the services of OBSI at the earlier of when the firm informs the client of its decision with regard to the complaint or 90 days after receiving the complaint. We remind registered firms of the guidance in Companion Policy 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* concerning compliance with the requirements under section 13.16, including the following:

A registered firm should not make an alternative independent dispute resolution or mediation service available to a client at the same time as it makes OBSI available. Such a parallel offering would not be consistent with the requirement to take reasonable steps to ensure that OBSI will be the independent service that is made available to the client. Except in Québec, we expect that alternative service providers will only be used for purposes of section 13.16 in exceptional circumstances.

Section 13.16 of NI 31-103 does not prohibit the use of an internal ombudsman, but an internal ombudsman is not an “alternative” to OBSI in the sense that the client must pick one or the other – OBSI must be made available even if a client has pursued the complaint with the internal ombudsman. The SROs each have specific requirements that must be met where an internal ombudsman process is offered by the firm to its clients.

In staff’s view, responding to a complaint fairly and effectively includes avoiding potential client confusion. If a registered firm’s complaint handling system includes an internal ombudsman, there is the potential for clients to confuse or conflate the firm’s internal ombudsman with OBSI. A practice that misleads clients into thinking that they must exercise the option of using the internal “ombudsman” before they can access OBSI’s services would be inconsistent with the requirements of NI 31-103 and SRO rules to make OBSI’s services available to clients not later than 90 days after having received a complaint.

Ultimately, investors may not be fully aware of their options or may get worn down by this extended process and abandon their claims, or settle for less than they may have obtained had they gone directly to OBSI after receiving the firm's decision concerning their complaints. The prejudice to clients is compounded by the fact that the 180-day time limit to access OBSI's services after receiving a firm's decision continues to run during the internal ombudsman process unless the independent service, the firm and the client involved in a complaint have agreed to longer notice periods than the 90 and 180 day periods as a matter of fairness.

We also note that the statutory limitation periods for clients to seek redress in the courts continue to run during the internal ombudsman process.

Where firms offer the option of using an internal ombudsman, we remind firms of their obligation to treat clients fairly and make available the services of OBSI.

In communications with clients, we emphasize the importance for firms that use an internal ombudsman to clearly indicate that:

- the internal ombudsman is employed by the firm or is an affiliate of the firm and, unlike OBSI, is not an independent dispute resolution service;
- the client may submit a complaint to OBSI without going to the internal ombudsman if the firm has not provided the client with a written notice of its decision within 90 days of the client complaining to the firm;
- if a client is not satisfied with the firm's decision, the client may immediately submit a complaint to OBSI without going to the internal ombudsman and that the client has 180 days after receipt of the firm's decision to submit their complaint to OBSI;
- the services of OBSI are free;
- the use of the firm's internal ombudsman process is voluntary, specifying the estimated length of time the internal ombudsman process is expected to take, based on historical data;
- statutory limitation periods continue to run while an internal ombudsman reviews a complaint, which may impact a client's ability to commence a civil action.

The disclosure of the services of OBSI should be given at least equal prominence to those of the internal ombudsman and should provide clear, transparent and easy to understand information, including full OBSI contact information, necessary for clients to make an informed decision on their complaint escalation options.

It is never an acceptable practice for a firm to operate its complaint handling system in a manner in which investors are being misled or worn down in the ways discussed above.

Questions

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