

OBSI/IFIC Webinar February 8, 2024: Follow up questions from participants and OBSI responses

How does OBSI ensure that they have the most recent risk rating for a fund in their database?

Our risk rating database is updated each time we encounter a fund for which we do not already have a risk rating for the time period in question. For example, consider a scenario where an investor held mutual fund 'XYZ' in 2020. When completing our risk analysis, we would look to see if our database already includes the prospectus/Fund Facts risk rating for this fund for 2020. If the database already includes the rating, we would use the rating for the purpose of our analysis. However, if our database does not include the prospectus/Fund Facts risk rating for 2020, we will review the applicable prospectus and update our database with the rating.

How do you determine the risk for an exempt market product?

- When evaluating the risk of an exempt market product, we gather as much reliable financial data as possible from a range of sources such as OMs, financial statements, statistical data, management discussions and/or fund performance reports. Throughout this process, we diligently research publicly accessible information while also engaging with the firm to see if they have any additional information to provide.
- If we are able to find reliable data from public sources and/or the firm, we proceed to risk rate the security using our comprehensive approach of assessing quantitative metrics and qualitative variables.
- If reliable financial data from public sources and/or the firm is not available, we would consider risk factors commonly associated with exempt market products. These factors include:
 - Lack of analyzable information
 - Ambiguity regarding product details
 - Limited liquidity or market accessibility (e.g. client redemption restrictions)
 - Heightened risk of permanent capital loss
- After considering these factors, we often conclude that the exempt market security is high risk, but this is not always the case.

What do you do in a case where a client says one thing, but their documentation says another?

When an investor says that their documentation (for example, their KYC forms) is inaccurate and/or the investor and advisor have conflicting recollections about their discussions, it may be necessary for us to collect and consider additional information. For example, we will consider when and how the documents were completed, whether copies were provided to the investor, and whether the wording on the documents is clear and expressed in terms the investor was likely to understand. We will also consider any evidence gathered during interviews and any related evidence such as emails or voice recordings. We will

weigh all the evidence available to us (from both interviews and documents) and determine whether the KYC information in the firm's files is reasonable based upon the information the firm had at the time the documents were created.

Going back to the exempt product risk, do they use a 5-point scale or the 3-point scale?

Regardless of the security type, including exempt market products, OBSI uses the same risk scale for our analysis that the firm uses. For example, if a firm uses a 3-point scale in their KYC documents, we complete our analysis using a 3-point scale. If the firm uses a 5-point scale in their KYC documents, we complete our analysis using a 5-point scale. Our goal is to determine whether the risk rating applied by the firm was reasonable in the circumstances at the time the recommendation was made. This means we try to emulate as much of the firm's process as possible.

How do you determine whether to look at the account as a whole and whether to look at the individual securities in the account? What factors play into this?

In every suitability case, we analyze the entire account and compare it to the investor's risk tolerance and investment objectives. This helps us identify any suitability concerns. To gain a comprehensive understanding of the account's composition, we assess each security based on risk tolerance, investment objective and asset type. After completing this process, our template allows us to compare the overall composition of the account to the investor's risk tolerance, investment objective and asset type. Following this analysis, if we determine that only some securities in the account are unsuitable, we will then focus on those specific securities.

You are not taking inflation or tax concerns into account. You don't seem to allow even 1 or 2% in precious metals for medium risk portfolios, balanced against low to medium risk funds. Why is that?

- We do take certain tax consequences into account in our loss calculations. As a general rule, we will include tax credit or net deduction benefit amounts when there is a direct link to the investment strategy and the evidence shows the investor actually claimed the benefits. For example, we include the tax benefits of leverage loan interest deductions and flow-through shares in our calculations. However, we generally will not attempt to capture the tax effect of capital gains/losses on disposition in our calculations due to the uncertainties and the forward-looking assumptions we would have to make and the evidence gathering that would be required.
- With respect to portfolio diversification and allocations to specific asset classes, we examine the financial plan or strategy in each case to ensure it was reasonable for the investor and was communicated effectively. Depending on the circumstances of the case, it may be reasonable for a plan to contemplate specific amounts of low and high-risk assets as part of an overall medium-risk portfolio, and we will take this into consideration into our analysis (including any inflation or tax concerns relevant to the investor). However, where such a plan is not in place, we will focus on analyzing the investments in relation to the investor's documented risk threshold.
- When a firm or advisor informs us they combined low-risk and high-risk securities to achieve a medium-risk portfolio profile, we will ask for supporting documents and analysis (such as an asset allocation plan or a correlation analysis) to show that the combination of investments at various

risk levels did in fact achieve a medium-risk profile for the overall portfolio. In practice, we have found that the risk characteristics of high-risk investments with respect to volatility and magnitude of total loss are usually much higher relative to the profile of medium and low-risk securities, and consequently such "risk offsetting" is difficult to achieve.

Is suitability of investments being determined on the KYC profile provided by the dealer? Or is client risk tolerance/objectives assessed by OBSI?

- Signed KYC documents are important evidence of the investor and advisor's communications and KYC process at the time of account opening and/or at the time a recommendation was made. In the course of a suitability investigation, we will consider whether the KYC information and investment parameters recorded by the firm are reasonable given the investor's circumstances at the time. If the recorded information is reasonable, then we will generally use it in our suitability analysis, unless there is evidence of wrongdoing in relation to the documents (for example, if we determine that the investor was instructed to sign blank forms).
- If we determine that the KYC information recorded by the firm is not reasonable based on the information that would have been available to the advisor at the time, then we will go beyond the KYC documents and substitute the information that would have been reasonably available to the advisor at the time and we will use this substituted KYC information in assessing the reasonableness of the investment parameters.

Would there be a difference in calculating a loss on a non-registered investment account (vs TFSA/RRSP) since distributions are taxable?

- In most cases, we do not account for taxes when calculating the profit/loss (P&L) on investments in a non-registered investment account. This is because the primary concern usually involves suitability and not taxation. Put simply, taxes would have been incurred whether the investments were suitable or not.
- However, if taxation is an integral part of an investment strategy, such as cases involving flow-through share securities and leverage investment strategies, we will account for the net tax benefits to the investor and incorporate this in our P&L calculation.

For the mutual fund portfolio, could we get some more case studies that show KYC that would have had a blended portfolio of income and growth, and percentages of medium or even higher risk. For example, if the KYC allowed for 10% high, but was invested 30% high (in other words just asking for a series of case studies showing some less extreme examples)

Yes. The examples we use in our presentation are intentionally simplified to allow for a better understanding of our methodology. However, we plan to create a more complex case study for future presentations.

Is there a timeline for investors to file a complaint if improper holdings are discovered after the account is closed or changed back to the appropriate risk tolerance and objectives?

Further to section 5 of our Terms of Reference, we can investigate 's complaint if:

- The complaint was made to the participating firm no more than six years after the investor knew or reasonably ought to have known about the problem or issue giving rise to the complaint; and
- The investor submits their complaint to us within 180 days of receiving the firm's substantive response regardless of whether the account remains open or the issue was subsequently corrected.

Is compensation based on the % the investment was offside or on the full amount of the offside investment?

We generally focus on the percentage of the investments that were unsuitable. For example, let's say a consumer had a risk tolerance of 50% medium and 50% high, but their account was invested in 30% medium risk investments and 70% high risk investments. We would compare the performance of the excess high-risk investments (20%) to a medium-risk benchmark to determine if the consumer incurred financial harm.