February 15, 2013

VIA E-MAIL

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

Ontario Securities Commission 20 Queen St. West 19th Floor, Box 55 Toronto, Ontario M5H 3S8 *Attention*: The Secretary *E-mail*: comments@osc.gov.on.ca	Autorité des marchés financiers 800, square Victoria, 22e étage C.P. 246, tour de la Bourse Montréal, Québec H4Z 1G3 *Attention*: Anne-Marie Beaudoin Corporate Secretary *E-mail*: consultation-en-ours@lautorite.qc.ca

Dear CSA Staff:

Re: CSA Notice and Request for Comment on Proposed Amendments to National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations and to Companion Policy 31-103CP Registration Requirements, Exemptions and Ongoing Registrant Obligations relating to a mandatory Dispute Resolution Service Provider (the OBSI Proposal).

This submission is made by the Exempt Market Dealers Association of Canada (the **EMDA**) in response to the request for comments published by the Canadian Securities Administrators (**CSA**) on November 15, 2012 in connection with the OBSI Proposal.

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WHO IS THE EMDA?

The EMDA is a not-for-profit association founded in 2002 to be the national voice of exempt market issuers, exempt market dealers (**EMDs**) and participants in the exempt market across Canada. The EMDA plays a critical role in the exempt market by:

- assisting its hundreds of dealer and issuer member firms/individuals to understand and implement their regulatory responsibilities;
- providing high quality and in-depth educational opportunities to exempt market participants;
- encouraging the highest standards of business conduct amongst its membership across Canada;
- increasing public and industry awareness of the exempt market and its role in the capital markets;
- being the voice of the exempt market to securities regulators, government agencies, other industry associations and the capital markets;
- providing valuable services and cost-saving opportunities to its member firms and individual dealing representatives; and
- connecting its members across Canada for business and professional networking.

Additional information about the EMDA is located on our website at: www.emdacanada.com.

WHO ARE EXEMPT MARKET DEALERS?

EMDs may act in two primary capacities in the capital markets: (a) as a dealer or underwriter for any securities which are prospectus exempt; or (b) as a dealer for any securities, including investment funds which are prospectus qualified (mutual funds) or prospectus exempt (pooled funds), provided they are sold to clients who qualify for the purchase of exempt securities. The qualification criteria for exempt purchasers and exempt securities are found in National Instrument 45-106 *Prospectus and Registration Exemptions* (**NI 45-106**).

EMDs are fully registered dealers who engage in the business of trading in exempt securities, or any securities to qualified exempt market clients. EMDs are subject to full dealer registration and compliance requirements and are directly regulated by the provincial securities commissions. The regulatory framework for EMDs is set out in National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (**NI 31-103**) which applies in every jurisdiction across Canada.

EMDs must satisfy the same "Know Your Client" (**KYC**), "Know Your Product" or (**KYP**) and trade suitability obligations as other registered dealers which are IIROC or MFDA members. NI 31-103 sets out a comprehensive dealer regulatory framework (substantially similar for all categories of dealer, including investment dealers) which requires EMDs to satisfy a number of regulatory obligations including:

- educational proficiency;
- capital and solvency standards;
- insurance;
- audited financial statements;
- know your client;
- know your product;
- trade suitability;
- compliance policies and procedures;

- books and records;
- client statements;
- trade confirmations;
- disclosure of conflicts of interest and referral arrangements;
- complaint handling;
- dispute resolution;
- maintenance of internal controls and supervision sufficient to manage risks associated with its business;
- prudent business practices requirements;
- registration obligations; and
- submission to regulatory oversight and dealer compliance reviews.

EMDs may focus on certain market sectors (*e.g.,* oil and gas, real estate, mining or minerals, technology, venture financing, etc.) or may have a broad cross-sector business model. EMD clients may be companies, institutional investors, accredited investors, or eligible investors who are qualified to purchase exempt securities pursuant to an offering memorandum.

EMDs provide many valuable services to small, medium and large businesses, investment funds, merchant banks, financiers, entrepreneurs, and individual investors, through their ability to participate in the promotion, distribution and trading of securities, as either a principal or agent.

EMDA COMMENTS ON THE OBSI PROPOSAL

1. The OBSI Proposal lacks important details

While the EMDA appreciated the opportunity to discuss this concept with OSC staff several months prior to the release of the OBSI proposal, we were discouraged to see the OBSI Proposal lacked clarity or important details on key issues which would impact EMDs. This suggests the OSBI Proposal is premature and has been initiated prior to adequate consideration and disclosure of proposed operating, governance or financial model for a significantly expanded OBSI, and absent resolution of key issues for EMDs and other registrants. Should the CSA mandate OBSI under these conditions it would be tantamount to a sole-source contract scenario where vendor is granted a monopoly absent any determination of costs, impact on users or in-depth assessment on whether the vendor is actually capable and qualified to provide the service.

Based on the very limited information provided by the CSA, the EMDA is not able to fully evaluate the merits of the OBSI proposal or whether it would achieve a fair outcome for EMDs. We continue to believe that the current principle based model in NI 31-103 offering registrants a choice of dispute resolution service provider should be maintained.

2. The CSA has not sufficiently explained its reasoning

NI 31-103 is currently drafted to allow registrants choice in selecting an appropriate dispute resolution mechanism to be provided at no cost to its clients. We agree with this principles based model and are not clear why this model requires change prior to it even becoming effective. Without any experience seeing this process in action on what basis has the CSA determined it to be a failure or in need of change? We are unclear why the CSA is proposing a

significant change in approach for this area of NI 31-103 particularity since this same course of action to mandate OBSI use was specifically rejected when NI 31-103 was originally drafted. We would appreciate further details from the CSA on what has prompted this reversal of policy and on what basis has the original model been deemed inadequate?

The CSA notice cites potential client confusion as a key rationale for the OBSI proposal, yet given the explicit requirement for registrants to inform their client of the dispute resolutions process we are unclear how the CSA can assert potential confusion as an issue. It is more likely that client confusion would stem from the myriad of 13 securities regulators, and various insurance company, trust company and banking dispute resolution structures across Canada and Quebec-only procedures and we do not believe this proposal will meaningfully improve any of these systemic financial services industry complexities.

We do believe that guidelines on appropriate dispute resolution providers would be helpful and we see the merits in creating approval guidelines for complaint bodies in a similar manner to what the Federal government announced in July 2012 for banking services. Creating parameters for the dispute resolution service is a responsible approach consistent with the principles-based regulatory regime in NI 31-103. The EMDA would support and we encourage the CSA to consider an approach similar to that which now applies to the banking sector. While the direction of the Federal government in respect of banking was noted by the CSA in the OBSI Proposal we would appreciate further information on why the CSA seems to have rejected the Federal government's approach and is moving in the opposite direction.

3. EMDs are not retail brokers and differ from IIROC and MFDA dealers

The current constituency of OBSI principally includes IIROC dealers, MFDA dealers and retail commercial banks, all of which service high volume retail client relationships. EMDs do not engage retail clients and they are more likely to have episodic and infrequent interactions with a limited pool of accredited investors or other prospectus exempt purchasers. Most EMDs broker exempt market products to clients and facilitate the purchase of securities in client name with effectively no ongoing client relationship. Many EMDs, including both large and small dealers, do not maintain ongoing client accounts or hold client assets as agent or custodian for the client which is a significant departure from the typical IIROC or MFDA business model.

The result is a client relationship model where EMDs are often small businesses and they often rely on a small base of clients returning for subsequent transactions. This directly contributes to a significantly higher incentive to settle client concerns in the interests of maintaining client relationships than would be the case in a high volume retail brokerage or bank where client relationships are more commoditized. We expect the incidence of EMD clients resorting to a dispute resolution service will be significantly less than those of large retail dealers like IIROC and MFDA firms. We are concerned that the costs of servicing high volume complaint matters from banking, IIROC dealers and MFDA dealers will be subsidized by new EMD and adviser registrants which are significantly less likely to generate complaints of this nature.

4. Absence of a proposed Fee Model for EMDs

The OBSI Proposal notes that "[t]he CSA has been working with OBSI to develop a fee model that will be fair to all registrants" but curiously there was no information provided on what that proposed fee model for EMDs or other registrants would be. In the EMDA's discussions with the Ombudsman and senior OBSI staff since the release of the OBSI Proposal, and in discussions going back more than two years, it has been apparent that OBSI is unclear

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on how to establish a fee model for EMDs and are unable to describe features of a fee model for EMDs that would be equitable or fair.

We are also concerned that throughout our recent and past discussions with OBSI they are principally focussed on revenue stability in adjusting to this proposed significant expansion of its mandate. A focus on increased staff and overhead required by being prepared to service EMDs and other new categories of registrants is not likely to result in a decision to minimize unnecessary costs on EMDs. This is of particular concern as it is clearly evident that OBSI would not just require more personnel but would require a higher level of skills and capabilities that its staff currently do not possess. Absent information to the contrary, we expect OBSI will strongly favour an annual AuM or assets-based charge to all EMDs, regardless of usage, to ensure their staff and overhead budgets are protected. We also expect the current IIROC and MFDA firms using OBSI will be concerned about subsidizing services for new categories of dealers and advisers. Naturally, they will push for high fees on EMDs and other new users to ensure no impact on their current fees and service levels.

The EMDA is concerned that the overhead needs caused by high volume complaints from retail client IIROC and MFDA brokerage firms will be supported by annual fees from EMDs whose non-retail client will be much less likely to resort to OBSI to resolve disputes. We expect this to be even further exacerbated in the case of portfolio managers and investment fund managers dealing primarily with high net worth private clients and institutional clients. While we appreciate the OBSI is experiencing a revenue squeeze due to the departure of dissatisfied bank users, we do not think the financial stability of the OBSI should be supported by unnecessarily mandating EMDs and other registrants to use a service ill-equipped for their clients' needs.

The EMDA has consistently represented to the OSC and the OBSI that the only fee model which would reflect the unlikely incidents of use by EMDs and at the same time ensure potentially complex matters were handled by sophisticated experts would be a fee per use model, as would be the case in an ADR structure. However, it is evident that a per use fee model would represent a significant change to OBSI financial and operational arrangements and it is not apparent that such a model can be reconciled with the high staff and overhead design of OBSI. As an example of high overhead costs at OBSI, we are concerned by the cited capability of the OBSI to respond to client inquiries in "170 different languages" which seems to be an indication of an excessively high overhead and staffing level given that any client matters coming to the OBSI will have been contracted between client and registrant in one of two official languages of Canada. We believe a per use model and access to expert dispute resolution as needed, is not compatible with an OBSI tariff style, commoditized complaint investigation service.

On this basis we are unable to see how the OBSI could establish a reasonable fee model to support their need to maintain a high overhead staff model without charging significant annual fees to EMDs and other new categories of dealers and advisers. We are concerned that the OBSI Proposal will lead to EMDs being overcharged for services their clients may rarely access, and further, that new annual OBSI fees will pose a particular financial burden on smaller EMDs well beyond what they might reasonably incur were they required to absorb per use costs from an ADR style dispute resolution service.

We believe the same quality of decision for clients with lower costs to the industry and individual EMDs can be achieved through an industry association ADR plan or a mediator chosen by the dealer on its own. This is the model NI 31-103 currently provides and we encourage the CSA to reconsider if moving to mandatory OBSI participation truly benefits clients or registrants.

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5. Qualifications and Experience of OBSI Staff

We believe, and OBSI staff has to their credit acknowledged in a meeting with the EMDA Executive, that the existing infrastructure and staff of OBSI are unlikely to be capable of managing the complexity or substance of complaints arising from the exempt market. Current OBSI staff are investigators with no mediation experience, no specialized knowledge of the exempt market, are unfamiliar with exempt market products and are structurally ill-equipped to evaluate suitability issues or potential complex loss awards generated from EMDs.

This challenge of expertise and staff qualifications suggests the OBSI will need to hire a new team to service EMDs or more likely, resort to higher qualified external experts on an as-needed basis to manage EMD client complaints. Interestingly, this model which OBSI has conceded may be required would engage the same type of external professionals accessible in an ADR environment and is perhaps evidence that the right model for EMDs is actually an ADR service and not OBSI.

We also believe that a mediation service may in many cases be better suited to high net worth individual who are clients of an EMD rather than the more limited investigation style currently employed by OBSI in servicing its retail brokerage and banking users. The limited range of capability within the current OBSI model and lack of mediation skills suggests EMD clients (and high net worth individual and institutional portfolio manager clients) may be better serviced by a broader ADR service rather than the limited one-size-fits-all approach upon which OBSI operates. We encourage the CSA to consider this point against their stated desire for the theoretical clarity of a 'common dispute resolution service'. The commonality that exists across retail brokerage and banking relationships does not cross over into the complex products and sophisticated client relationships prevalent in the non-retail client and institutional space where EMDs (and portfolio managers) operate.

6. Complexity of Exempt Market Securities – Suitability and Loss Assessment Challenges

The OBSI has endured years of controversy over its inability to fairly and consistently apply a suitability and loss assessment calculation and its inability to provide timely complaint settlement service. The challenges of fairly and consistently assessing valuations and losses by OBSI staff have, to date, been in the relatively straightforward context of readily available market indices and easy to obtain publicly traded securities valuations to populate loss calculations. How does the OBSI propose to calculate suitability and loss assessments in the context of: 1) illiquid exempt market securities, 2) complex suitability assessments behind the sale of exempt market securities, 3) no applicable market indexes for analogous performance comparisons, and 4) no independent price verifications from secondary market trading?

We believe this is a critical issue for EMDs and speaks to the incapacity of OBSI to service the complexity of EMD client complaints. The CSA needs to seriously consider this issue, and ensure a satisfactory framework on exempt securities valuation and loss assessments is in place prior to any determination that OBSI has the capability to service exempt market client complaints and achieve fair and reasonable outcomes for both investors and EMDs.

We have raised this issue with OBSI and had hoped their staff had some past experience encountering exempt market securities through IIROC dealer complaints and therefore had on hand some workable methodology which they would propose to utilize in handling EMD complaints. We were disappointed to hear that no such experience and methodology existed. The OBSI does not appear to have a clear understanding of the nature and type of products sold in the exempt market and neither they nor the CSA have proposed a solution to this significant challenge. Without resolution of this critical issue we can only believe that the OBSI Proposal is premature.

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We believe current OBSI staff lack the ability to manage this complex valuation and loss assessment task and that the problem itself suggests the need for more sophisticated expertise the likes of which can be more readily found in ADR services rather than retail complaint investigation services like OBSI. In any event we cannot properly asses the ability of OBSI to handle EMD client complaints with such a significant issue in doubt.

EMDA Recommendation

We recommend the CSA reconsider the current principles based approach in NI 31-103 and continue to allow EMDs to select dispute resolution providers that can provide the level of skill and expertise that exempt market clients will require. We encourage the CSA to consider introducing criteria on what is an acceptable dispute resolution service in the interests of investors and of dealers. Alternatively, we recommend exempting EMDs from the OBSI Proposal.

In any event we believe the CSA should suspend any plans to implement the OBSI Proposal until such time as the competency of OBSI to manage this expanded mandate into the exempt market and non-retail client area can be demonstrated, and until key issues affecting EMDs have been satisfactorily addressed.

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The above comments are respectfully submitted by the Board of Directors of the Exempt Market Dealers Association of Canada on behalf of its membership.

We thank you for the opportunity to provide you with our comments on the OBSI Proposal and welcome any opportunity for further dialogue on this issue.

Yours very truly,

The Exempt Markets Dealers Association of Canada

Per: "*Geoffrey Ritchie*"
Executive Director