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## Ideas of Fairness in Financial Services Dispute Resolution

Mary Condon

*Osgoode Hall Law School of York University, mcondon@osgoode.yorku.ca*

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# AN EXPLORATION OF FAIRNESS:

## INTERDISCIPLINARY INQUIRIES IN LAW, SCIENCE AND THE HUMANITIES

Edited by Dr. Janis P. Sarra



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# IDEAS OF FAIRNESS IN FINANCIAL SERVICES DISPUTE RESOLUTION

*Mary Condon\**

## 1. INTRODUCTION: FAIRNESS IN FINANCIAL SERVICES

It is a widespread phenomenon in jurisdictions with developed financial services industries that there is some form of organized resolution process for disputes between consumers and providers of financial services.<sup>1</sup> Most recently, the *G20 High-Level Principles on Financial Consumer Protection*, developed by the Task Force on Financial Consumer Protection of the OECD Committee on Financial Markets (CMF), includes, as the ninth of ten principles, a principle dealing with “Complaints Handling and Redress”. This principle provides that

[j]urisdictions should ensure that consumers have access to adequate complaints handling and redress mechanisms that are accessible, independent, fair, accountable, timely and efficient. Such mechanisms should not impose unreasonable cost, delays or burdens on consumers. In accordance with the above, financial services providers and authorised agents should have in place mechanisms for complaint handling and redress. Recourse to an independent redress process should be available to address complaints that are not efficiently resolved via the financial services providers and authorised agents’ internal dispute resolution

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\* Professor, Osgoode Hall Law School, York University and Vice-Chair, Ontario Securities Commission. The views expressed in this chapter are personal and do not represent the views of any regulatory body.

<sup>1</sup> Those of the United States, United Kingdom, Australia, New Zealand, and Canada are most often discussed in the literature, but there are others.

mechanisms. At a minimum, aggregate information with respect to complaints and their resolutions should be made public.<sup>2</sup>

In this chapter, I consider the various ways in which the idea of fairness is given content in this dispute resolution regime and try to understand how and why some of these ideas achieve legitimacy and some do not. A few framing comments should be made. First, the context for the analysis of fairness in this regime is that of two-party disputes, a context with which lawyers are very familiar. On the other hand, the basic premise of the kinds of dispute resolution services discussed in this chapter is that they are outside the formal legal system. For example, Gilad argues that the system of informal dispute resolution practiced by the Financial Ombudsman Service (FOS) in the United Kingdom is “explicitly designed to offset some of the advantages enjoyed by RPs [repeat players] in court litigation”.<sup>3</sup> Nor are such processes intended to be directly “regulatory”, in the sense that they are not intended to usurp the role of regulators in establishing appropriate norms and standards for firm-client interaction or investigating breaches of regulatory or self-regulatory requirements. Instead, they are focused on redress for clients on a relatively informal, case-by-case basis.

The other central point here, and the core of the argument in this chapter, is that in these two-party disputes, by definition, one of the parties is always an organization—the financial services firm.<sup>4</sup> This case study of financial services dispute resolution, therefore, is an opportunity to consider the way in which ideas of fairness are defined by, and with respect to, *organizations*, and specifically in contexts where organizations are pitted against individuals. Does fairness systematically mean something different to an organization than it means to an individual? Confronting the question of how organizations “think” about fairness is useful and timely, not just in the context of the resolution of financial complaints on a granular basis, but more generally in the context of the global financial crisis

<sup>2</sup> Task Force on Financial Consumer Protection of the OECD Committee on Financial Markets (CMF), *G20 High-Level Principles on Financial Consumer Protection* (October 2011), online: OECD <<http://www.oecd.org/regreform/liberalisationandcompetition-interventioninregulatedsectors/48892010.pdf>>.

<sup>3</sup> Sharon Gilad, “Why the ‘Haves’ Do Not Necessarily Come Out Ahead in Informal Dispute Resolution” (2010) 32: 3 *Law & Policy* at 307.

<sup>4</sup> E.g., Ombudsman for Banking Services and Investments (OBSI), “Terms of Reference” (2010), online: OBSI <[http://www.obsi.ca/images/Documents/How\\_We\\_Work/Terms\\_of\\_Reference/tor\\_dec2010\\_english.pdf](http://www.obsi.ca/images/Documents/How_We_Work/Terms_of_Reference/tor_dec2010_english.pdf)> (refer to “participating firm”—that is, those financial services providers that are members of the OBSI).

and its aftermath.<sup>5</sup> In the discussion to follow, I consider several alternative definitions of fairness that could be applicable to the situation of informal dispute resolution; then I attempt to draw some conclusions about the relationship between these versions of fairness and the challenge of ongoing *legitimacy* for dispute resolution decision-making.

## 2. EMPIRICAL DESCRIPTION OF FINANCIAL DISPUTE RESOLUTION PROCESS IN CANADA

I will use the Canadian example as a focus for discussion, recognizing that the legislative and structural context might be different in other jurisdictions. But I will try to indicate the features of the system that are common across a number of jurisdictions, as well as where they are different. At the moment, the body that performs external financial dispute resolution in the financial context in Canada is called the Ombudsman for Banking Services and Investments (OBSI).<sup>6</sup> It was established in 1996 to review complaints made by customers against banks, and in 2002 was expanded to include complaints made against investment firms and credit unions. It is important to note that its formation was not legislated, but rather, the result of voluntary agreement among members of the financial services industry. However, in Canada, the two biggest self-regulatory organizations (SRO) within the investment industry<sup>7</sup> make it a requirement, through their rules, that members of the SRO be members of OBSI. In accordance with its terms of reference, the role of the Ombuds is to receive and investigate complaints and, thereafter, if appropriate, to make recommendations to participating firms and complainants as to the appropriate resolution of a complaint.<sup>8</sup>

The mandate of the Ombuds is to investigate a complaint once the participating firm has either rejected it or recommended a resolution that

<sup>5</sup> See Dimity Kingsford-Smith, "Can There be a *Fair Share*? Fairness, Regulation, and Financial Markets" (Chapter 17 of this volume).

<sup>6</sup> See Ombudsman for Banking Services and Investments (OBSI), "About Us", online: OBSI <<http://www.obsi.ca/en/about-us>>.

<sup>7</sup> See The Investment Industry Regulatory Organization of Canada (IIROC), online: IIROC <[www.iiroc.ca](http://www.iiroc.ca)> and The Mutual Fund Dealers Association of Canada (MFDA), online: MFDA <[www.mfda.ca](http://www.mfda.ca)>.

<sup>8</sup> OBSI, *supra* note 4 (OBSI's terms of reference are explicit that the Ombuds is NOT to provide legal, accounting, or other professional advice).

the complainant does not accept.<sup>9</sup> Consideration by OBSI of a complaint therefore occurs *after* the firm has investigated internally; that is, it is only when the complainant is not satisfied with the internal resolution offered by the firm that a complaint will come to OBSI. There is a threshold amount beyond which the Ombuds may not recommend that a firm pay a complainant.<sup>10</sup> There are similar thresholds in other jurisdictions, though the amounts vary. One standard feature of these kinds of dispute resolution systems is that there is no cost to the complainant of bringing a case to OBSI for investigation and resolution. Meanwhile, the costs of operating OBSI are paid out of the membership fees that banking and financial services members pay to OBSI.

OBSI's "fairness statement" says that it

[r]esolves complaints with a view to what is fair and reasonable under the circumstances of each individual complaint [but also that it will] resolve complaints using an informal non-legalistic approach taking into account general principles of good financial services and business practice, law, regulatory policies and guidance, professional body standards and any relevant code of practice or conduct applicable to the subject matter of the complaint.<sup>11</sup>

A unique feature of the Canadian process is that recommendations of OBSI that the firm should pay money to an investor to resolve a complaint are not binding on that firm.<sup>12</sup> OBSI's terms of reference say that if a firm refuses to accept its recommendation, OBSI should publicly name that firm and the recommendation made by OBSI.<sup>13</sup> In practice, OBSI has done this infrequently. Nor, in Canada, is there an appeal mechanism from an OBSI decision, though this opportunity is available in jurisdictions such as the United Kingdom.

<sup>9</sup> OBSI, *supra* note 4 at s. 9 (certain subject matters for complaints are outside the Ombuds' mandate; e.g., issues related to risk management policies and practices of a firm, pricing of financial services, scale of fees or charges generally offered to customers of the firm).

<sup>10</sup> That is, no amount greater than C\$350,000 in respect of any single complaint.

<sup>11</sup> OBSI, "OBSI Fairness Statement" (2011), online: OBSI <[http://www.obsi.ca/images/Documents/How\\_We\\_Work/Fairness\\_Statement/obsi\\_fairness\\_statement\\_en.pdf](http://www.obsi.ca/images/Documents/How_We_Work/Fairness_Statement/obsi_fairness_statement_en.pdf)>.

<sup>12</sup> OBSI, *supra* note 4 at s. 24.

<sup>13</sup> *Ibid* at s. 27.

### 3. EXAMPLES OF TYPICAL ISSUES THAT BECOME THE SUBJECT OF FINANCIAL SERVICES DISPUTES

The Navigator report<sup>14</sup> indicates that Canada has a much smaller number of complaints annually about banking and financial services than, for example, Australia, even though Australia's population is smaller.<sup>15</sup> The same report notes that investment-related complaints are "on average more complex and costly to investigate than other financial services complaints".<sup>16</sup> Many of the complaints brought to OBSI by investors in Canada concern the suitability (or otherwise) of the investments recommended by their dealer or advisor for those investors, in light of relevant information that should have been collected and deployed by the firm, such as investors' "risk tolerance", their investment goals, or their financial circumstances. Particular features of investments recommended by advisors, such as the sales charges payable or the appropriateness of a particular "risk rating" for a financial product, are a recurring source of complaint. More specific problems have related to the methodology that is used by OBSI to determine how much compensation to recommend for the investor in the event that a financial recommendation is made. For example, should investors be compensated for lost opportunities if it is determined some years later that certain investments were inappropriate? Other conundrums revolve around the principles to be applied if a dealer recommended products to clients "off-book", that is to say, beyond the ambit of the products approved to be sold by the firm as a whole. This issue is a source of particular tension for firms in the sense that the individual advisor or dealer may be found to be operating outside the ambit of her or his employment, but the firm is nevertheless ultimately called upon to satisfy OBSI's recommendation, if any, in favour of the client.

As is evident from the discussion above, in resolving many of these disputes, there is a need for some kind of "investigation" as to the positions of both sides, as well as, in some cases, an assessment of the

<sup>14</sup> Navigator Company, *Ombudsman for Banking and Financial Services and Investments Report, 2011 Independent Review* (2011), online: OBSI <[http://www.obsi.ca/images/Documents/Ind\\_Rev/independent\\_review\\_of\\_obsi\\_2011.pdf](http://www.obsi.ca/images/Documents/Ind_Rev/independent_review_of_obsi_2011.pdf)> (this is an external reviewer's report on OBSI. The Dispute Resolution Committee of Canada's Joint Forum of Financial Market Regulators, which is currently the group of regulators responsible for overseeing OBSI, requires such a review to take place every three years).

<sup>15</sup> *Ibid* at 19.

<sup>16</sup> *Ibid* at 10.

credibility of the story provided by one side or the other. This process serves to further blur the line between these sorts of dispute resolution processes and the types of activities engaged in by internal, firm-based, regulatory compliance and/or enforcement processes or the civil courts. It also, as I argue later, calls into question the credibility of OBSI to perform these activities in the absence of the usual institutional and normative structures provided by the official legal system, such as rules of evidence, norms for determining credibility, damages rules, and so on.

#### 4. FAIRNESS AS PROCESS?

There is an explicit continuum between consistency of decision-making and fairness expressed in OBSI's fairness statement. Thus, the statement indicates that the OBSI will

[r]esolve complaints in accordance with externally reviewed policies and procedures to ensure consistency of approach and outcome in similar complaints. Notwithstanding this, the fairness objective is paramount and the Ombudsman shall not be bound by any previous OBSI recommendation.<sup>17</sup>

OBSI publishes on its Web site a variety of "case studies" that are presumably intended to illustrate how the organization handles a variety of factual scenarios. It has also recently consulted with stakeholders about its approach to determining the quantum of losses suffered by an investor and the circumstances in which it will determine that an advisor gave unsuitable investment advice to a client. As noted, OBSI explicitly prioritizes its "fairness objective" at the expense of consistency. Thus, it indicates that the case studies on its Web site are "not intended to set precedents".<sup>18</sup>

Gilad argues that debates about the adequacy of these forms of dispute resolution stem from a divergence of interests among individual complainants and firms. She argues that individuals typically want "individualized justice", whereas organizations want rules.<sup>19</sup> This point recognizes that there is a structural difference between an individual complainant and the organization on the other side of the dispute.

<sup>17</sup> OBSI, *supra* note 11.

<sup>18</sup> See OBSI, Case Studies Web page, online: OBSI <www.obsi.ca>.

<sup>19</sup> Gilad, *supra* note 3 at 283 (specifically, she argues that "the typically indeterminate nature of informal dispute resolution settings renders them less susceptible to large organizations' and other repeat players' capacity to 'play for rules'").

Organizations want to be able to plan and to achieve predictability, as adverse decisions by an organization such as the OBSI not only have negative reputational effects, but also affect how advisors are trained and calls into question the adequacy of the firm's internal compliance processes. Meanwhile, clients are interested in redress on a one-time only basis, with a high degree of attention paid to context-specific elements. Yet, the subject matter of the dispute is typically about the *relationship* that has been forged between these two participants with varying interests at play and varying perspectives on the appropriate outcome.

It was noted above how OBSI attempts to define the content of the fairness standards it imposes. Crucially, that content includes *but goes beyond* the legal standards imposed by courts, regulators, or professional bodies, to consider "general principles of good financial services and business practice". In other words, not only does this sort of dispute resolution prioritize individualized fairness as opposed to consistency with prior OBSI recommendations, but those recommendations are based on the interpretation of norms that are not limited to the ones enshrined in legal precedent or current regulatory requirements. In this sense, a well-established process is subordinated to the achievement of substantive outcomes, on the theory that individual complainants are vulnerable to disadvantage when dealing with sophisticated, well-financed firms.<sup>20</sup> But one result of this approach is that OBSI cannot necessarily look to legal precedent to provide justification for the results it recommends, but must seek credibility for its decision-making from other sources.

## 5. FAIRNESS AS OUTCOME?

Meanwhile, the Canadian Ombuds service stresses that its work does not necessarily result in most of its decisions being in favour of the consumer. Data from the Navigator report indicates that the ratio of "overall decision win/loss for industry" was 71/29 in Canada, based on the 2010 annual report of OBSI.<sup>21</sup> Apparently, the fact that firms win many more cases than they lose does not give the organizations that are the subject

<sup>20</sup> An example is that OBSI's investigation may go beyond the information recorded on the foundational *know your client* form filled in at the outset of the relationship between the investor and the advisor, so as to uncover additional information about that investor's financial circumstances or investment goals.

<sup>21</sup> Navigator Company, *supra* note 14 (comparative figures for industry win/loss ratios in Australia and the United Kingdom were 61/39 and 50/50, respectively).

of complaints much comfort. Despite the possibility that these numbers could be interpreted by firms to mean that OBSI's investigations mostly turn out to support the firm's "side of the story", their concerns about the uncertainty of those outcomes remain.<sup>22</sup> Clearly, part of the concern derives from the costs associated with the operations of OBSI, which the Navigator report indicates is pitched at \$7,158 *per* complaint, higher than either Australia (\$4,320) or the United Kingdom (\$902). The Navigator report attributes this higher cost in part to the greater willingness of OBSI to "investigate" complaints as compared to their international counterparts.

Perhaps more surprisingly, the trend whereby individual complainants "lose" more matters than they win is not a subject of persistent dissatisfaction by individual investors or investor advocates. This trend is despite the fact that the stakes could be high for complainants if the investment disputes at issue relate to their retirement portfolios, and particularly if the discovery of shortcomings in handling investment accounts is belated.

## 6. ATTRIBUTES OF FAIR DISPUTE RESOLUTION?

The argument of this chapter so far has been that neither an interpretation of fairness as a particular prescriptive, rule-oriented process to be followed, nor an interpretation that focuses on who wins and who loses, has been successful at quelling ongoing dissatisfaction with external financial dispute resolution in Canada. In the first case, one side has a radically different understanding of a fair process than the other does. In the second, neither side appears to regard win/loss rates as particularly relevant to an assessment of how well external dispute resolution works in practice. This perception raises the question of whether there are other indicia of fairness that might be more universally persuasive.<sup>23</sup>

At least two possibilities suggest themselves. One involves the notion of the *independence* of the decision-maker, and the other relates to the *transparency* of the decisions made. With respect to the first, it has been noted above that one of the high-level principles developed by the OECD

<sup>22</sup> *Ibid* at 8, 11, 13, 15, 16.

<sup>23</sup> See Mark E. Warren, "Democracy and the Everyday Origins of Fairness" (Chapter 1 of this volume).

with respect to financial consumer protection referenced the need for complaint handling systems that are independent. An interesting question, therefore, is whether, if a decision-maker is perceived to be independent and impartial as between both sides to a dispute, would it matter that the norms used to decide outcomes were more open-ended, or individualized than, for example, a legal system would support? In other words, it is possible that independence of perspective and open-mindedness may be valuable in and of itself, as a source of credibility for the decision-maker. In advancing this argument, I am cognizant of the cautionary note sounded by Gilad's work, in which she calls for interrogation of the "heuristics" used by financial dispute decision-makers.<sup>24</sup> Examples of such heuristics include factors such as whether the complainant was represented, whether the complainant was a repeat complainant, and whether, in general, the complainant was perceived as "worthy" or "unworthy".<sup>25</sup> Equivalent heuristics that reference characteristics of financial services firms could also be interrogated. What Gilad's argument points to is that an independence of perspective cannot be assumed, but must be demonstrated to exist through actual decisions rendered.

This latter point implicates the other possible indicia of fairness, which is the transparency of the decisions made. In this regard, it has been noted above that OBSI's terms of reference provide that the investigation and outcome of specific complaints is confidential, at least until such time as the Ombuds decides to "name and shame" a firm that has not accepted its recommendation.<sup>26</sup> One significant consequence of the lack of transparency attendant on OBSI's investigative and decision-making processes is that it prevents any systematic reassessment of the decision-making practices deployed,<sup>27</sup> including whether or not OBSI did in fact maintain its impartiality in the process of coming to a recommendation, or alternatively whether it adopted particular working assumptions of complainant or firm characteristics in its decision-making. In other words, it may be an underlying structural problem for this dispute resolution system that the decision-making engaged in cannot be evaluated by observers for the presence of features that would make it more generally acceptable.

<sup>24</sup> Gilad, *supra* note 3 at 284.

<sup>25</sup> *Ibid.*

<sup>26</sup> OBSI, *supra* note 4 at ss.18-20 (Section 28 of the terms of reference does allow for public annual reporting by OBSI as to its activities, and reasons for the recommendations of OBSI in individual cases are provided to the parties on a confidential basis).

<sup>27</sup> Navigator Company, *supra* note 14 (other than in the context of a review like that of the Navigator Report, which occurs every three years).

## **7. CONCLUSION: THE RELATIONSHIP BETWEEN FAIRNESS AND LEGITIMACY**

The argument of this chapter has been that, in this example of financial services decision-making, one of the disputing sides ascribes a different content to fairness than the other side does. For the participating firms involved, fairness resides in the ability to count on known patterns of behaviour deployed by the Ombuds service, predictability of outcome and, relatedly, to conformity with other systems for dispute resolution, notably court-based systems. For the organizations involved in these disputes, there are multiple processes at issue, such as internal complaint handling protocols, OBSI investigations and recommendations, potential SRO arbitrations, court-based adjudication, and so on. Not only that, but these organizations obviously have considerations at play other than the fairness of dispute resolution processes, including operational cost, efficiency, and overall profitability.

None of these considerations is an issue for the individual complainant on the other side of these disputes. Yet, the normative justification for the existence of a dispute resolution process like the one described above is precisely that individual complainants will be disadvantaged by the requirement to mobilize the more formal mechanisms available, not only because of how much these processes would cost the complainant, but because typically the amount of losses incurred would not justify the expenditure required, from a cost-benefit point of view.

Ultimately, I argue that resolving this impasse of competing definitions of fairness may require a closer look at other, foundational ways of ascribing content to the idea of fairness in external dispute resolution, beyond a focus on comparisons with the traditional attributes of legal-type processes, or on typical outcomes. Two possible forms of normative commitment that could hold some promise of rendering financial dispute resolution more enduringly legitimate have been briefly canvassed. Further evaluation of the merits of these interpretations of fairness in the specific context of informal dispute resolution may even hold broader promise for the assessment of post-crisis financial systems more generally.