OMBUDSMAN
for Banking Services and Investments | des Services Bancaires et d'Investissement

CONFIDENTIAL &
WITHOUT PREJUDICE

INVESTIGATION REPORT

Date: **December 15, 2014**
Clients: **Mr. and Mrs. B**
Firm: **Sentinel Financial Management Corp. (Sentinel)**

CONFIDENTIALITY

This report is intended solely to assist the client and firm (the parties) in resolving their dispute and is not intended for broader use, circulation or publication. This document and its content is not to be provided to or discussed with anyone other than the parties and their professional advisors such as lawyers and accountants, if any, without prior written consent of the Ombudsman. The parties are reminded of their confidentiality obligations to the Ombudsman set out in the Consent Letter signed by them. The contents of our report are not intended to be, nor should they be interpreted to be, legal advice or opinion.

INVESTIGATION SUMMARY

Investment Advisor:	▪ Ms. K	
Product:	▪ Enviro-Can Private Placement	
Period:	▪ December 2009 – June 2013	
Key Conclusions:	▪ Ms. K recommended and facilitated Mr. and Mrs. B's $275,000 investment in Enviro-Can Private Placement in her capacity as their Sentinel advisor. ▪ Mr. and Mrs. B reasonably believed that the investment was approved by and made through Sentinel. ▪ Ms. K did not invest Mr. and Mrs. B's money in Enviro-Can but instead deposited it in her personal bank account. ▪ Sentinel is responsible for the losses incurred by Mr. and Mrs. B as a result of Ms. K's recommendation.	
Recommendation:	$242,000 $3,461.54 $245,461.54	Compensable losses Interest Total Recommendation

STANDARD OF REVIEW

OBSI is obligated to assess and resolve complaints using a fairness standard, as set out in OBSI's Terms of Reference:

> The Ombudsman shall make a recommendation or reject a Complaint with reference to what is, in the Ombudsman's opinion, fair in all the circumstances to the Complainant and the Participating Firm. In determining what is fair, the Ombudsman shall take 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.

While OBSI considers the rules and standards developed by other bodies, including regulatory bodies such as the Investment Industry Regulatory Organization of Canada (IIROC), the Mutual Fund Dealers Association of Canada (MFDA), and the securities commissions that form the Canadian Securities Administrators, the focus for OBSI is on what is fair between the parties in the particular circumstances. Therefore, OBSI's conclusions will not necessarily be the same as conclusions drawn by another body bound by specific rules or subject to a different standard.

OBSI's member firms are the parties to complaints made by their customers. As such, any recommendations we make are made against the firms, not against the individual advisors employed by the firms. While we can and do generally rely on the law of vicarious liability for the relationship between the firms and the individual advisors, the general fairness standard in our mandate and the fact of membership in OBSI is the basis upon which our recommendations are made.

BACKGROUND

- In 2006, Mr. and Mrs. B transferred the mutual funds they held at another investment firm to Ms. K at Sentinel. Mr. and Mrs. B had been referred to Ms. K by her parents, whom they had known for over 20 years.

- When they started investing with Ms. K, Mr. B was 66 years old and Mrs. B was 62 years old. Mr. B worked part-time as an insurance adjuster. They had retired from farming several years earlier, sold part of their farm, and invested the proceeds in mutual funds for their retirement.

- At a meeting in December 2009, Ms. K recommended Mr. and Mrs. B invest in Enviro-Can Private Placement (Enviro-Can). Mr. and Mrs. B were presented with the option to choose from a variety of guaranteed investments with one- to five-year terms and various rates of return.

- Between December 2009 and October 2011, Mr. and Mrs. B invested $275,000 in Enviro-Can. For their initial investment of $125,000, they used cash from the sale of

part of their farm. For subsequent investments, they sold mutual funds they held at Sentinel to purchase additional units of Enviro-Can.

- In March 2011, Mr. and Mrs. B requested an $8,000 withdrawal from their Enviro-Can investment. They requested an additional $25,000 withdrawal in May 2012. Each time they requested a withdrawal, they received their money in a timely manner. Also, on more than one occasion, Ms. K provided Mr. and Mrs. B with an "Enviro-Can Private Placement Confirmation of Transactions" showing their various Enviro-Can investments and accrued interest.

- In February 2013, the Financial and Consumer Affairs Authority of Saskatchewan (FCAA) contacted Sentinel regarding an anonymous tip it had received that Ms. K was depositing money from investors into a personal bank account. Sentinel conducted an investigation and discovered that Ms. K had recommended Enviro-Can to some of her Sentinel clients. Sentinel notified the affected clients and on March 4, 2013 it terminated Ms. K's employment.

- On March 12, 2013, the FCAA issued a cease-trade order against Ms. K. On March 26, 2014, the FCAA issued a Statement of Allegations against Ms. K alleging that she sold Enviro-Can "off-book" (meaning she sold the security outside of the firm) and that she knowingly misappropriated investors' funds and deposited them in her personal bank account. A hearing for Ms. K has been set for April 6, 2015.

- We understand the RCMP has commenced a criminal investigation into Ms. K's activities related to Enviro-Can.

- To date, neither the FCAA nor the RCMP have been able to conclude that Enviro-Can was an actual investment. Mr. and Mrs. B have not recovered any money through the FCAA process or the RCMP's criminal investigation. As a result, Mr. and Mrs. B have lost the entire $242,000 remaining of their investment in Enviro-Can ($275,000 - $33,000).

COMPLAINT

- In letters to Sentinel dated June 3 and 4, 2013, Mr. and Mrs. B requested Sentinel to compensate them $242,000 plus a reasonable rate of return.

SENTINEL'S RESPONSE

- In a letter to Mr. and Mrs. B dated September 11, 2013, Sentinel said:

    - Ms. K engaged in securities-related business activities which were not carried on for the account or through the facilities of Sentinel by selling, recommending or facilitating the sale of securities investments to Mr. and Mrs. B directly;

    - Ms. K failed to comply with the policies and procedures of Sentinel by engaging in this type of outside business activity, which was not disclosed to and approved

by Sentinel, thereby interfering with its obligation to supervise her;

- Ms. K's conduct was unbecoming of an approved person and she failed to observe high standards of ethics and conduct by engaging in this type of activity; and

- there was no evidence of lack of supervision or omission by Sentinel.

- Sentinel did not offer Mr. and Mrs. B any compensation.

OBSI ANALYSIS

In the course of our investigation, we reviewed documents provided to us by Sentinel and Mr. and Mrs. B. We interviewed Mr. and Mrs. B regarding the complaint. We also had discussions with Mr. C, President of Sentinel. In light of the criminal proceedings against Ms. K, we did not interview her. We have also considered the applicable industry rules, regulations and practices as well as case law related to off-book transactions.

When reviewing off-book complaints, OBSI first determines if the client(s) reasonably believed the investments were approved by and made through the investment firm. If we reach that conclusion and find that the client(s) incurred financial harm, we consider whether the activity was securities-related business for which the investment firm should be held vicariously liable. If we find the investment firm is vicariously liable, we then consider whether the client should be held responsible for part of their loss. It follows that OBSI examined these key issues in respect of Mr. and Mrs. B's complaint:

1. Did Mr. and Mrs. B reasonably believe that their investment in Enviro-Can was approved by and made through Sentinel?

2. Did Mr. and Mrs. B incur financial harm as a result of their investment in Enviro-Can?

3. Who bears responsibility for the financial harm, if any?

Issue 1 – Did Mr. and Mrs. B reasonably believe that their investment in Enviro-Can was approved by and made through Sentinel?

- Mr. and Mrs. B say they believed they were purchasing Enviro-Can through Sentinel just like their mutual fund investments. They say they trusted Ms. K and based on their past experience with her, they had no reason to question her recommendation to purchase Enviro-Can.

- The Sentinel documents Mr. and Mrs. B signed indicate they have moderate/average investment knowledge which is defined on the forms as "one who invests in the market, has some knowledge of the industry, investing, or the risks involved, but

doesn't educate themselves with information about investing and the risks involved." Having interviewed Mr. and Mrs. B and considered their investment experience, we agree this is a reasonable representation of their investment knowledge. It is also clear that they trusted Ms. K and heavily relied on her for investment advice.

- Mr. and Mrs. B describe themselves as cautious investors who want to maximize their returns without taking undue risk. Therefore, they were attracted to the returns and guarantees of Enviro-Can as Ms. K presented them. The documents they received from Ms. K indicated they could choose from a variety of guaranteed investments with one- to five-year terms and various rates of return. Mr. and Mrs. B chose the five-year term, which guaranteed an 8% return with the possibility of additional returns depending on the performance of the market. Considering Mr. and Mrs. B's investment knowledge and the degree to which they relied on Ms. K for advice, we do not believe there is anything about how Enviro-Can was presented that should have indicated to them that Enviro-Can was not approved by and purchased through Sentinel.

- Sentinel's primary business is investment and financial services, which according to its website includes products other than mutual funds, such as exempt products (products sold without the need for a prospectus to be issued). Furthermore, Sentinel acknowledges that Ms. K engaged in securities-related business when she recommended Enviro-Can. Based on this and the evidence we collected during our investigation, there was no reason for Mr. and Mrs. B to doubt that Enviro-Can was an investment that Ms. K could sell as a Sentinel advisor.

- For some of the Enviro-Can purchases, Mr. and Mrs. B signed subscription agreements (applications to participate in the Enviro-Can investment). For others, Ms. K signed subscription agreements on their behalf while they were out of the country. The subscription agreements Mr. and Mrs. B signed were addressed to Enviro-Can Private Placement, care of Ms. K at her Sentinel office address. While the subscription agreements did not specifically reference Sentinel, Mr. and Mrs. B signed many other third-party investment application forms that did not reference Sentinel so that would not have concerned them. While Mr. and Mrs. B may not have noticed the subscription agreements included Ms. K's Sentinel office address when they signed them, it is likely this would have only reinforced to Mr. and Mrs. B that Enviro-Can was approved by and being purchased through Sentinel.

- All the cheques for Mr. and Mrs. B's Enviro-Can investments, except one, were made payable to K Financial and signed by Mr. B. The other cheque was made payable to Ms. K. Mr. and Mrs. B cannot recall if they completed the "payable to the order of" section or if Ms. K completed this section on their behalf. Our review indicates that all of the cheques (including the cheque payable to Ms. K) have handwriting in the "payable to the order of" section that is not consistent with the other handwriting on the cheque. In any event, Mr. and Mrs. B say they certainly would not have questioned a cheque payable to Ms. K since she was their Sentinel advisor, or one payable to K Financial, since that was Ms. K's business name.

- On two occasions, in March 2011 and May 2012, Mr. and Mrs. B requested withdrawals from their Enviro-Can investments. Each time, Mr. and Mrs. B received the amount they requested in a timely manner. On more than one occasion, Ms. K provided them with written updates on the performance of their Enviro-Can investments. We note that these updates were not on Sentinel letterhead and Enviro-Can did not appear on their Sentinel account statements, but that did not raise concerns for Mr. and Mrs. B as they received their money as requested and, according to the information provided to them by Ms. K, were receiving returns as they understood they would when they purchased the product.

Conclusion

Mr. and Mrs. B were referred to Ms. K by her parents whom they had known for 20 years. They trusted Ms. K as their investment advisor and relied heavily on her for advice. Considering their relationship with Ms. K, their investment knowledge and experience, and the evidence we collected, we do not believe the Enviro-Can investments or Mr. and Mrs. B interactions with Ms. K regarding Enviro-Can would have caused them to question whether the investments were being sold through Sentinel. We therefore accept that Mr. and Mrs. B reasonably believed that Enviro-Can was an investment made through and approved by Sentinel.

Issue 2 – Did Mr. and Mrs. B incur financial harm on Enviro-Can?

- Mr. and Mrs. B invested $275,000 in Enviro-Can. Ms. K deposited the money in her personal accounts for her own use. Mr. and Mrs. B received back $33,000, but they lost the remainder of their investment, in the amount of $242,000.

Issue 3 – Who bears responsibility for the financial harm, if any?

Vicarious Liability

- The case law is clear that mutual fund dealers and investment dealers are vicariously liable for the actions of their investment advisors in regard to securities-related business. As Mr. Justice D.J. Gordon said in *Blackburn v. Midland Walwyn Capital Inc.* [2003] O.J. No. 621 (OSCJ), affirmed on appeal [2005] O.J. No. 678 (OCA), at para 191 regarding vicarious liability: "…a firm is absolutely responsible for the conduct of its stockbroker." The reasons for holding investment dealers liable for the conduct of their investment advisors were explained by McLachlin J., as she then was, in *Bazley v. Curry*, [1999] 2 S.C.R. 534 (S.C.C.), at para 31:

> Vicarious liability is arguably fair in this sense. The employer puts in the community an enterprise which carries with it certain risks. When those risks materialize and cause injury to a member of the public despite the employer's reasonable efforts, it is fair that the persons or organization that create the enterprise and hence the risk should bear

> the loss. This accords with the notion that it is right and just that the person who creates a risk bear the loss when the risk ripens into harm.

- Sentinel says that selling the Enviro-Can investment was outside Ms. K`s scope of authority and not carried on through Sentinel, and therefore it should not be held responsible for the losses Mr. and Mrs. B incurred.

- *Bazley v. Curry*, [1999] 2 S.C.R. 534 (S.C.C.) is the leading case in Canada concerning vicarious liability for actions that may be outside an agent's literal scope of employment, but that nevertheless are sufficiently connected to the employer's operations to justify the imposition of vicarious liability. In *Bazley*, McLachlin J. (as she then was) said we should "openly confront the question of whether liability should lie against the employer, rather than obscuring the decision beneath semantic discussions of 'scope of employment' and 'mode of conduct'." She went on to say that the "fundamental question is whether the wrongful act is sufficiently related to conduct authorized by the employer to justify the imposition of vicarious liability. Vicarious liability is generally appropriate where there is a significant connection between the creation or enhancement of a risk and that wrong accrues therefrom, even if unrelated to the employers' desires….Once engaged in a particular business, it is fair that an employer be made to pay the generally foreseeable costs of that business. In contrast, to impose liability for costs unrelated to the risk would effectively make the employer an involuntary insurer."

- In the recent Ontario Superior Court of Justice decision in *Straus Estate v. Decaire*, 2011 ONSC 1157, upheld on appeal to the Court of Appeal for Ontario, 2012 ONCA 918, the court confirmed that mutual fund dealers are vicariously liable for off-book securities-related activities of their investment advisors.

- In this case, Sentinel acknowledges that Ms. K was engaged in securities-related business when she recommended Enviro-Can to Mr. and Mrs. B. Were it not for Ms. K's registration through Sentinel to sell securities, she would not have been in a trusted position to recommend Enviro-Can to them.

- Given the above, we find that Sentinel is vicariously liable for Mr. and Mrs. B's losses related to Enviro-Can.

Client Responsibility

- In the Alberta Court of Queen's Bench in *S. Maclise Enterprises Inc. v. Union Securities Ltd.*, [2008] 12 W.W.R. 539 the trial judge said "Courts should avoid a single element theory such as "unusual transaction" or "to whom the check was made", or "activity outside of the employer's license", as these concepts are overly simple and do not properly engage in the *Bazley* analysis." Therefore, in considering whether responsibility ought to be apportioned to Mr. and Mrs. B, we have considered the whole context of Ms. K's dealings with Mr. and Mrs. B and the Enviro-Can investment.

- As mentioned above, Mr. and Mrs. B were not sophisticated investors. They trusted Ms. K and we see nothing that should have alerted or indicated to Mr. and Mrs. B that Enviro-Can was not approved by and made through Sentinel. They did not find it unusual to make cheques payable to K Financial, given it was Ms. K's business name, or to sign subscription agreements, since they had previously signed numerous documents with Ms. K for their other investments at Sentinel. They had no reason to question why they were not on Sentinel letterhead since they were satisfied with the performance of the investment and were receiving money when requested.

- For these reasons, we cannot conclude that Mr. and Mrs. B are responsible for their losses.

OBSI Membership

- Participating firms, not their advisors, are members of OBSI. Where OBSI determines that a client has incurred financial harm that should be compensated, it is the participating firm, as the OBSI member, that is responsible for compensating the client.

- Sentinel is a member of the MFDA, whose rules require that member firms participate in OBSI. As such, it is subject to the rules under which OBSI operates.

- It is therefore Sentinel that is the party responsible for the recommendations that OBSI makes with respect to the clients of Sentinel.

- Whether the firm then goes back to the representative to try to recover any compensation paid is a business decision for the firm to make and is not part of OBSI's process.

Conclusion

As Ms. K's mutual fund dealer, Sentinel is responsible for the losses Mr. and Mrs. B incurred due to Ms. K's investment recommendation.

Recommendation

OBSI is obligated to assess and resolve complaints according to what is fair to the parties in the particular circumstances of each case. In all of the circumstances of this complaint, we believe it is fair that Sentinel compensate Mr. and Mrs. B $242,000 plus interest of $3,461.54[1], totaling $245,461.54.

[1] Interest is calculated using the average 3-month Canadian Treasury Bill yield of 0.93% (as calculated by the Bank of Canada) compounded annually from June 3, 2013 to the date of this report.