

## INVESTIGATION REPORT

**Date:** August 15, 2012  
**Client:** Mrs. M  
**Firm:** Macquarie Private Wealth Inc. (Macquarie)

### CONFIDENTIALITY

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### INVESTIGATION SUMMARY

<b>Investment Advisor:</b>	▪ Mr. B						
<b>Accounts:</b>	▪ Cash account, Spousal RRSP and Spousal RRIF account						
<b>Period:</b>	▪ September 2000 to April 2009						
<b>Key Conclusions:</b>	<ul style="list-style-type: none"> <li>▪ Mrs. M was a lower-risk investor with little investment experience or knowledge.</li> <li>▪ Mr. B's recommendations made Mrs. M's portfolio increasingly unsuitable. In addition, the trading in her accounts may have been excessive in 2005 and 2006.</li> <li>▪ Mrs. M incurred financial harm as a result of the unsuitable investments.</li> </ul>						
<b>Recommendation:</b>	<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="text-align: right; width: 150px;">\$153,817</td> <td>Compensable losses</td> </tr> <tr> <td style="text-align: right;">\$3,457</td> <td>Interest on recommendation</td> </tr> <tr> <td style="text-align: right; border-top: 1px solid black;">\$157,274</td> <td>Total recommendation</td> </tr> </table>	\$153,817	Compensable losses	\$3,457	Interest on recommendation	\$157,274	Total recommendation
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## OVERVIEW OF DEALER HISTORY

- Mrs. M began investing with Yorkton Securities Inc., a predecessor in name to Macquarie Private Wealth Inc., in 2000. Yorkton's name was changed twice between 2000 and April 2009, when Mrs. M began moving her accounts to a new dealer. In 2002, Yorkton Securities Inc. became First Associates Inc. In 2005, First Associates Inc. changed its name to Blackmont Capital Corporation. The changes in name did not affect any liability of the dealer to its clients. In December 2009, the dealer firm was sold by its then owner, CI Financial Corp., to the Macquarie Banking Group, which changed the dealer's name to Macquarie Private Wealth Inc. in February 2010. The further change in name did not cancel or change the liability of the dealer to Mrs. M for the previous problems with her investments.
- The fact is that the dealer is the same one that Mrs. M dealt with from 2000 and where all the problems leading to her losses occurred. The change of name is cosmetic and irrelevant to the issue of compensation. When Macquarie bought the dealer, by then called Blackmont Capital Corporation, it bought all the benefits and burdens of all the accounts, including that of Mrs. M. It is Macquarie that will decide whether she is compensated for her losses. OBSI's jurisdiction is in respect of the dealer firm and that entity has remained the same, albeit under a different name, throughout the relevant time period. Macquarie Private Wealth Inc. is now the name of the same dealer with which Mrs. M invested and it owes her the compensation found due to her in this report.

## BACKGROUND

- After Mrs. M divorced in 1980, at age 45, she worked part-time for 16 years at [redacted] University as a faculty member in the School of [redacted], while raising five children. She retired in 1998. In 1983, she invested approximately \$16,000 from her mother's estate in mutual funds. She did not have any other investments until after she remarried in 1996 and sold her home in 1997.
- In 1998, Mrs. M started investing at Firm A with her son, Mr. F, as he started out as an investment advisor. When her son moved to [redacted] in 2000, he suggested she transfer her accounts to a trusted colleague, Mr. B. Mr. B became Mrs. M's Firm A investment advisor in March 2000. Mrs. M says she had no investment knowledge and completely trusted Mr. B based on the endorsement from her son.
- In September 2000, Mr. B started working for Yorkton Securities Inc. (Yorkton) and Mrs. M followed him there, opening a Spousal RRSP and a cash account. The transfer to Yorkton was completed in October 2000. At October 31, 2000, Mrs. M's portfolio was worth approximately \$231,000.
- On September 20, 2000, Mrs. M signed a New Client Application Form (NCAF) for her cash and Spousal RRSP accounts indicating she had good investment knowledge

(defined on the NCAF as three to ten years investing). Her investment objectives were documented as 50% interest or dividends and 50% long term with a 100% low risk tolerance. Mrs. M was 65 years old at the time.

- In January and February 2001, the cash account holdings were transferred to Mrs. M's Spousal RRSP account. There was no subsequent activity in her cash account.
- On November 29, 2001 or December 3, 2001<sup>1</sup>, Mrs. M signed an Update to Client Account Agreement Form updating her Know Your Client (KYC) information. While her investment objectives remained unchanged, her risk tolerance was increased to 10% low and 90% medium. This KYC information was repeated on additional KYC updates signed on January 21, 2004 and November 16, 2004.
- In December 2004, Mrs. M's Spousal RRSP account was converted to a Spousal RRIF account.
- On May 9, 2005, Mr. B's assistant sent Mrs. M a letter informing her that while reviewing the trading activity in her account, it was noted that the investment objectives and/or risk levels on record were inconsistent with her current holdings and that her KYC information had to be updated. In the letter, Mr. B suggested risk tolerance parameters of 70% medium and 30% high risk and asked Mrs. M to sign and return the KYC update if she was in agreement. Mrs. M signed the KYC update on May 12, 2005.
- On June 6, 2008, Mr. B's assistant sent Mrs. M a letter similar to the May 2005 letter, but this time Mr. B suggested risk parameters of 25% medium and 75% high risk. In the letter, Mr. B asked Mrs. M to sign and return the KYC update if she was in agreement. Mrs. M did not sign this document.
- On October 8, 2008, Mr. B sent Mrs. M a form letter stating that the markets had been volatile and recommending she stay the course in light of her long-term investment goals.
- On January 23, 2009, Mr. B's assistant wrote Mrs. M a letter stating the Compliance Department required an update of KYC information every two years. With the letter, Mr. B's assistant included an NCAF for Mrs. M to complete and sign. The investment objective and risk tolerance sections were left blank, while the net worth section was filled in and highlighted in pink. The investment knowledge section was ticked as being good. Mrs. M did not sign or return the form.

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<sup>1</sup> Mrs. M dated the form twice, so it is not clear on which date she signed it.

- On March 12, 2009, Mrs. M's lawyer, Mr. K, wrote a letter of complaint to the dealer on her behalf. In April 2009, Mrs. M transferred her Spousal RRIF account in-kind to another investment firm. We calculate Mrs. M's losses as follows:

*Table 1: Combined account performance October 2000 – April 2009*

	Spousal RRSP/RRIF and Cash Account
Transfer in	\$230,679.92
Deposit/Contribution	\$11,984.50
Withdrawal	\$106,167.06
Capital invested	\$136,497.36
Ending equity value	\$90,902.17
Gain/(Loss)	(\$45,595.19)

## COMPLAINT

- In his March 12, 2009 letter and in subsequent correspondence, Mr. K wrote to the dealer saying:
  - Mrs. M should not have been moved from low-risk to higher-risk investments;
  - Over time, her portfolio's equity allocation increased significantly and by January 2003, 90% of her portfolio was invested in equities;
  - The investments Mr. B made were contrary to the investment objectives and risk levels on the KYC forms;
  - Mrs. M was not consulted when her risk tolerance parameters changed to 10% low and 90% medium in January 2004<sup>2</sup>;
  - In May 2005, Mr. B suggested 70% medium and 30% high risk tolerance parameters. Mrs. M, being an unsophisticated investor, signed the KYC update based on Mr. B's recommendations. These new risk tolerance parameters were a marked departure from the prior risk tolerance parameters and were made without consulting with Mrs. M;
  - In 2005 and 2006, Mrs. M's Spousal RRIF account was churned. Mr. B bought and sold about \$652,000 of investments in the account in 2005 and \$1.5 million in 2006;
  - In a June 2008 letter to Mrs. M, Mr. B recommended new risk levels of 25% medium and 75% high. This time, Mrs. M did not sign the form because she was uncomfortable with the recommendation;

<sup>2</sup> The change actually occurred in November 2001.

- In January 2009, Mr. B's assistant sent Mrs. M a KYC form but the investment objectives and risk tolerance sections were left blank. Mrs. M did not complete and sign the form;
- There was no consultation with Mrs. M regarding whether or not the investments Mr. B recommended were suitable for her, which they are not;
- Mr. B did not discuss most of the trades with Mrs. M and this was not a discretionary account;
- Mrs. M's portfolio once valued at more than \$500,000 fell to \$87,000 in January 31, 2009 and only a small portion of the drop is due to her mandatory RRIF withdrawals;
- Had the dealer properly supervised Mr. B, the situation could have been avoided; and
- Mrs. M wants to be compensated \$275,000 to resolve her complaint.

#### THE DEALER'S RESPONSE

- On October 6, 2009, the dealer wrote to Mr. K saying:
  - According to the KYC information on record, Mrs. M is 74 years old and has good investment knowledge having invested for three to ten years before joining the dealer;
  - When the portfolio was transferred to the dealer in September 2000, the asset mix ranged from medium-risk mutual funds to income fund trust units and a variety of medium to higher-risk equities, a balance which Mr. B maintained to achieve growth and income;
  - Overall, Mrs. M's holdings generally appeared to be in line with her stated risk profile and investment objectives. However, the purchase of higher-risk investments may have been outside her risk parameters and may not have been in line with her financial circumstances;
  - From inception in September 2000 until transfer out in April 2009, Mrs. M withdrew \$106,107 and contributed \$17,809 and her total realized and unrealized net losses are \$27,431.21<sup>3</sup>; and
  - Assuming the portfolio was unsuitable and that Mrs. M's profile ought to have remained at 100% low risk throughout the relevant period, the dealer would assess her damages at \$27,431.21 plus a nominal amount for opportunity loss.

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<sup>3</sup> Our review of the dealer's calculation suggests it is based on the approximate October 31, 2000 value of the Spousal RRSP account of about \$224,000, but does not account for subsequent contributions made in 2001 and 2004 from the cash account totalling \$17,775.60.

- The dealer offered \$30,000 to compensate Mrs. M, which she did not accept.

## OBSI ANALYSIS

In the course of our investigation, we reviewed the documentation provided to us by Mrs. M and the dealer including correspondence between Mrs. M, her lawyer and the dealer, various account application and update forms, account statements, including some from Firm A, and Mr. B's written comments regarding the complaint. In addition to interviewing Mrs. M in the presence of her lawyer, Mr. K, we interviewed Mr. B and Ms. D, the Manager, Retail Compliance at Macquarie. We have also considered the applicable industry rules, regulations and practices.

OBSI examined the following key issues in respect of Mrs. M's complaint:

1. What were Mrs. M's investment objectives, risk tolerance and investment knowledge?
2. Were Mrs. M's investments and the trading in her accounts suitable and were there discretionary or unauthorized trades?
3. If Mrs. M's investments were not suitable or authorized, did Mrs. M incur financial harm?
4. If Mrs. M incurred financial harm, who should bear responsibility for the losses?

### **Issue 1 – What were Mrs. M's investment objectives, risk tolerance and investment knowledge?**

#### **Investment Knowledge**

- Mrs. M's investment knowledge was documented on the dealer's NCAF and KYC forms as "Good." Good is defined on the forms as having invested for three to ten years. Mr. K wrote to Macquarie saying Mrs. M is an unsophisticated investor with very limited knowledge which did not change with the passage of time.
- Before transferring to the dealer, Mrs. M had invested \$16,000 from her mother's estate in mutual funds with a bank in 1983. In 1998, she transferred those investments and the proceeds of the sale of her home to Firm A where she invested for two years with her son. She says she left the money entirely in her son's hands to look after. When her son moved away from Canada in 2000, he referred her to Mr. B who took over as her advisor.
- During our interview, Mrs. M told us that she had held Canada Savings Bonds as a child and knew that bonds and GICs are safer than stocks, but said she does not have much knowledge about stocks. She says when her son started out as an investment advisor she told him to put the money in something low-risk. She believes he put some of her money in bank stocks which she understood to be safe, low-risk

investments.

- Mrs. M was unable to describe the characteristics of bonds, stocks or other types of securities, accurately describe their risks, or relate them to her understanding of bank stocks. We also found she could not explain basic investment terms such as blue chip stocks or the relationship between risk and return.
- Mrs. M says she had always relied on her investment advisors to manage her portfolio. She says that when Mr. B or his assistant would call with a recommendation she would say “Ok, you’re the experts, you decide”. She says she followed their advice without question because she did not understand their reasons for the recommendations. Mrs. M says she completely trusted Mr. B based on her son’s endorsement and referral.
- In our interview with him, Mr. B described Mrs. M’s investment knowledge as average, despite recording “Good” on the KYC forms, and agreed that she had never refused any of his recommendations nor came to him with investment ideas of her own.
- In our view, and as acknowledged by Mr. B, Mrs. M’s investment knowledge was not good. In light of the very basic understanding of investments she displayed during our interview and that she invariably followed Mr. B’s recommendations without understanding or questioning them, we find Mrs. M’s level of investment knowledge was minimal at best and that she completely relied on Mr. B.

#### **Personal Circumstances, Income and Net Worth**

- When Mrs. M began investing with Mr. B in September 2000, she was 65 years old and had been retired for about two years from [redacted] University where she had been a part-time faculty member in the School of [redacted] for 16 years. She had divorced in 1980 and had five adult children. In 1996, she remarried and moved into her new husband’s home; they shared day-to-day expenses. She sold her house in 1997 and invested the proceeds with her son. She owned an older car and a cottage she had received in her divorce settlement. She says in 2000 the cottage was worth about \$100,000 and she maintained it and paid the property taxes from her income. Her only other asset was her investments, worth about \$231,000, all of which were at the dealer.
- Mrs. M’s KYC forms show that in 2000 she had \$10,000 in liquid assets, which she believes was the value of her car, and \$100,000 in fixed assets, which she says was the value of the cottage. In 2004, the KYC forms show \$10,000 in liquid assets and \$300,000 in fixed assets, which she says was the approximate combined value of the cottage and her investments.
- The KYC forms showed she had \$29,000 in annual income in 2000 and \$50,000 in annual income in 2004. Mrs. M’s [redacted] pension is \$32,000 per year and is not indexed. She also receives \$5,000 per year in income from her father’s estate, as well

as CPP. Mrs. M says she filled out the income and net worth sections on the KYC forms as requested by Mr. B or his assistant. She believes they reasonably represent her net worth and income.

- Overall, given that she was 65 years old and retired, we find Mrs. M had a modest net worth of about \$300,000, most of which was invested at the dealer, and a modest income of about \$50,000, most of which was not indexed and would not keep up with inflation. While she was remarried, her and her new husband's assets were separate.

### Investment Objectives and Risk Tolerance

- Mrs. M says she was a low-risk investor and that she wanted her investments to increase in value for when she would need to take minimum RRIF payments. She says she had no particular percentage return expectations but she wanted to earn a bit more than she could get at a bank. She says otherwise, she would have just put her money with a bank.
- Mrs. M says she knew her son had invested her in some bank stocks, and she believed that when Mr. B became her advisor all of her investments were low-risk.
- We reviewed Mrs. M's Firm A account statements for the years 1999 and 2000. Our analysis shows that her combined accounts were approximately invested 60% in low-risk fixed income investments mainly comprised of provincial bonds, and 40% in medium-risk equities and equity-based investments. The portfolio contained one high-risk investment worth about 4% of the portfolio. The portfolio was still allocated this way when it was transferred to the dealer. Therefore, the portfolio was not entirely low-risk as Mrs. M believes it was, but it was balanced with an emphasis on lower-risk fixed income investments which we find suitable in her circumstances.
- Table 2 summarizes the investment objective and risk tolerance information on the KYC forms and update letters Mrs. M signed between 2000 and 2005:

*Table 2: KYC forms – Investment objectives and risk tolerance information*

	Sept. 2000	Nov. 2001	Jan. 2004	Nov. 2004	May 2005
Investment Objectives	50% Interest or Dividends	50% Interest or Dividends	50% Interest or Dividends	50% Interest or Dividends	
	50% Long Term	50% Long Term	50% Long Term	50% Long Term	
Risk Tolerance	100% Low	10% Low 90% Medium	10% Low 90% Medium	10% Low 90% Medium	70% Medium 30% High

- Mrs. M says she does not recall discussing the forms with Mr. B and that she met with him in his office only twice, once at Firm A and once at the dealer. She says Mr. B provided the forms and updates with the risk and investment objective information



already completed and that she signed them without understanding their importance because she trusted Mr. B and he told her the forms were required. She says she signed the 2001 KYC information update form, which increased her risk tolerance from 100% low to 10% low and 90% medium, without understanding there was any change from previous forms. She says she noticed the high risk indication on the 2005 form and felt uncomfortable with it. She says she signed it because, as discussed further below, Mr. B discounted the high-risk parameter telling her that none of her investments were high-risk. Also, Mr. B's assistant said it was required and she trusted them as the experts.

- The September 2000 KYC form Mr. B prepared indicates Mrs. M had a 100% low risk tolerance and investment objectives equally weighted between interest or dividend-paying investments and long-term investments. Mr. B says he interpreted “interest or dividend-paying” investments as income-producing investments and “long-term” investments as growth investments.
- The risk tolerance and investments objectives on the September 2000 KYC do not align. In particular, growth investments are not considered low-risk investments so it is impossible for an investor to have 100% low risk tolerance and a 50% growth objective. Mr. B was not able to explain this discrepancy. To add to the confusion, Mr. B said he thought Mrs. M had transferred to the the dealer a 100% medium-risk portfolio, which she did not, and that the income component was derived from dividend-paying equities. Unfortunately, Mr. B has no notes documenting why he completed the September 2000 KYC document the way he did.
- All of this being said, the way the September 2000 KYC form was completed is in line with what Mrs. M thought she held: all low-risk investments including some bank stocks. The form is also somewhat consistent with Mrs. M's portfolio at Firm A: a lower-risk balanced portfolio.
- During her first year at the dealer, Mrs. M's portfolio asset allocation shifted towards equity securities at increasing risk levels and away from her previous lower-risk balanced portfolio. During his interview, Mr. B said he explained to Mrs. M that the change from 100% low risk to 10% low and 90% medium on the November 2001 KYC update form was related to the equities in her account. Mr. B has no notes of his discussions and could not point to any change in Mrs. M's personal or financial circumstances to support such a change to her portfolio. Rather, Mr. B explained that he applied an approach he described as “medium-risk and growth” for all his clients. He said that instead of investing in bonds, he always recommended equity investments that paid dividends or had the potential for capital appreciation. Although Mrs. M was 65 years old at the time, he said such a portfolio was suitable because she was reasonably financially secure, did not have much debt, had some real estate and was married to a “successful individual.”
- Based on Mr. B's acknowledgment, we find the 2001 and 2004 KYC forms were completed to reflect the holdings in Mrs. M's account and to align with Mr. B's

general investment approach as opposed to reflecting Mrs. M's objectives or tolerance for risk.

- Mr. B explains that the dealer's Compliance Department requested he send the 2005 and 2008 KYC forms to Mrs. M indicating she had a higher risk tolerance because in the Compliance Department's view, Mrs. M held some high-risk investments in her account. He says he did not agree with the Compliance Department that any of Mrs. M's investments were high-risk. In fact, he says he told Mrs. M he did not agree with the Compliance Department's assessment and that her investments were no more than medium-risk, entirely discounting the high risk parameters on the forms.
- For these reasons, we find the 2005 KYC form Mrs. M signed showing 30% high risk, and the 2008 KYC form showing a 75% high risk tolerance, which she did not sign, were prepared to reflect the investments she held rather than her actual risk tolerance and investment objectives.

## Conclusion

When Mrs. M transferred her investments to the dealer, she was 65 years old and retired with a modest income and a modest net worth to support her needs in the long-term. She says she wanted, and thought she had at the time, a 100% low-risk portfolio as the September 2000 KYC form shows. In fact, when she first transferred to dealer, she held a balanced portfolio with an emphasis on low-risk fixed income investments.

For the reasons outlined in the section above, the KYC forms that Mr. B prepared and had Mrs. K sign from 2001 to 2008 did not accurately reflect her risk tolerance and investment objectives. Instead, it would have been appropriate for Mrs. M to have a 100% low-risk portfolio, as indicated on the September 2000 KYC form, or to have a portfolio consisting of 40% medium-risk equity investments and 60% low-risk bonds as she previously held. Therefore, we examined the suitability of her actual investments relative to this range of potentially suitable investment parameters.

## Issue 2 – Were Mrs. M's investments and the trading in her accounts suitable and were there discretionary or unauthorized trades?

### Investment Suitability

- We conducted a detailed analysis of the risk profile and characteristics of the securities in Mrs. M's accounts. Our analysis shows that in 2000, Mr. B began selling bonds and buying stocks. By October 2001, only 11% of the portfolio was in bonds, with the remainder in balanced and equity-based mutual funds, two bank stocks and an income trust. By then, the high- and medium-high risk holdings had increased from about 4% to 38%. By April 2003, there were no bonds left in the account and the risk level had further increased. By April 2005 and continuing through to 2009, 87% to 100% of the portfolio was in high- and medium-high risk holdings with a substantial portion of the portfolio exposed to the resource sector and to income trusts (many being resource-based income trusts).

- Based on semi-annual assessment dates from October 31, 2000, soon after her accounts were opened, to March 31 2009, shortly before they were transferred away, our analysis shows that Mrs. M's portfolio held, on average, 2% in cash, 2% in balanced funds, 6% in bonds and 90% in equities. In addition, on average, only 7% of the portfolio was low-risk, while 28% was medium-risk, 26% was medium-high and 38% was high-risk.
- During our interview, Mr. B agreed there was a shift to resources, which he believes to be a "good place" to invest. He says all his clients' portfolios had a healthy exposure to the resources sector. He says these companies have "pristine balance sheets", are "printing money" which makes them "cash rich", and they "don't know what to do with their money." Regarding his assessment of the sector's risk level, he stated: "We need resources and that sector has some of the strongest earnings of any sector in the world. I would say that they are blue chip." He finds the view that the resource sector is risky to be very broad and general and believes it is possible to invest in the resource sector in a conservative fashion.
- Based on our analysis of Mrs. M's portfolio, we cannot agree that Mr. B conservatively invested in the resource sector or in general. We also cannot agree with his assertion and representation to Mrs. M that none of her investments were high-risk.
- Consistent with our analysis, the dealer's Compliance Department found the portfolio included higher-risk investments and requested Mr. B update the KYC forms. He prepared the updated form showing up to 75% high risk to reflect the increasing risk in the account. The dealer provided us with copies of three Compliance Department emails to Mr. B dated May 2006, October 2006 and May 2008 enquiring about Mrs. M's account. The 2006 queries were both with regard to the suitability of two large positions in the Spousal RRSP account. In the 2008 query, the Compliance Department qualified the portfolio as "more medium to higher risk," referenced the concentration in two securities and asked for comments on how this investment strategy fit for Mrs. M given her age, net worth and income. Mr. B responded addressing one stock, which he said was not high-risk, but he did not address the other elements of the query.
- Our analysis shows that Mrs. M's portfolio included too little in bonds, too much in equities, and that it was too risky overall. The portfolio was not aligned with Mrs. M's preference for low-risk investments nor was it reflective of a suitable 60% low-risk fixed income and 40% medium-risk growth portfolio.

### **Unauthorized Trading**

- Mrs. M complained that she was not consulted about most of the trading in her accounts.
- Mr. B says he discussed every investment he made with Mrs. M in an open and clear manner. Mr. B says he would call her and say "this is what I think we should do" and

explain his reasoning. He says she would listen and agree with the recommendation. He adds that those calls were short, lasting about two or three minutes.

- Mrs. M says she received a call, typically from Mr. B's assistant, about once a week to discuss trades, some of which were proposed, some of which had already been placed. She says that at other times she got "slips" in the mail when she had not spoken to Mr. B or his assistant. Regardless, she says she agreed with their advice and followed it without question although she did not understand it. She says they were the experts, and because the recommendations meant nothing to her, she had no input in the decisions.
- Some discretionary trading may have taken place in Mrs. M's accounts. While she confirms she was aware of the trading in her accounts and did not object to it, based on her minimal investment knowledge and experience and her reliance on Mr. B, we do not believe Mrs. M knew there was any problem to which she should object. Rather, she trusted Mr. B and his assistant as the experts and she followed their advice and direction.

### **Excessive trading**

- Mrs. M says her portfolio was churned, specifically in 2005 and 2006.
- We reviewed the transaction history of Mrs. M's accounts, which shows that from September 2000 to April 2009, Mr. B recommended 232 transactions (114 purchases and 118 sales) equating to 29 transactions per year or about two and a half per month, on average.
- The investment industry uses the annual turnover rate to evaluate excessive trading. The turnover rate is calculated by dividing the total dollar amount of purchases during a particular time period by the average net equity for the same period. One measure for excessive trading is the 2-4-6 rule: 2 indicates possible excess trading and/or churning, at 4 excess trading is presumed and at a rate of 6 there is conclusive evidence of excess trading and/or churning. All measures carry the caveat that excessive trading may be established at a lower rate.

- We calculated Mrs. M’s turnover rate from 2000 to 2009 to be approximately 1.18 (see Table 3 below). Since an eight-year timeframe could mask periods of excessive trading, we also calculated the turnover rate from 2005 to 2006 and determined that it was 2.32.

*Table 3: Mrs. M’s Investment Turnover Rate*

	Overall	2005 to 2006
Start of Period	September 2000	January 2005
End of Period	April 2009	December 2006
Number of Days	3,137	729
Duration (YRS)	8.59	2
Purchases	\$3,266,379.45	\$2,178,167.38
Average Equity	\$321,525.06	\$470,643.66
Ratio	1.18	2.32

- The turnover rate in 2005 and 2006 indicates possible excessive trading during this period.

## Conclusion

Our analysis shows that Mrs. M’s portfolio was unsuitable. It was too risky with too much in equities and too little in bonds relative to a balanced portfolio with emphasis on low-risk income investments. It also was not in keeping with Mrs. M’s preference for low-risk investments.

Mr. B and his assistant may or may not have sought Mrs. M’s consent for each trade. Nevertheless, she knew of the trading in her accounts and always followed their advice without question. However, with minimal investment knowledge and her reliance on Mr. B, and given Mr. B’s inaccurate representations about the risk of her investments, Mrs. M did not understand and could not have ascertained that her investments were not suitable. She also did not appreciate that at times the trading in her account may have been excessive.

## Issue 3 – Did Mrs. M incur financial harm?

- In its response to Mrs. M’s complaint, the dealer acknowledged that the “higher risk investments within the portfolio may have been outside [Mrs. M’s] risk parameters and exceeded her financial circumstances.” It calculated her losses at \$27,431 which was understated as it appears not to capture Mrs. M’s subsequent RRSP contributions totaling more than \$17,000. The dealer said that assuming the portfolio was unsuitable and Mrs. M’s portfolio ought to have remained at 100% low-risk, her damages would include a nominal amount for opportunity loss. It offered \$30,000 to resolve her complaint in exchange for a release that excluded Mr. B, leaving her free to pursue a claim against Mr. B if she desired.

- In our attempt to settle this matter with the dealer, we proposed compensation based on a comparison of Mrs. M's actual unsuitable portfolio performance to a balanced portfolio allocated 60% to laddered benchmark government bonds and 40% to some of the actual medium-risk holdings in Mrs. M's account. We calculated that Mrs. M incurred financial harm of \$160,992. We explained that the objective of such a comparison was to determine the financial position Mrs. M would have been in had she been suitably invested. Macquarie would not accept the settlement proposal, saying the comparison portfolio we used was not reasonable and resulted in an inappropriate amount of compensation. While we credit Macquarie for recognizing a suitability problem and making an offer to resolve the matter, it did not use a comparison portfolio in calculating its offer to Mrs. M and we cannot accept its approach as reasonably restoring her to the position she would have been in.
- We have further considered Mrs. M's assertion that she wanted 100% low-risk investments, along with our view that a lower-risk balanced portfolio would also have been suitable in her circumstances. In the end, we compared the performance of Mrs. M's actual investments to two potentially suitable comparison portfolios:
  - The first portfolio was allocated 100% to the DEX All Government Bond index representing low-risk fixed income investments. This portfolio assumes Mrs. M held 100% low-risk investments as shown on the first KYC form, and as she says she wanted.
  - The second portfolio was allocated 60% to the DEX All Government Bond index and 40% to the S&P TSX 60 index representing good-quality medium-risk equity securities that offer the potential for growth. This portfolio is in keeping with a balanced portfolio emphasizing lower-risk fixed income that we believe would have suited Mrs. M's circumstances and was reflective of her previous portfolio. We note that in our original proposal to Macquarie, we used actual and other investments as benchmarks which are less objective than using common indices as benchmarks. Therefore, we adjusted our calculations to use a common fixed income index and a common equity index as benchmarks.
- Our calculations covered the period from October 31, 2000, shortly after the accounts were opened at the dealer, until April 28, 2009, when the portfolio was transferred away, and took into account the timing of Mrs. M's withdrawals. We also considered trading costs. In particular, we reduced the performance of the DEX index by 0.39% to reflect the cost of a passively managed ETF government bond portfolio. Further, if Mrs. M had used 40% of her capital to buy and hold good-quality equities, at a 2% commission rate we estimate she would have paid \$1,850 ( $\$231,000$  approximate portfolio value at account opening  $\times$  40%  $\times$  2%) in purchase commissions. Over eight years, only moderate trading would have been required and we assume approximately 10% of the equity portion of the portfolio would have been sold and reinvested each year for additional trading commissions of approximately \$3,060, for a total of

\$4,910. In our calculations we made a deduction from the comparison portfolio performance for this amount. The results of our calculations are summarized in Tables 4 and 5 below:

*Table 4: Suitable performance calculation – 100% DEX*

	Combined Spousal RRSP and Cash Account
Net amount invested <sup>4</sup>	\$136,497
Suitable Ending Value	\$285,104
Gain (Loss)	\$148,607
<b>Financial Harm (\$45,595 actual loss + \$148,607 suitable gain)</b>	<b>\$194,202</b>

*Table 5: Suitable performance calculation – 60% DEX , 40% TSX*

	Combined Spousal RRSP and Cash Account
Net amount invested <sup>5</sup>	\$136,497
Suitable Ending Value	\$249,629
Less: Commissions	\$4,910
Gain (Loss)	\$108,222
<b>Financial Harm ( \$45,595 actual loss + \$108,222 suitable gain)</b>	<b>\$153,817</b>

If, like Macquarie, we accept the September 2000 KYC form in part by relying on the documented 100% low-risk parameter and Mrs. M's assertion that she wanted only low-risk investments, then her financial harm is \$194,202. If we conclude the KYC documents are not accurate at all, and instead conclude that her previous balanced portfolio allocation with 60% low-risk fixed income and 40% medium-risk equities was suitable, then Mrs. M's financial harm is \$153,817.

Since we believe either portfolio would be suitable, Mrs. M's financial harm is at least \$153,817.

#### **Issue 4 – Who should bear responsibility for the losses?**

Investment dealers are vicariously liable to their clients for the actions of their investment advisors in regard to securities-related business. Investment dealers also have a direct responsibility to their clients to properly supervise advisor conduct. Below, we examine how both of these responsibilities apply to Macquarie in this case. We also consider whether Mrs. M should be held responsible for a portion of her loss.

#### **Vicarious Liability and Supervision**

- The case law is clear that investment firms 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

<sup>4</sup> Funds deposited and transferred in less withdrawals.

<sup>5</sup> Funds deposited and transferred in less withdrawals.

vicarious liability: "...a firm is absolutely responsible for the conduct of its stockbroker." The reasons for holding investment firms 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 created 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.

- In this case, the dealer recognized that Mrs. M's investments were increasingly not suitable relative even to the KYC information it had on record. To address the problem, the dealer requested Mr. B to complete updated KYC forms. Mr. B completed and asked Mrs. M to sign KYC forms that reflected the risk profile of the securities in the account rather than ensuring that the KYC forms accurately reflected Mrs. M's actual objectives and risk tolerance. As a result, the dealer's requests that Mr. B update the KYC forms effectively masked the increasing discrepancy between Mrs. M's true objectives and risk tolerance and her portfolio profile.
- The best chance to prevent Mrs. M's losses rested with the dealer. If it had enquired when the risk parameters first increased from 100% low to 10% low and 90% medium and then continued to increase, and ensured Mr. B understood his responsibility to collect accurate and reliable KYC information, this issue may never have arisen. Mrs. M should not be required to pay for the inaccurate KYC information that allowed the kind of trading in unsuitable securities that caused her losses.

### **Client Responsibility**

- Mrs. M was an unsophisticated investor with very little investment knowledge. She relied entirely on Mr. B to make recommendations that suited her needs and circumstances. She followed and accepted Mr. B's advice throughout and signed forms as he requested. It turns out that Mr. B overstated her risk tolerance and objectives, invested her in securities that were unsuitable and at times may have traded more frequently than would have been appropriate.
- In *Re Daubney*, (2008) 31 OSCB 4817, the Ontario Securities Commission panel said the duty of care with respect to the recommendation of suitable investments is placed upon "the registrant who is better placed to understand the risks and benefits of any particular investment product. That duty cannot be transferred to the client" (para 210). In *Re Lamoureux*, (2001) ASCD no 613, the Alberta Securities Commission said "this responsibility cannot be substituted, avoided or transferred to the client, even by obtaining from the client an acknowledgement that they are aware of the



negative material factors or risks associated with the particular investment.”

- We further note in *Re Lamoureux*, at Part VI (B)1, it states “Similarly, the probative value of a signed acknowledgement may vary greatly, depending upon the sophistication of the investor, the content of the acknowledgement and the circumstances under which it was signed.”
- Mrs. M is not a sophisticated investor. There is no evidence that Mr. B properly explained the KYC information or reviewed it with Mrs. M or that she understood it, and it is clear that he completed it inaccurately. Mr. B admits describing the investments he recommended as less risky than we and the dealer assessed them to be. We find it clear that Mrs. M was not aware of the risk of her investments or that they were not suitable.
- Given her lack of investment knowledge, it is unclear from Mrs. M’s perspective what more she could have done. It does not appear to us that there is any basis to impose contribution on her, because she does not appear to have acted negligently. Mrs. M relied on Mr. B, in his capacity as her trusted advisor, and there is nothing unreasonable about her reliance. To require her to bear responsibility for the financial harm arising from unsuitable investments and trading she did not understand is not fair to her.

## Conclusion and Recommendation

The dealer, now named Macquarie, is vicariously liable for Mr. B’s unsuitable activities in Mrs. M’s accounts. The dealer also had responsibility through its compliance function to ensure that Mrs. M was suitably invested. The dealer was responsible and best positioned to prevent Mrs. M’s losses and we recommend Macquarie compensate her at least \$153,817 for her financial harm. In addition, we recommend \$3,457 in interest on the losses from March 12, 2009<sup>6</sup> for total compensation of \$157,274.

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<sup>6</sup> Interest is calculated using the average 3-month Canadian Treasury Bill yield of 0.65% (as calculated by the Bank of Canada) compounded annually from March 12, 2009 to the date OBSI’s report is final.