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

CONFIDENTIAL &
WITHOUT PREJUDICE

INVESTIGATION REPORT

Date: September 20, 2012
Client: Ms. S
Firm: Macquarie Private Wealth Inc. (Macquarie)

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 completed on April 8, 2010. 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:	▪ Mr. H
Accounts:	▪ Ms. S's Spousal RRSP account ▪ Mr. S's RRSP account ▪ Mr. and Ms. S's RESP account and joint cash account
Period:	▪ June 2005 to June 2008
Key Conclusions:	▪ The clients were primarily medium-risk growth investors. However, they needed some income from their investments and were willing to have up to 20% of their portfolio in high-risk investments. ▪ Mr. H's investment recommendations included too many high-risk investments, which was unsuitable. He also underestimated the risk profile of the investments he recommended and would not have accurately described the risks of some investments to the clients. Ms. S, who made their investment decisions, did not know and could not have independently identified the risk level of their investments. ▪ Macquarie is vicariously liable for Mr. H's unsuitable recommendations. In addition, Macquarie missed the opportunity to prevent financial harm by failing to identify the excess high-risk exposure and ensure Mr. and Ms. S's investments were suited to their risk tolerance parameters.
Recommendation:	$72,464 Compensable losses $2,327 Interest on recommendation $74,791 Total recommendation

401 Bay Street, Suite 1505, P.O. Box 5, Toronto, Ontario M5H 2Y4 Tel: 416.287.2877 Fax: 416.225.4722 Toll Free Call Centre: 1.888.451.4519
Email: ombudsman@obsi.ca Web site: obsi.ca

OVERVIEW OF DEALER HISTORY

- Mr. and Ms. S 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 June 2008, when Mr. and Ms. S began moving their 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 Mr. and Ms. S for the previous problems with their investments.

- The fact is that the dealer is the same one that Mr. and Ms. S dealt with from 2000 and where all the problems leading to their 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 Mr. and Ms. S. It is Macquarie that will decide whether they will be compensated for their 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 Mr. and Ms. S invested and it owes them the compensation found due to them in this report.

BACKGROUND

- Ms. S says she and her late husband began investing in the early 1990s when their children were young. They invested a fixed amount each month in mutual funds with their bank until 1999. When their investment advisor left the bank, he was replaced by an advisor who soon moved to Montreal. In February 2000, Mr. and Ms. S transferred their investments to Yorkton Securities Inc. and a new advisor, Mr. O, who was closer to home. They opened a joint cash account, an RRSP account for Mr. S, and a Spousal RRSP account for Ms. S.

- Mr. and Ms. S say Mr. O recommended a leverage strategy, using a home equity line of credit against their previously mortgage-free home. He also recommended labour sponsored investment funds (LSIFs) for tax deduction purposes, and various mutual funds.

- On June 7, 2005, the dealer wrote to Mr. and Ms. S saying Mr. O had "chosen to retire from the financial industry" and Mr. H was their new investment advisor. At the time, Mr. and Ms. S were concerned with their portfolio and its declining value. On June 18, 2005, they met with Mr. H and Mr. N, Vice President and Branch Manager of the dealer to discuss their portfolio. Mr. H recommended they reposition their portfolio to generate growth as well as income to help make their loan payments.

- On July 8, 2005, Mr. H prepared and Mr. and Ms. S signed NCAFs for each of their accounts.
- On July 11, 2005, Mr. and Ms. S wrote to Mr. N reiterating their concerns about their portfolio, saying they had raised concerns with Mr. O for some time but were always told to hang on for the long term. They sought assurance and confirmation that Mr. N and Mr. H would make every effort to recover their losses, respond to their concerns and ensure a "sustained profit."
- On August 1, 2005, they wrote to Mr. N thanking him for meeting with them and saying that based on their discussion they were confident their investments would be well handled by Mr. H and Mr. N.
- On August 11, 2005, Mr. and Ms. S signed a NCAF to open a RESP account. On all of the NCAFs they signed in July and August 2005, their investment knowledge was recorded as good (which is described on the form as three to ten years investing), their investment objectives were shown as 20% interest or dividends, 60% long term, 15% medium term, 5% short term, and their risk tolerance was shown as 10% low, 70% medium and 20% high.
- In July and August 2005, the mutual funds in Mr. and Ms. S's accounts were sold and the proceeds were reinvested in stocks and income trusts according to Mr. H's recommendations.
- There were various meetings and email exchanges between Mr. H and Mr. and Ms. S about the accounts between mid-2005 and early 2008 which show Mr. and Ms. S continued to be concerned with losses in their portfolio. In January 2008, Mr. H recommended they move into guaranteed investment certificates (GICs) so they would not lose anything further. No changes were made to the account holdings.
- In June 2008, Mr. and Ms. S transferred three of their accounts away from the dealer. The RESP was transferred away in September 2008.
- On April 27, 2009, Mr. S passed away.

COMPLAINT

- On August 27, 2008, Mr. and Ms. S complained to the dealer saying:
  - While they had three to ten years of investment experience, they had only invested in (GICs), Canada Saving Bonds (CSBs) and mutual funds and had no knowledge of dividends, capital gains and losses, income trusts, stocks, etc.;
  - When they met Mr. N and Mr. H in 2005, they told them they wanted to recoup their losses but were not willing to lose more capital. It was agreed that caution was needed, yet their portfolio value declined steadily. Had the dealer not

convinced them it could get their accounts back on track, they would have transferred away;

- They agreed they needed investment income but they were not told investments with high dividends could cause them capital losses. Given their financial situation, they were over-exposed to unsuitable high-risk investments;
- Mr. H's strategy of using income-producing investments to make loan payments was unsuitable. The investment values declined while loan amounts remained the same;
- The RESP account was particularly unsuitable. While they needed to maximize growth, they had three teenagers who would need the money in the short term. When their RESP account value dropped in 2007, Mr. H advised them to take out a loan for their eldest child's education;
- On several occasions, they told Mr. H they were uncomfortable with the continual decline of their principal and with their exposure to income trusts. However, their concerns were dismissed; and
- By the last meeting in 2008, they had lost faith in Mr. H's ability to make suitable investment recommendations and his suggestion to invest in GICs was too little too late.

- Mr. and Ms. S did not specify the amount of compensation they were seeking.

THE DEALER'S RESPONSE

- On February 5, 2009, the dealer responded to Mr. and Ms. S saying:
  - When they met Mr. H on June 18, 2005, Mr. and Ms. S expressed concerns and discussed their expectations and goals in regard to their portfolio;
  - Mr. H determined that cash flow from the investments was necessary to pay down their loans. He recommended income-producing assets, including income trusts and common stocks;
  - All accounts appear to be in line with Mr. and Ms. S's risk profile and investment objectives;
  - Mr. H met their goal to maximize the growth of the RESP in the short term by purchasing several high quality growth stocks with dividends. The suggestion to consider a loan for the oldest child was made to give the RESP a chance to recover some of its value before beginning withdrawals;
  - The portfolio value declined overall with the joint cash account incurring the most losses. The decline was mainly caused by the decrease in the price of the income

trusts. It was Mr. H's opinion, along with many others in the financial industry that income trust values would eventually recover. However, the recovery did not occur before Mr. and Ms. S sold or transferred them away;

  - Mr. and Ms. S had various meetings with Mr. H and received materials explaining their holdings, cash flow reports, gain and loss reports and email updates; and
  - During Mr. and Ms. S's last meeting with Mr. H on January 10, 2008, he recommended they modify the portfolio to include fixed income products including GICs to assure no further loss of principal, but Mr. and Ms. S did not act upon the recommendation.

- The dealer did not offer compensation.
- In October 2009, Ms. S wrote to OBSI and the Investment Industry Regulatory Organization of Canada (IIROC) with her concerns.

IIROC'S RESPONSE

- On January 13, 2010, IIROC wrote to Ms. S saying:
  - The percentage of higher-risk investments held in all of the accounts appeared to have exceeded the high risk tolerance parameters noted on the NCAFs;
  - The excess high-risk investments held in both RRSP accounts appeared to be due to the labour sponsored investment fund (LSIF) holdings;
  - Each account had losses between 2005 and 2008;
  - While it would not pursue formal disciplinary proceedings, it had taken other measures against Mr. H.

OBSI ANALYSIS

In the course of our investigation, we reviewed correspondence between Mr. and Ms. S and the dealer, and between Ms. S and IIROC, account applications, account statements, various account summaries and income projections Mr. H or his assistant prepared, emails between Mr. H or his assistant and Mr. and Ms. S, Ms. S's notes about meetings with Mr. H, Mr. H's written comments on the complaint and a summary timeline of contacts with Mr. and Ms. S which he compiled after the clients complained. He would not provide copies of relevant pages of his journal where he says he made the contact notes because he says it included notes about personal matters. We interviewed Ms. S regarding the complaint as well as Mr. H and Mr. N, and we discussed the matter with Ms. D, Manager, Retail Compliance. We have also considered the applicable industry rules, regulations and practices.

In the course of our discussions with Ms. S, she was clear that while they had been concerned about Mr. O, they had set that period behind them when Mr. H became their advisor in June 2005 and had elected to move forward with the dealer based on Mr. N and Mr. H's assurances. Therefore, she says her complaint pertains specifically to the period from mid-2005 to 2008 while their accounts were under Mr. H's management.

OBSI examined the following key issues in respect of Ms. S's complaint:

1. What were Mr. and Ms. S's investment objectives, risk tolerance and level of investment knowledge?

2. Were their investments suitable?

3. If Mr. and Ms. S's investments were not suitable, did they incur financial harm?

4. If they incurred financial harm, who should bear responsibility for their losses?

Issue 1 – What were Mr. and Ms. S's investment objectives, risk tolerance and level of investment knowledge?

Investment Knowledge

- On July 8 and August 11, 2005, Mr. and Ms. S signed NCAFs indicating their investment knowledge was "Good (3 to 10 years investing)."

- During our interview, Ms. S said that she and Mr. S had little investment knowledge. She says Mr. S had previously been in charge of their accounts and knew a bit more than her, but that by 2005 she was primarily responsible for their investments because Mr. S was ill and could not keep on top of it.

- During our interview with Mr. H, he agreed that Ms. S was in charge of their investment accounts and that while Mr. S attended meetings and participated in discussions he left the decisions in Ms. S's hands. Mr. H says he was surprised by their lack of investment knowledge despite having invested for a number of years. He described Ms. S's investment knowledge as low and Mr. S's as being on the medium end of low-medium. He said Ms. S was "naturally nervous," that she did not want to look at their account values because she was upset that they had declined, that she wanted her advisors to make decisions for her and was inclined to transfer responsibility to them. He says he wanted them to be involved and learn about investing, that he or his assistant spoke to Ms. S almost weekly to help manage her concerns and provided her with detailed information and access to their account information on line so she could follow the account values.

- Ms. S says she was very busy with work and with raising her children and since she understood little about investing she followed her advisors recommendations, trusting them as the professionals. She agrees that Mr. H provided information, that she looked at the account values on-line regularly, called him with her concerns as the

account values continued to fall and that at some meetings she took notes so she could try to follow the information Mr. H was providing. She says that he mostly described investments as “solid” and talked about the “yield,” “target returns” and about the companies and their investment prices going up, but she says that he never talked about risk, or about the portfolio and how their investments all worked together. Her notes substantiate her recollection. For example, her May 3, 2006 notes show that Mr. H spoke about individual investments such as “Diageo – will continue to go up,” “Amtelecom – buying it’s own stock – sign it’s going up soon,” Xceed – healthy firm”, “Tree Island – hang in there – excellent company”. Ms. S’s August 22, 2006 notes show, for example, “Chattem – up, new highs every day,” “Sequoia – hit $4 yesterday,” “Amer. Cap. Strat. – shares show uptrend,” “Evergreen – strong yield 12%,” “Westshore – co. is profitable”.

- In our interview, we found Ms. S could not describe terms like “yield,” “dividend” or “income trust” and could not explain how Mr. H related capital gains or losses and dividend income to their return, but that she could understand the difference between the price when they bought and sold investments and this is the information she followed on line. In our discussions we found that Ms. S understood that bank accounts, GICs and CSBs had low rates of return and little risk, that mutual funds are spread out over many stocks so they have less risk than an individual stock, and investors occasionally take high risk to make a quick profit. She also believed the old adage that you should not put all your eggs in one basket, so not too much should be in any one investment. However, she could not describe the risk levels of their investments either individually or as a portfolio.

- Given our discussion with her, we find Ms. S has good common sense, could do basic math, and appreciates some general investment concepts, but has little specific investment knowledge. We agree with Mr. H’s description of Ms. S’s investment knowledge as low.

Personal Circumstances, Investment Objectives and Risk Tolerance

- On July 8 and August 11, 2005, Mr. and Ms. S signed NCAFs indicating the same investment objective and risk tolerance information for all of their accounts as summarized in Table 1 below.

Table 1: Mr. and Ms. S’s documented investment objectives and risk tolerance

Investment Objectives	20% interest or dividends 60% long term 15% medium term 5% short term
Risk Tolerance	10% low 70% medium 20% high

- In 2005, Mr. and Ms. S were both 49 years old. Mr. S was working as [redacted] and was earning $75,000 per year. Ms. S was working as [redacted] and was earning $85,000 per year, for a combined annual household income of $160,000. They were raising three teenage children who were approaching post-secondary school age. They had been saving monthly for their children's education since they were young.

- Mr. and Ms. S's NCAFs show they had $10,000 in liquid assets and $475,000 in fixed assets. In June 2005, their joint account, RRSP and Spousal RRSP investments at Macquarie were worth approximately $194,321. In August 2005, they transferred in their RESP investments worth $50,031. In addition, they held some mutual funds at another firm worth about $50,000.

- Ms. S says in 2005 their outstanding investment loan balance was $150,000 and they had also borrowed for home improvements, for a total home equity line of credit of approximately $200,000. She says they also had smaller personal lines of credit totaling about $25,000. Mr. and Ms. S's loan payments were approximately $1,300 to $1,500 per month. Ms. S says they were "pretty close to the edge" between income and expenses and were having trouble paying the lines of credit. She says that in June 2005, Mr. H told them they needed to generate cash flow from their investments to pay down their debts and he spoke about changing their investments to receive "dividends." They agreed they needed income and they wanted to recover their previous investment losses. Ms. S could not specify the return they were looking for, but she says they wanted their investments to grow at a reasonable rate. However, she says they were clear with Mr. H and Mr. N that they were very concerned with the recent decline in their portfolio value and that they told him they could not afford and did not want to lose more money.

- Mr. H says that Ms. S wanted the impossible, meaning high returns with low risk. While he acknowledges that Ms. S would have opted for the safety of GICs, he says she was also desperate to recover previous losses and that it was very important to her to pay down their debts. He says he advised Mr. and Ms. S they could not be in low-risk investments like GICs, nor could they stay in their previous mutual fund portfolio which offered no cash flow, and still pay their debt.

- Mr. H says that Mr. and Ms. S needed their investments to grow and provide interest, dividends or other income with securities like Bell stocks, convertible debentures, common stocks and income trusts, but that bonds were not appropriate because they would provide no growth. In all, he summarized Mr. and Ms. S's investment objective as 100% growth with 20% allocated to generate income. He says they accepted the "middle ground" for risk in the RESP and joint account to reach their goal for growth and income, and accepted a little below moderate risk for the RRSP and Spousal RRSP.

- Ms. S says that Mr. H suggested the investment objective and risk information that was recorded on the NCAFs and they thought it made sense. She says they understood that it included a 20% high risk allowance, the purpose of which was to

recoup their previous losses and to occasionally "make a quick profit and get out." She says they understood the rest of the portfolio would be primarily medium-risk which she knew would not to be as safe as GICs but could offer higher returns than GICs would provide. She says, and Mr. H agrees, they had no experience investing in stocks or income trusts before he met them. Ms. S says she had no understanding that income trusts were risky and they could lose value. Ms. S says Mr. H recommended income trusts as a "fantastic" investment for making money and earning dividends, which is how he said he always invested clients who needed income, and that they would see their investments rise in value. Although she says she was concerned with the number of income trusts in their accounts relative to the basic idea that she should not put all her eggs in one basket, she followed Mr. H's advice and assurances that income trusts would work well for them.

Conclusion

In 2005, although Mr. and Ms. S had a reasonable income, all the parties agree that they were having trouble paying their debts and they needed income from their investments. At the same time, Ms. S says they wanted their investments to grow at a reasonable rate and to recover their previous losses.

While Mr. and Ms. S were concerned with not losing money and Mr. H acknowledges that Ms. S would have preferred to invest in GICs, Ms. S understood that they were not investing in GICs, CSBs or bank deposits, that most of their investments would be medium-risk for the potentially higher rate of return they could provide, with up to 20% in higher-risk investments. Although Mr. H says and we agree that Ms. S's investment knowledge was low and she was not able to independently assess the risks of the investments Mr. H recommended, our discussions with Ms. S suggest she understood enough to agree to the parameters on the NCAF forms she signed despite her low-risk preferences.

At Mr. and Ms. S's ages and in their personal and financial circumstances, we find the 20% income, 80% growth objectives and 10% low, 70% medium and 20% high risk tolerance parameters documented on the NCAFs were reasonable. They reflected Mr. and Ms. S's needs and goals, and we examined the suitability of their investments relative to them.

Issue 2 – Were Mr. and Ms. S's investments suitable?

- We conducted detailed analysis of the investments in the portfolio using historical information about the securities at the time of their purchases. Mr. H liquidated the Spousal RRSP, RRSP and joint cash accounts in July 2005 and reinvested in new securities in August and September 2005. The RESP account was opened in August 2005 and reinvested in September 2005. Therefore, we assessed the account holdings at semi-annual intervals from September 2005 to March 2008, shortly before Mr. and Ms. S's began transferring their accounts away from Macquarie.

- Our analysis shows that Mr. and Ms. S's investments included mostly growth-oriented securities with about 30% on average in income-producing securities, which were mainly income trusts. While not interest or dividend income per se, as specified on the NCAFs, the investments were generally in keeping with Mr. and Ms. S's growth and income objectives and with their understanding that the income from their holdings was coming from income trusts.

- However, consistent with IIROC's analysis, our analysis shows that by September 2005 each of Mr. and Ms. S's accounts included too much in high-risk investments relative to their 20% high risk tolerance parameter and too little in medium-risk investments compared to their 70% medium risk parameter. Specifically, on average from September 2005 to March 2008 the portfolio was 57% invested in high-risk investments (ranging by account from 48% to 65%), 34% in medium-risk and 9% in low-risk cash.

- The dealer contends that Ms. S was well informed about her investments and that Mr. H recommended income-producing investments in the clients' best interest based on information available at the time. Ms. S agrees that Mr. H provided information and explanations about his recommendations, but says Mr. H never discussed the risk of the individual holdings or described the risk of portfolio as a whole. Her meeting notes make no reference to any discussion about risk. Mr. H has no notes about the nature of his discussions with Mr. and Ms. S and the emails he exchanged with Mr. and Ms. S do not include any information about the risk of their investments.

- Mr. H told us during our interview that he believed all Mr. and Ms. S's holdings were medium-risk. Given IIROC's and OBSI's assessments, we find it clear that Mr. H underestimated the risk profile of at least some of the securities he recommended and therefore, even if he had discussed risk, he would not have accurately explained the risk levels of some of the individual securities or the portfolio to Mr. and Ms. S.

- Ms. S says that despite their concerns about losses, the portfolio value started falling immediately after they began dealing with Mr. H and declined steadily thereafter. She says, and Mr. H agrees, that she was in contact with him and/or his assistant about her concerns with the declining values starting very shortly after their accounts were reinvested in September 2005 and regularly thereafter. At the one year mark in mid-2006, Ms. S says, and the emails between them show, that she and Mr. S met with Mr. H and Mr. N to discuss their concerns about the falling account values and that she continued to raise her concerns through 2007 and into 2008. She says, and her notes and the emails between them show, that Mr. H consistently told them they owned good securities, advised them to hang in there, spoke about a variety of reasons their investments would go up in value, explained that the income trust dividends were still healthy, and despite the detrimental effect the Government of Canada's October 2006 decision to change the tax treatment, the income trusts they had would recover their values in time. Ms. S says Mr. H along with Mr. N appeared very knowledgeable and qualified, and that they were continually upbeat about the prospects for their investments, making no mention of risk. Since Mr. H had told her

GICs could not help them pay their debts and she did not know what else she could do, she says she followed his advice to stay invested based on his assurances it would get better. In fact, Mr. H agrees Mr. and Ms. S did what he told them to do and that if they had not followed his advice, he would not have taken them on as clients.

- However, by the end of 2007, Ms. S says she was sufficiently concerned with the continuing declines to seek other opinions and that they met with advisors at several firms in late 2007 and early 2008. She says that one person after another told her their portfolio was unsuitable and exposed them to too much risk. Shortly after, in June 2008, the majority of Mr. and Ms. S's accounts were transferred elsewhere. The RESP account was transferred away from Macquarie in September 2008.

Conclusion

In general, we find that Mr. and Ms. S's investments were aligned to their growth and income objectives. However, they had too much in high-risk investments, exceeding their 20% high risk tolerance, and too little in medium-risk investments relative to their 70% medium-risk tolerance parameter.

Based on Ms. S's low level of investment knowledge and Mr. H's view that they were invested only in medium-risk securities, we do not believe Ms. S understood or could have independently assessed that they were over exposed to high-risk investments until she sought third-party opinions in late 2007 and early 2008.

Issue 3 – If Mr. and Ms. S's investments were not suitable, did they incur financial harm?

- Since we are not concerned with the performance of the suitable medium and lower-risk investments in Mr. and Ms. S's portfolio, we focused our calculations on the high-risk investments. In our attempt to settle this matter with the dealer, we proposed compensation based on a comparison of Mr. and Ms. S's high-risk investments to the performance of a benchmark as though only 20% of the portfolio had been high-risk and the excess high-risk holdings had been suitably invested in their actual medium-risk securities. We calculated that Mr. and Ms. S incurred financial harm of $48,892.

- Although Macquarie acknowledges Mr. and Ms. S incurred losses, it responded to our settlement proposal saying the losses stemmed from the October 2006 announcement by the Government of Canada changing the tax treatment of income trusts. On this basis, and because it contends that Ms. S was well informed about their investments, the dealer refused to accept the settlement proposal and it offered no alternative resolution for consideration.

- In our original proposal to the dealer, we used Mr. and Ms. S's actual medium-risk investments as performance benchmarks. Since there were few suitable medium-risk investments in Mr. and Ms. S's accounts, using them as performance benchmarks could pose a concentration problem. It is also less objective than using a common index as a performance benchmark. Therefore, in this report we have adjusted our

calculations to use the S&P TSX Composite Total Return index to represent medium-risk securities. We note that this index includes some dividend-paying stocks and income trusts in keeping with Mr. and Ms. S's goal to generate cash flow from a portion of their investments. However, since Mr. and Ms. S were taking income from their investments in cash, we have used index performance figures that account for dividends paid in cash, rather than dividends reinvested. We also note that although we did not include Mr. and Ms. S's LSIF holdings in our original calculations, we have included them in our revised calculations. The LSIFs were held by Mr. and Ms. S when Mr. H became their advisor. While they were illiquid and could not be sold, he needed to take them into account when making his recommendations and assessing the risk profile of the portfolio overall. Therefore, we find no basis to exclude them.

- Our calculations covered the period from September 30, 2005 to the date each account was transferred away in June and September 2008 and took into account the timing of purchases and sales of high-risk investments. We note that no adjustment has been made to the index performance for trading costs since Mr. and Ms. S had fee-based accounts on which trading commissions were not applied. The results of our calculations are summarized in Table 3:

Table 3: Comparative performance calculation

	Actual Performance	**Benchmark Performance**
	High-risk securities from all accounts	65% in TSX Composite TR Index (57% average - 20% allowable)/57% 35% actual high-risk securities (100%-65%)
Net Capital Invested	$99,623	$99,623
Less: Ending Value	$15,519	$104,456*
Less: Distributions	$16,473	-*
Gain (Loss)	($67,631)	$4,833
Financial Harm (actual loss + benchmark gain)		**$72,464**

*index performance includes dividends paid but not reinvested.

Conclusion

Mr. H's recommendations left Mr. and Ms. S unsuitably invested with too much high-risk exposure, causing them financial harm of $72,464 ($67,631 + $4,833).

Issue 4 – If Mr. and Ms. S incurred financial harm, who should bear responsibility for their 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 the dealer in this case. We also consider whether Ms. S should be held responsible for a portion of their loss.

Vicarious Liability

- The case law is clear that 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.

Supervision

- In this case, the dealer failed to recognize that by September 2005, too much of Mr. and Ms. S's investments were in high-risk securities and to take steps to ensure their investments were suited to their risk tolerance parameters. If it had identified that the high risk level in each account exceeded 20% and followed up with Mr. H to adjust the holdings in keeping with Mr. and Ms. S's risk tolerance parameters, this issue could have been addressed before it caused financial harm. The best chance to prevent Mr. and Ms. S's losses rested with the dealer.

Client Responsibility

- Ms. S has low investment knowledge. She followed her account values and raised concerns about their decline repeatedly, but relied on Mr. H to make recommendations that suited their needs and circumstances. She followed his advice to remain invested based on his assurances that the security prices would rise and that they were continuing to receive good income, not knowing they were exposed to too much risk. As it turns out, some of the investments were not suitable and the portfolio

value did not rise as Mr. H assured them.

- 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."

- There is no evidence that Mr. H explained the risks of the investments he recommended and he acknowledges he believed some were less risky than we and IIROC assessed them to be. We find it clear that Ms. S was not aware of the risks of her investments or that they were not suitable until she sought outside opinions shortly before transferring away.

- Given her lack of investment knowledge, it is unclear from Ms. S's perspective what more she could have done. It does not appear to us that there is any basis to impose contribution on her. Ms. S raised her concerns with Mr. H throughout their relationship and relied on Mr. H, in his capacity as her trusted advisor. There is nothing unreasonable about her reliance. To require her to bear responsibility for the financial harm arising from unsuitable investments she did not understand would not be fair to her.

Conclusion and Recommendation

The dealer is vicariously liable for Mr. H's unsuitable investment advice. It also had responsibility through its compliance function to ensure that the clients were suitably invested. It failed to recognize or take steps to resolve the fact that were too many high-risk investments in Mr. and Ms. S's accounts. The dealer was responsible and best positioned to prevent the clients' losses and Ms. S, who reasonably relied on Mr. H's advice, should not now be required to pay for the unsuitable investments she did not know of and that the dealer allowed to stand in their accounts. Therefore, we recommend Macquarie compensate Ms. S $72,464 for her financial harm. In addition, we recommend $ 2,327 in interest on the losses from August 27, 2008[1] for total compensation of $74,791.

---

[1] Interest is calculated using the average 3-month Canadian Treasury Bill yield of 0.XX% (as calculated by the Bank of Canada) compounded annually from August 27, 2008 to the date OBSI's report is final.