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

CONFIDENTIAL &
WITHOUT PREJUDICE

INVESTIGATION REPORT

Date: **December 15, 2014**
Clients: **Ms. L**
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:	▪ Mr. K	
Product:	▪ Enviro-Can Private Placement ▪ Foreign Currency Investment Pooled Account	
Period:	▪ October 2008 – August 2013	
Key Conclusions:	▪ Ms. K recommended and facilitated Ms. L's $20,000 investment in Enviro-Can Private Placement in her capacity as her Sentinel advisor. ▪ Ms. L reasonably believed that Enviro-Can was approved by and made through Sentinel. ▪ Ms. K did not invest Ms. L's money in Enviro-Can but deposited them in her personal bank account. ▪ Ms. L understood that her $7,000 investment in the Foreign Currency Investment Pooled Account with Ms. K was of a personal nature and not through Sentinel. ▪ Sentinel is responsible for the losses incurred by Ms. L as a result of Ms. K's recommendation to invest in Enviro-Can.	
Recommendation:	$20,000 $248.93 $20,248.93	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

- Ms. L started investing with Ms. K in 1999 at another investment firm. In 2003, she transferred her investments to Ms. K, who had moved to Sentinel. In 2003, Ms. L was 75 years old, retired, and receiving a teachers' pension and Old Age Security. She also owned her home.

- At a meeting in October 2008, Ms. K recommended Ms. L invest in a "Foreign Currency Investment Pooled Account" product (foreign currency pool). Between 2008 and 2010, Ms. L invested a total of $7,000 in the foreign currency pool using cash from her bank account.

- In 2010, at a meeting scheduled to discuss investing additional money into her Renaissance fund held with Sentinel, Ms. K recommended Ms. L invest in "Enviro-Can Private Placement" (Enviro-Can). Ms. L was presented with the option to choose from a variety of guaranteed investments with one- to five-year terms and various rates of return.

- Ms. L invested $20,000 in Enviro-Can using redemption proceeds from investments she held outside of Sentinel.

- 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 receiving investment funds into a personal bank account. Sentinel conducted an investigation and discovered that Ms. K was recommending Enviro-Can investments to some of her 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.

- Neither the FCAA nor the RCMP have been able to conclude that Enviro-Can was an actual investment. Ms. L has not recovered any money through the FCAA process or the RCMP's criminal investigation for her investment in the foreign current pool or Enviro-Can.

COMPLAINT

- In a letter to Sentinel dated August 9, 2013, Ms. L requested Sentinel to compensate her $27,000 for her investment in the foreign currency pool and Enviro-Can plus a reasonable rate of return.

SENTINEL'S RESPONSE

- In a letter dated September 11, 2013, Sentinel responded to Ms. L saying:

    - Ms. K engaged in securities related business activities which was not carried on for the account or through the facilities of Sentinel by selling, recommending or facilitating the sale of securities investments to Ms. L 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 Ms. L any compensation.

OBSI ANALYSIS

In the course of our investigation, we reviewed documents provided to us by Sentinel and Ms. L. We interviewed Ms. L 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.

With respect to the foreign currency pool, Ms. L says Ms. K described it as an investment where a group of her friends were pooling money together in the hopes of generating returns by buying and selling foreign currency. Unlike her other investments with Sentinel, she was not required to sign any formal paperwork, the amount she invested each time was relatively small and she was using her personal funds for the purchases as opposed to money from her investments. For these reasons, we cannot conclude that Ms. L had a reasonable basis to believe the foreign currency pool was an investment approved by or made through Sentinel and we are not recommending compensation for losses she incurred on that investment. The remainder of our report focuses on Ms. L's investment in Enviro-Can.

OBSI examined the following key issues with respect to Ms. L's complaint about the Enviro-Can investment:

1. Did Ms. L reasonably believe her investment in Enviro-Can was approved by and made through Sentinel?

2. Did Ms. L incur financial harm as a result of her investment in Enviro-Can?

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

Issue 1 – Did Ms. L reasonably believe her investment in Enviro-Can was approved by and made through Sentinel?

- Ms. L met with Ms. K to invest additional money into the mutual funds she held with Sentinel. Ms. L says she believed she was purchasing Enviro-Can through Sentinel, just like the mutual funds she had intended to purchase. She says she trusted Ms. K based on her past experience with her and had no reason to question her recommendation to purchase Enviro-Can.

- The Sentinel documents Ms. L signed indicate that she has a moderate/average investment knowledge that is defined 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 Ms. L and considered her investment experience, we agree that this is a reasonable representation of her investment knowledge. It is also clear that she trusted Ms. K and heavily relied on her for investment advice.

- Ms. L says she was attracted to the returns and guarantees of Enviro-Can as Ms. K presented them. The documents she received from Ms. K indicate she could choose from a variety of guaranteed investments with one- to five-year terms and various rates of return. Ms. L chose the five-year term which guaranteed an 8% return with the possibility of additional returns depending on the performance of the market. Considering Ms. L's investment knowledge and the degree to which she relied on Ms. K for advice, we do not believe there is anything about how Enviro-Can was presented that should have indicated to her 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 Ms. L to doubt that Enviro-Can was an investment that Ms. K could sell as a Sentinel advisor.

- For the Enviro-Can purchase, Ms. L signed a subscription agreement (an application to participate in the Enviro-Can investment) that was addressed to Enviro-Can Private Placement, care of Ms. K at her Sentinel office address. While the subscription agreement did not specifically reference Sentinel, Ms. L signed many other third-party investment application forms that did not reference Sentinel so that would not have concerned her. While Ms. L may not have noticed the subscription agreement included Ms. K's Sentinel office address when she signed them, it is likely this would have only reinforced to Ms. L that Enviro-Can was approved by and being purchased through Sentinel.

- The cheque for the Enviro-Can investment was made payable directly to Ms. K. Ms. L says that Ms. K said her role in the Enviro-Can investment was to gather the investment money and forward it off at regular intervals to Enviro-Can. Thus, Ms. L did not question making a cheque payable directly to Ms. K. Also, typically the cheques used to pay for her previous investments purchased through Sentinel were made payable to a third party, not to Sentinel.

- During 2010 and the first part of 2011, Ms. L asked Ms. K questions about tax reporting and the value of her Enviro-Can investment which Ms. K answered to her satisfaction. Ms. K also provided Ms. L with periodic updates on the performance of her Enviro-Can investment. These updates were not on Sentinel letterhead and Enviro-Can did not appear on her Sentinel account statements, but that did not raise concerns for Ms. L. She was used to receiving information about her other investments directly from the issuers and/or Sentinel.

Conclusion

Ms. L trusted Ms. K as her investment advisor and relied heavily on her for advice. Considering her relationship with Ms. K, her investment knowledge and experience, and the evidence we have collected, we do not believe the Enviro-Can investments or Ms. L's interactions with Ms. K regarding Enviro-Can would have caused her to question whether the investments were being sold through Sentinel. We therefore accept that Ms. L reasonably believed Enviro-Can was an investment made through and approved by Sentinel.

Issue 2 – Did Ms. L incur financial harm on Enviro-Can?

- Ms. L invested $20,000 in Enviro-Can. Ms. L has not received any of her investment back.

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 Enviro-Can 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 Ms. L incurred on that investment.

- *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 Ms. L. 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 her.

- Given the above, we find that Sentinel is vicariously liable for Ms. L'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 Ms. L, we have considered the whole context of Ms. K's dealings with Ms. L and the Enviro-Can investment.

- As mentioned above, Ms. L was not a sophisticated investor. She trusted Ms. K and we see nothing that should have alerted or indicated to Ms. L that Enviro-Can was not approved by and made through Sentinel. She did not find it unusual to make a cheque payable to Ms. K because all her investments through Sentinel were made payable to a third party. She did not find it unusual to sign a subscription agreement that did not reference Sentinel because she had previously signed numerous third-party investment applications that did not reference Sentinel. Finally, she had no reason to question why the periodic statements Ms. K provided her were not on Sentinel letterhead.

- For these reasons, we cannot conclude that Ms. L is responsible for her loss on the Enviro-Can investment.

OBSI Membership

- Participating firms, not 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 Ms. L incurred due to Ms. K's recommendation to invest in Enviro-Can.

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 Ms. L $20,000 plus interest of $248.93[1], totaling $20,248.93, representing the amount lost on her Enviro-Can investment.

[1] Interest is calculated using the average 3-month Canadian Treasury Bill yield of 0.92% (as calculated by the Bank of Canada) compounded annually from August 9, 2013 to the date of this report.