

## INVESTIGATION REPORT

**Date:** September 13, 2013  
**Client:** Mr. S  
**Firm:** Union Securities Ltd. (Union Securities)

### 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 the parties. The contents of our report are not intended to be, nor should they be interpreted to be, legal advice or opinion.

### INVESTIGATION SUMMARY

<b>Investment Advisor:</b>	▪ Mr. F	
<b>Accounts</b>	▪ Non-registered cash and margin accounts	
<b>Period:</b>	▪ 2008 to 2010	
<b>Key Conclusions:</b>	<ul style="list-style-type: none"> <li>▪ Mr. S's primary investment objective was to preserve his capital for retirement, but he was willing to take some risk with his investments for growth.</li> <li>▪ The investments, trading and use of margin Mr. F recommended were entirely unsuitable. Mr. F failed to advise Mr. S of the risks or any negative factors associated with his recommendations.</li> <li>▪ Mr. S had limited investment knowledge and relied entirely on Mr. F's advice. He did not know his investments were unsuitable and was not in a position to have limited his losses before almost all of the money he invested at Union Securities was lost.</li> <li>▪ Union Securities is responsible for the losses Mr. S incurred due to Mr. F's unsuitable advice.</li> </ul>	
<b>Recommendation:</b>	\$315,353	Compensable losses
	\$9,769	Interest
	\$325,122	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. (Emphasis added.)

While OBSI considers the rules and standards developed by other bodies, including regulatory bodies like the Investment Industry Regulatory Organization of Canada (IIROC) and the Mutual Fund Dealers Association of Canada (MFDA), 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 firms, not against 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.

## OVERVIEW

Mr. S and Mr. F met socially in 2007. In April 2008, Mr. S opened an account at Union Securities with Mr. F to invest an inheritance he received. Mr. S had limited investment experience and knowledge and he relied entirely on Mr. F's advice and expertise. Mr. S's primary investment objective was to preserve his capital for retirement, but he was willing to take some risk with his investments for growth. Mr. S understood that Mr. F would use his skills and take such care with his inheritance that it would be protected from any unreasonable risk of loss and that he would earn more money under Mr. F's management than elsewhere.

In 2008, Mr. S was 60 years old and planned to retire in a short time. He had no private pension and would rely on his investments, about 60% of which were at Union Securities, for retirement income. Mr. S was primarily concerned with preserving his capital while earning some income and growth.

Mr. F first recommended that Mr. S invest all of the money in his account in one stock, BCE, which was a risky proposition in and of itself, but was particularly risky because the stock was the subject of an uncertain takeover bid. Although the uncertainty of the

takeover increased, Mr. F recommended buying more in the fall of 2008, assuring Mr. S the takeover was a sure thing. The recommendations were wholly unsuitable based on Mr. S's investment objectives and risk tolerance.

In the spring and summer of 2008, Mr. F made additional stock recommendations. In September 2008, Mr. F recommended Mr. S open a margin account. Mr. F traded frequently, borrowing on margin through September and October 2008. Such aggressive, short-term trading and the high use of margin was entirely unsuitable for Mr. S, exacerbating the already unsuitable risks of a concentrated portfolio. Further, Mr. F never advised Mr. S of the negative factors or risks of his recommendations or that he could potentially lose substantial amounts of money on the trades. When Mr. S raised questions and concerns, Mr. F reassured him, providing only information to support his opinions, whether reasonable or not. In addition, Mr. S says that many of the trades in the fall of 2008 were unauthorized.

In October and November 2008, the markets were volatile and falling rapidly. The value of the stocks in Mr. S's account dropped sharply and by early December 2008 Union Securities had sold all of the stocks to cover margin calls. In March 2010, Mr. S withdrew the small remaining balance and closed his account having lost almost all of the money he invested.

For the reasons outlined in this report, we conclude that Union Securities should compensate Mr. S for his losses.

**BACKGROUND**

- Mr. S met Mr. F in a social context in 2007. They met regularly for dinner with a group of friends. At the time, Mr. S was working in Edmonton, Alberta on a temporary contract.
- On April 15, 2008, Mr. S signed documents to open a non-registered cash account at Union Securities with Mr. F. His investments objectives were shown on the documents as 70% capital preservation, 20% income, and 10% long-term growth. His risk tolerance parameters were shown as 50% low and 50% moderate. Mr. S was 60 years old at the time.
- On April 28, 2008, Mr. S deposited \$270,441 in the account, which was the proceeds of an inheritance. He deposited a further \$62,026 to his account in July 2008 and \$20,200 in September 2008, bringing his total investment at Union Securities to \$352,667 (\$270,441 + \$62,026 + \$20,200).
- Mr. F recommended that approximately \$265,000 of the initial \$270,441 deposit be used to purchase BCE Inc. (BCE), which had announced a planned sale of all of its shares to a group led by the Ontario Teachers' Pension Fund. Several additional trades were placed through the spring and summer of 2008. By September 2008, all of the money Mr. S deposited was invested in stocks.
- On September 19, 2008, Mr. S signed documents to convert his cash account to a margin account. Mr. S's investment objective and risk tolerance information remained the same.
- After establishing the margin account, the volume of trading increased significantly. Between September 19, 2008 and November 30, 2008 there were more than 30 trades in the account, with the purchases primarily made on margin. Mr. S says that many of the trades were unauthorized.
- In October and November 2008, the value of most of the securities in Mr. S's account declined significantly, triggering margin calls. Later in November, the planned sale of BCE to the Ontario Teachers' Pension Fund was cancelled and the share price dropped, triggering another margin call.
- By December 3, 2008, all but one security in Mr. S's account had been sold to cover the margin calls. The only remaining position was illiquid and Mr. S was left with a margin debt of \$7,962, on which interest accrued monthly. On March 5, 2010, the previously illiquid security was converted to a liquid security. Mr. S sold it, paid his margin debt and withdrew the remaining balance of \$18,483.
- Mr. S deposited a total of \$352,667 to his Union Securities accounts and withdrew \$18,483, for a loss of \$334,184, most of which was incurred in October and November 2008.

**COMPLAINT**

- In eight letters and emails dated in November and December 2008, January, February and March 2009, Mr. S complained to Union Securities saying, among other things, that:
  - Mr. F made trades in his account without his authorization or acknowledgement, and he found it unbelievable that an experienced advisor could recommend that he buy and hold stocks that resulted in a loss of \$350,000 in an eight-week period;
  - the margin levels in his account were not monitored properly and were allowed to go up to 125% when he understood the limit would be no more than 70% of his original investment; and
  - Mr. F provided assurances that the investments he recommended were safe when they were actually speculative.
- Mr. S asked Union Securities to compensate him for his losses.

**UNION SECURITIES'S RESPONSE**

- In letters dated February 4, February 26 and April 3, 2009, Union Securities responded to Mr. S's complaint, saying:
  - emails exchanged between Mr. F and Mr. S, and statements made by Mr. S in his complaint letters, show that Mr. S authorized or acknowledged some of the trades he noted in his complaint;
  - it sent trade confirmations and monthly statements to Mr. S and it was his responsibility to complain as soon as he saw any unauthorized trades. Instead, he waited until December 2008; and
  - the securities selected for Mr. S's margin account appear to be high-grade stocks that paid good income or dividends and all of the securities were within his investment objectives.
- Union Securities did not offer compensation.

**INVESTMENT INDUSTRY REGULATORY ORGANIZATION OF CANADA  
(IIROC)**

- On June 22, 2012, IIROC issued a Notice of Hearing (IIROC Notice 12-0197) alleging that:
  - between April and December 2008, Mr. F acted contrary to IIROC Dealer Member Rule 1300.1 (q) by failing to ensure recommendations he made for Mr. S were suitable;
  - between September and November 2008, Mr. F acted contrary to IIROC Dealer Member Rule 1300.4 by using discretion with respect to purchases in Mr. S's account;
  - between April and December 2008, Mr. F's branch manager, Mr. M, acted contrary to IIROC Dealer Member Rule 1300.1 (p) and IIROC Dealer Member Rule 2500 by failing to adequately supervise Mr. S's account to ensure holdings in the account were suitable for him.
- The IIROC hearing took place October 1, 2012. On January 22, 2013, the IIROC hearing panel issued its decision and reasons. It found that:
  - Mr. S had little previous market experience and was not a sophisticated investor. He reposed his full reliance, trust and confidence in Mr. F, as a friend, and Mr. F knew and intended that Mr. S would trust him in respect of trading decisions;
  - Opening the accounts, buying and holding BCE shares and every other trade was introduced by Mr. F. Mr. S would never have initiated even one of these steps without Mr. F's counsel;
  - Mr. F failed to determine Mr. S's risk appetite and risk tolerance because he pretended to Mr. S that he could protect him from any risks with his years of skill and expertise;
  - Mr. S's evidence was that he was looking for safe, stable investments that would give him a steady return and preserve his capital as it would be a major source of income on retirement. Mr. F recorded Mr. S's investment objectives as 70% capital preservation, 20% income and 10% long-term growth, with risk factors of 50% low and 50% moderate. There was no evidence that these goals were to be disregarded;
  - Mr. F did not meet his suitability obligation to ensure that the risk associated with the investments he recommended compared with Mr. S's risk profile and his capacity to withstand investment losses;
  - There was nothing in the evidence to suggest that Mr. F cautioned Mr. S of any risk that following his advice may result in losses. In particular, Mr. F did not

advise Mr. S of any negative factors associated with investing such a large amount in the BCE stock, that the BCE deal may not go through or that there were other less risky alternatives. Mr. F also did not make Mr. S aware of the risks of the extensive margin he used to purchase securities;

- The evidence establishes on a balance of probabilities that Mr. F traded in Mr. S's account at his discretion in three instances in September, October and November 2008;
- Mr. M failed in his supervisory obligation by placing too much trust in Mr. F by failing to respond to a number of indications that should have led him to take further steps, such as to inquire about trading that was *prima facie* inconsistent with Mr. S's investment objectives.

## OBSI ANALYSIS

In the course of our investigation, we reviewed all the documents provided to us by Mr. S and Union Securities. We interviewed Mr. S, Mr. F and Mr. L, Union Securities' Chief Compliance Officer. We had several discussions with Mr. P, President of Union Securities and Mr. L regarding OBSI's findings. We have also considered the applicable industry rules, regulations and practices.

Mr. S complained that some trades in September and October 2008 were unauthorized. In contrast, Mr. F says all trades were discussed and approved. The email evidence we received from Union Securities only confirms that Mr. S approved three trades in September 2008. As noted above, the IIROC hearing panel found that on the balance of probabilities Mr. F made three discretionary trades in Mr. S's account. In discussions with Union Securities in our attempt to resolve this matter, Union Securities acknowledged that some of the trades were questionable and offered to compensate Mr. S for 50% of the losses on those trades (approximately \$40,000). We agree that some of the trades are questionable. However, given our findings that the trades and the use of margin were unsuitable (as discussed in detail in the sections below), we did not examine this issue further.

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

1. What were Mr. S's personal and financial circumstances, investment experience and knowledge, and investment objectives and risk tolerance?
2. Were the investments, trading and use of margin in Mr. S's account suitable?
3. If the investments, trading and use of margin were unsuitable, did Mr. S suffer financial harm?
4. Who should bear responsibility for Mr. S's financial harm, if any?

**Issue 1 – What were Mr. S’s personal and financial circumstances, investment experience and knowledge, and investment objectives and risk tolerance?**

**Personal and financial circumstances**

- Mr. S signed a New Client Information Form (NCAF) when he opened his account at Union Securities in April 2008, as summarized in Table 1 below. The same information was shown on the NCAF he signed in September 2008 to open the margin account.

*Table 1: NCAF information as of April 15, 2008:*

Age	60 years old
Occupation	[redacted]
Approximate annual income from all sources	\$200,000
Estimated net liquid assets	\$400,000
Estimated net fixed assets	\$800,000
Estimated total net worth	\$1,200,000

- In April 2008, Mr. S was 60 years old, working on contract for [redacted] as a software writer/developer and project manager. He earned a contract rate of \$90 per hour. His annual income ranged between \$165,000 and \$187,000. Although his contract with [redacted] was expected to end in April 2009, it was terminated in November 2008. Mr. S had planned to retire after his contract with [redacted] ended.
- According to account statements we reviewed, in April 2008, Mr. S had approximately \$243,500 of investments in registered retirement accounts with [Firm X], which was primarily invested in mutual funds Mr. S says were recommended by his [Firm X] advisor. Between April and July 2008, Mr. S deposited \$352,667 to his Union Securities account, which was primarily an inheritance after his parents passed away. Mr. S’s investments totaled approximately \$596,167 (\$243,500 + \$352,667). He and his wife also owned their home, which he says was worth about \$650,000 in 2008 and was mortgage-free.
- After his employment with [redacted] ended and he retired, Mr. S’s began taking a monthly income of approximately \$1,000 from his RRIF account at [Firm X]. He also began receiving \$480 per month from CPP. Mr. S did not qualify for OAS until 2013, when he turned 65. Aside from his investments, Mr. S has no private pension or other sources of retirement income.
- In 2008, Mr. S’s income was relatively high, but he was working on a contract that was due to end within a year. He was 60 years old and would retire in a short time with no private pension plan. Mr. S had just under \$600,000 in investments that he would rely on in retirement to supplement his government pension income, about \$353,000, or 60% of which was invested at Union Securities.



**Investment experience and knowledge**

- Both of Mr. S's NCAFs indicate he had "limited" investment knowledge. In our interview with him, Mr. F confirmed that the investment knowledge he listed on the KYC was accurate. Mr. S described his investment knowledge to us as "novice."
- Before investing with Mr. F, Mr. S had registered retirement savings accounts at [Firm X]. His [Firm X] account statements show he was invested primarily in equity mutual funds that Mr. S says were recommended by his [Firm X] advisor. He says he never made his own investment decisions, but rather always relied on his advisor's recommendations. The money he invested with Union Securities was primarily from an inheritance he received in 2008.
- Mr. S and Mr. F agree they often communicated by email. The email correspondence we received from Union Securities shows that Mr. S relied entirely on Mr. F for advice and accepted all of Mr. F's recommendations. Even after experiencing significant losses in October 2008, Mr. S continued to email Mr. F for advice and to follow his recommendations.
- The IIROC hearing panel found that Mr. S had little previous market experience and had not examined the mutual funds he held in his ([Firm X]) accounts. It found that Mr. S would not have opened accounts or made any investments at Union Securities without Mr. F's counsel, but that Mr. F only gave Mr. S selected information to substantiate his opinions about the upside benefits of his recommendations. The IIROC hearing panel found no evidence to suggest that Mr. F educated Mr. S or that Mr. S otherwise learned about or understood the risks associated with any stock purchase or his own capacity for short- or medium-term losses. Rather, in the panel's view, Mr. S believed Mr. F would apply his expertise and take such care with his inheritance that it would be protected from any unreasonable risk of loss. It concluded that Mr. F knew or should have known in the circumstances of their previously established relationship that Mr. S was relying on Mr. F and that Mr. S reposed full trust and confidence in him. In fact, the hearing panel characterized Mr. S's level of trust and reliance as elevating his relationship with Mr. F to a fiduciary relationship.
- We found in our interview with him that Mr. S understood and could explain the difference between a stock and a bond, and he knew that stock prices fluctuate and could decline, but we do not believe he had the investment experience or knowledge to independently ascertain the risks of the stocks Mr. F recommended. Mr. S also had no prior experience with margin accounts and he was not aware of or able to explain the significant risks associated with trading on margin, despite having experienced it first-hand.
- Based on all of the foregoing, we conclude that Mr. S had limited investment experience and knowledge and that he relied entirely on Mr. F's advice and recommendations.

**Investment Objectives and Risk Tolerance**

- Mr. F recorded the following investment objective and risk tolerance information on the April 15 and September 19, 2008 NCAFs for Mr. S’s cash and margin accounts:

*Table 2: Investment objective and risk tolerance information on NCAFs*

Investment Objective	70% capital preservation 20% income 10% long-term growth
Risk Tolerance	50% low risk 50% medium risk

- Mr. S says when he opened his account with Union Securities he told Mr. F that he had a minimal risk tolerance and needed to preserve his capital to provide income in retirement.
- Although Mr. F filled out the NCAF for Mr. S, during our interview he denied that Mr. S told him he had minimal tolerance for risk. Nevertheless, he also told us he considered all of the investments he recommended to be low-risk, capital preservation-type investments that provided dividend rather than interest income.
- Mr. F defined capital preservation as “buying a rock solid, well-known company at a great price relative to its book value, trading value and dividend yield.” During our discussions with Mr. L, Union Securities’ Chief Compliance Officer, he described it similarly. While their definition is consistent with a value-type investment style (where one aims to buy stocks whose prices are lower than indicated by the issuers’ net asset value or book value and/or dividend yield), it is not consistent with the general meaning of capital preservation, which is to have no loss of capital. Nor is it consistent with the Canadian Securities Course, one of two required courses to qualify for registration as an investment advisor with an IIROC firm, which equates capital preservation with safety of principal and as providing some assurance that invested capital will remain intact. Since value stocks can decline in value just as any stock may, we cannot agree they can be characterized as capital preservation-type investments.
- In the IIROC hearing, Mr. F admitted to not advising Mr. S of any negative factors associated with any of the trades in his accounts. Further, the IIROC panel heard testimony to the effect that Mr. F made bold statements about his opinions and expertise and suggested the state of the markets indicated it was the time to be aggressive. In the hearing panel’s view, Mr. S trusted that Mr. F would apply his expertise to acquiring securities that he would be protected from any unreasonable risk of loss.
- While we were attempting to resolve this matter, Mr. L wrote to OBSI about Mr. S’s objectives and risk tolerance. Mr. L said that at all times, Mr. S’s intention was to open accounts for the purpose of purchasing quality, blue-chip dividend-yielding

equities.

- Relative to Mr. L's assertion, we carefully considered an email Mr. S sent to Mr. F on April 28, 2008, shortly after opening his account. In the email, Mr. S says "When we completed the profile we indicated we would invest in growth or dividend type stocks and we would have to confirm the decision to purchase speculative stocks. As Westaim is a speculative stock I confirm that I understand that there is risk involved and that investing a small percentage of the portfolio in these types of stocks is an acceptable risk."
- At the IIROC hearing, Mr. S testified that Mr. F required this written confirmation otherwise Union Securities' compliance department would consider the trade out of line. However, he also testified that Mr. F said the Westaim trade would be short-term and it was not speculative because the Chair of Westaim's board was also the board Chair for [redacted] (where Mr. S worked) and the Chair did not engage in speculation. Effectively, Mr. F discounted any risk and put the email request in the vein of an administrative requirement.
- In addition, the IIROC hearing panel heard evidence that Mr. F had raised stocks for discussion in the year before Mr. S opened his account and made statements about his expertise that led Mr. S to believe he would earn more money under Mr. F's management than at [Firm X]. The hearing panel concluded that Mr. S likely had an appetite to gain profits from stock purchases that Mr. F suggested or discussed, but that there was no evidence to suggest that Mr. F ever cautioned Mr. S of any risk that following his advice may result in losses. In the hearing panel's view, Mr. S believed Mr. F would take care with his inheritance to ensure Mr. S would have sufficient money in his account for a steady income stream in retirement.

## Conclusion

In 2008, Mr. S was 60 years old and expected to retire in the short-term. He has no private pension and would rely on his investments, about 60% of which were at Union Securities, for retirement income. Mr. S had limited investment experience and knowledge and he relied entirely on Mr. F's advice and recommendations.

Email evidence shows that Mr. S understood Mr. F would invest in growth- or dividend-oriented stocks in his account. This evidence squares with the testimony of Mr. S and Mr. F at the IIROC hearing that they discussed buying stocks even before Mr. S opened his Union Securities account. Mr. F says he considered all of the investments he recommended to be low-risk, capital preservation-type investments. Mr. F also admitted to the IIROC hearing panel he did not advise Mr. S of any negative factors associated with any of the trades he discussed or recommended. Further, the IIROC hearing panel found that he led Mr. S to believe he would apply such expertise to acquiring securities that he would be protected from any unreasonable risk of loss.

In all of the circumstances, we find that the NCAFs Mr. F prepared for Mr. S's accounts reflect Mr. S's primary objective to preserve his capital for retirement and his willingness to take some risk with his investments for growth.

## **Issue 2 – Were the investments, trading and use of margin in Mr. S's account suitable?**

- Union Securities says the securities selected for Mr. S's accounts appear to be high-grade stocks that paid good income or dividends and all of the securities were within Mr. S's investment objectives.
- We conducted a detailed analysis of the investments, trading and use of margin in Mr. S's account. We find that although some of the securities could have been considered suitable for a portion of Mr. S's account the manner in which they were traded and the use of margin employed to purchase several of them renders all of them unsuitable.
- When Mr. F first purchased BCE in Mr. S's account in April 2008, he bought approximately \$265,000 worth, representing about 98% of the approximately \$270,000 Mr. S initially deposited to the account. While there are no specific regulations to indicate what constitutes excess concentration, there is no question that investing 98% of a \$270,000 account created high concentration risk that was not suitable given Mr. S's investment objectives and risk tolerance. Mr. F admitted to the IROC hearing panel that he did not provide any cautionary advice to Mr. S about investing such a large portion of his account in one security.
- Furthermore, while Mr. F recommended BCE for the purpose of profiting from a corporate takeover bid, there were many barriers to the takeover bid and it was by no means certain that it would proceed or be profitable. For example, the takeover bid was structured as a leveraged buyout. The consortium that made the bid needed to arrange and get approval for the financing to pay for the deal which would be worth \$52 billion if completed, it needed CRTC approval, and it was subject to legal challenges. Specifically, BCE bondholders launched a lawsuit to prevent the deal from proceeding because they believed that the buyout would negatively impact existing bondholders. On March 7, 2008, the Quebec Superior Court dismissed the claims made by BCE bondholders. BCE closed at \$35.80 that day. Notwithstanding the favorable court decision, BCE shares traded significantly below the \$42.75 per share buyout price even before Mr. F recommended it. On May 22, 2008, the Quebec Court of Appeal upheld the BCE bondholders claim. BCE said that it would appeal to the Supreme Court of Canada. BCE closed even lower at \$32.62 that day reflecting increased risk that the buyout might not happen. If the buyout had been a certainty, BCE would have traded at or close to the buyout price. Mr. F admitted to the IROC hearing panel that he never advised Mr. S there was even a remote possibility to the deal might not go through because he held a firm conviction that it was a sure thing.

- On September 22 and 23, 2008, Mr. F purchased further BCE shares for approximately \$68,500 on margin, since additional cash deposits to the account during the summer of 2008 had been used to purchase other stocks. By September 30, 2008, Mr. F had Mr. S's account 65% allocated to BCE, continuing the high concentration risk he established earlier. Moreover, by then the BCE takeover was clearly at risk given news reports that the matter was again being taken to court. Despite the risk, Mr. F admitted to the IIROC hearing panel that he told Mr. S he was even more confident in September than in April 2008 that the takeover deal would go through and he gave Mr. S no cautionary advice that there was a potential the deal might not go through.
- On May 1, 2008, Mr. F purchased shares of Westaim Corporation, a high-risk stock, for a total cost of \$5,268. As a high-risk security, it was not suited to Mr. S's risk tolerance. At Mr. F's request, Mr. S sent Mr. F an email on April 28, 2008, acknowledging his understanding that Westaim was a speculative stock. But he did so on the understanding from Mr. F that Westaim was not a speculative trade because it would be short-term and the Chair of the board, who was also the chair of [redacted]'s board, did not speculate. At the IIROC hearing, Mr. F said the email was "for Mr. S's benefit and Mr. F's protection."
- In any event, Mr. F had an obligation to ensure his recommendations were suitable in Mr. S's circumstances. In *Re Lamoureux*, (2001) ASCD N0. 613, the Alberta Securities Commission (ASC) panel said "the obligation to ensure that recommendations are suitable or appropriate for the client rests solely with the registrants. 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." On this basis and in the circumstances here, disclosure of the risks of Westaim and Mr. S's email, did not make an otherwise unsuitable investment recommendation suitable.
- On July 16, 2008, Mr. F purchased shares of Epcor Power limited partnership (Epcor) in Mr. S's account for a total cost including commissions of \$62,002. While we consider Epcor to be a medium-risk stock and perhaps not unsuitable in and of itself, combined with BCE (which was the only other stock in the account at the time), Mr. S's account was entirely invested in equities with a large concentration in BCE. We find it clear that the account holdings overall were entirely mismatched to Mr. S's investment objectives and risk tolerance.
- On September 11, 2008, Mr. F purchased shares of [redacted – Mr. S's employer] in Mr. S's account for a total cost of \$20,119. We find [redacted – Mr. S's employer] was a medium-high risk stock and as such, was too risky and not suitable for Mr. S.

- On September 22, 2008, a further 3,500 [redacted – Mr. S’s employer] shares were purchased in Mr. S’s account on margin. In the IIROC hearing, Mr. F agreed that using margin increases the risk. Given that [redacted – Mr. S’s employer] was already too risky, purchasing it on margin exacerbated the excess risk and the purchase was not at all suitable.
- Also in September 2008, Mr. F recommended and purchased shares of Merrill Lynch and Barclays Bank using margin since Mr. S did not have cash remaining in his account. Notably, shares of Merrill Lynch and Barclays Bank, were purchased on September 17 and 18 respectively without cash in the account to settle the trades. The margin account was not opened until September 19 and was not approved until September 22, 2008. In total, the Merrill Lynch and Barclays Bank purchases, net of a partial Merrill Lynch sell on September 19, 2008, totaled approximately \$165,000 in margined purchases, which in essence were placed before Mr. S had the means to settle the trades. In any event, Mr. S’s account continued to be 100% invested in stocks, and the use of margin to purchase stocks was high-risk and therefore entirely unsuitable.
- After establishing the margin account, the volume of trading increased significantly. Between September 19 and November 30, 2008, there were more than 30 trades in the account, including more BCE shares, CBS Corporation, Lloyds Group, Nortel Networks and Hartford Financial Services Group stocks, and units of a Mavrix limited partnership. While a number of the positions were securities of large companies, several were financial sector specific, further exposing Mr. S not only to the concentration risk of BCE but also to sector concentration risk. Again, these stocks were purchased on margin, which magnified the risks and made the purchases entirely unsuitable.
- At the IIROC Hearing, Mr. F agreed that the risk of using margin increases as the amount of margin increases. As the markets became increasingly volatile in the fall of 2008, many sells were triggered to cover margin calls due to the falling account value. The margin sells locked in large losses and illustrate the increased risks of trading on margin. Such high risks were not at all suitable for Mr. S. During our interview, Mr. S said that before Mr. F introduced the concept of a margin account, he did not know what a margin account was, nor had he considered opening one. He says that Mr. F described a margin account as a low-risk way to increase returns using someone else’s money. Mr. F says that the establishment of the margin account was a business decision made jointly between himself and Mr. S. However, Mr. F admitted to the IIROC hearing panel that he failed to make Mr. S aware of the negative factors associated with opening a margin account and continued recommending trades similarly without disclosing any negative factors. The hearing panel found that Mr. F’s failures perpetuated Mr. S’s belief that Mr. F would protect him from losses given his special expertise and his skill.
- In response to OBSI’s settlement proposal, Union Securities referred to the margin account agreement, which provided the following risk disclosure statement: “Using

borrowed money to finance the purchase of securities involves greater risk than using cash resources only. If you borrow money to purchase securities, your responsibility to repay the loan and pay interest as required by its terms remains the same even if the value of the securities purchased declines.” As noted above, the probative value of a signed acknowledgement depends on the sophistication of the investor and the circumstances under which it was signed. In the absence of any warning from Mr. F, or in the alternative, the assurance that using margin was low-risk, the signed disclosure has little probative value. Further, the signed acknowledgement of the negative material factors or risks does not make the recommendation to invest on margin suitable. In fact, we find the use of margin was entirely unsuitable for Mr. S.

## Conclusion

For the reasons outlined above, we find the securities, trading and use of margin Mr. F recommended and employed in Mr. S’s accounts were entirely unsuitable. Further, Mr. F did not provide Mr. S with any advice about the risks or potential negative factors associated with his recommendation. Therefore, despite signing documents indicating he knew of the risk of using margin and that Westaim was a speculative investment, he did so relying on Mr. F’s assurances to the contrary. Given his limited investment experience and knowledge and the full reliance he placed on Mr. F, we find Mr. S had no understanding of the risks to which he was exposed.

### **Issue 3 – If the investments, trading or use of margin was unsuitable, did Mr. S incur financial harm?**

Mr. S deposited a total of \$352,667 to his Union Securities accounts and withdrew \$18,483, for a loss of \$334,184, most of which was incurred in October and November 2008.

In order to determine his financial harm due to unsuitable investments and unsuitable margin, we compared Mr. S’s actual losses to what he would have lost or gained if he had invested in a suitable portfolio. When determining the appropriate benchmarks to represent a suitable portfolio, we considered the KYC parameters on the NCAF and our conclusion that Mr. S’s primary investment objective was capital preservation while at the same time he was willing to take some risk with his investments for growth. To that end, we compared the performance of Mr. S’s actual investments to a portfolio allocated 50% to the DEX Universe Bond Index (a benchmark representing lower-risk income investments) and 50% to the S&P TSX 60 (a benchmark representing medium-risk equity investments). On the basis that Mr. S would have incurred some reasonable trading costs, we reduced the suitable portfolio performance by the \$3,744 in commissions Mr. S actually paid for stocks he purchased before establishing the margin account.

Due to margin calls, most of Mr. S’s stocks were sold between October and December 2008. He sold the last of his investments and closed his account on March 21, 2010 and we calculated his financial harm to this date.

Table 5: Actual vs. suitable portfolio performance to March 21, 2010:

	Actual Performance	Suitable Performance
Net capital invested	\$352,667	\$352,667
Ending value	\$18,483 <sup>1</sup>	\$337,580
Investment Gain (Loss)	(\$334,184)	\$(15,087)
Less: Commissions		\$3,744
Gain (Loss)	(\$334,184)	\$(18,831)
<b>Total Financial Harm</b>		<b>\$315,353</b>

**Issue 4 – Who should bear responsibility for Mr. S’s financial harm, if any?**

**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.

- 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 on “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.”
- In this case, Mr. F’s recommendations were not at all suitable for Mr. S. Union Securities is responsible for the financial harm arising from the unsuitable advice. However, we also considered whether Mr. S bears any responsibility for his losses.

**Client responsibility**

- Mr. S had limited investment experience and knowledge and he relied entirely on Mr. F’s advice and recommendations. As noted above, the IIROC hearing panel

<sup>1</sup> This value includes the actual total commissions Mr. S paid.



characterized the relationship as fiduciary in nature and found that Mr. S believed that Mr. F had such expertise, skill and experience and would apply his skills in such a way that he would not incur unreasonable losses. In fact, Mr. F admitted to the hearing panel that he did not warn Mr. S that he could incur losses as a result of his advice. Rather, the hearing panel even heard evidence that when Mr. S asked reasonable questions in the summer and early fall of 2008 about the likelihood that the BCE takeover deal might be in jeopardy based on news reports in the media, Mr. F went so far as to assure him not to worry, saying he was more sure than ever that the deal would go through and that there was no possible way it would not, it was a secure investment. Although Mr. S asked reasonable questions, the panel found that the evidence indicated Mr. F gave Mr. S only selected information, always to substantiate his expressed positions.

- In Union Securities' response to Mr. S's complaint, it said it sent Mr. S trade confirmations and statements. However, the confirmations and statements do not include information to highlight risk or suitability. Given his limited knowledge and the lack of disclosure from Mr. F about the risks of the stocks and trading in his accounts, these documents would not have provided Mr. S with a basis to determine there was a suitability problem. Further, Mr. S says he was not always able to review his trade confirmations and/or monthly statements immediately because he was moving back and forth between Edmonton where he was working and his home in Kelowna, British Columbia.
- By November 20, 2008, all of Mr. S's holdings were liquidated due to margin calls except for his positions in BCE and the Mavrix limited partnership. The shares in BCE were sold to cover margin debt on December 3, 2008, leaving Mr. S with a debit cash balance of \$7,962.23 as of December 31, 2008. Mavrix was not liquid at the time. As soon as it became liquid in 2010, Mr. S sold it and closed his account.

### **OBSI Membership**

- Quite apart from vicarious liability, however, firms are also responsible for the conduct of its advisors, employees, and representatives by virtue of their membership in OBSI.
- Union Securities is a member of the IIROC, whose rules require that member firms participate in OBSI. As such, it is subject to the rules under which OBSI operates.
- OBSI's mandate is in respect of its participating firms, not advisors. Once OBSI decides that a client should be compensated, based on its mandate of fairness, the party responsible for compensating the client is the firm, not the individual representative.
- It is therefore Union Securities that is the party responsible for the recommendations that OBSI makes with respect to the clients of Union Securities.

- Whether the firm then goes back to the advisor 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

Mr. S was not a knowledgeable investor and relied entirely on Mr. F's recommendations. He did not know that Mr. F's recommendations were unsuitable. While Mr. S was aware of losses as early as October 2008 and questioned Mr. F about them, he continued to rely on Mr. F's advice and reassurances that he would recover his losses. In the nature of their relationship, we find it entirely reasonable that Mr. S continued to follow Mr. F's advice.

Further, given the speed and extremity of the losses incurred in October and November 2008, we do not find that Mr. S had an opportunity or was in a position to have taken any steps to limit his losses before his investments were almost entirely lost.

We conclude it would be unfair to apportion responsibility to Mr. S for the financial harm arising from Mr. F's unsuitable recommendations. Union Securities is responsible for any financial harm caused by Mr. F's unsuitable recommendations.

## Recommendation

As stated earlier, 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 to recommend that Union Securities compensate Mr. S for \$315,353 plus interest of \$9,769<sup>2</sup> for total compensation of \$325,122.

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<sup>2</sup> Interest is calculated using the average 3-month Canadian Treasury Bill yield of 0.88% (as calculated by the Bank of Canada) compounded annually from March 22, 2010 to the date this report becomes final.