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

CONFIDENTIAL &
WITHOUT PREJUDICE

INVESTIGATION REPORT

Date: October 4, 2013
Client: Mrs. R
Firm: De Thomas Financial

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

Investment Advisor:	▪ Mr. DT	
Accounts:	▪ Non-registered and RRIF accounts	
Period:	▪ December 1999 to January 2010	
Key Conclusions:	▪ Mr. DT's recommendation that Mrs. R borrow $150,000 to invest was unsuitable. ▪ Some of the investments Mr. DT recommended for the RRIF account exceeded Mrs. R's moderate risk tolerance and were unsuitable relative to her balanced income and growth investment objective. ▪ Mrs. R relied heavily on Mr. DT. She had very little investment knowledge and did not know she was unsuitably invested. ▪ De Thomas Financial is responsible for the losses Mrs. R incurred due to Mr. DT's unsuitable recommendations.	
Recommendation:	$246,422	Compensable losses
	$7,901	Interest
	$254,323	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

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.

OVERVIEW

In 1997, Mrs. R's husband passed away. She was 71 years old at the time. Mrs. R had always relied on her husband to make their investment decisions and after his death she began making investment decisions on her own for the first time. Mrs. R trusted and relied heavily on Mr. DT and followed his investment recommendations without question. Mr. DT was closely involved in almost all aspects of Mrs. R's financial affairs, including her income tax preparation.

In June 2000, when she was 74 years old, Mr. DT recommended that Mrs. R borrow $150,000 to invest (referred to as leveraged investing, or a leverage strategy) and that she take income from her RRIF investments to make the loan payments. However, in her circumstances, Mrs. R needed income from her RRIF to supplement her pension income to meet her expenses and she could not afford large losses that could result from leveraged investing. There is also no evidence that Mr. DT explained to Mrs. R the potential downside risks of the strategy.

In addition, Mr. DT recommended growth-oriented investments in Mrs. R's RRIF account that were unsuitable relative to her balanced investment objective and were too risky relative to her medium risk tolerance. Mrs. R did not understand the characteristics and risks of the investments she held. As an investor with limited investment knowledge, she relied on Mr. DT's advice and recommendations.

It was not until after Mrs. R's children found unpaid bills in Mrs. R's home in April 2008 that they became involved in her financial affairs. In their effort to sort out the status of her finances and investments, Mrs. R's children obtained a third-party opinion in June 2009.

They learned the leverage strategy and her investments were risky and unsuitable. Shortly after, in August 2009, they sold Mrs. R's cottage to pay off the investment loan. By January 2010, all of Mrs. R's investments were withdrawn or transferred away from De Thomas Financial. Mrs. R incurred significant financial harm as a result of Mr. DT's unsuitable recommendations.

For the reasons outlined in this report, we conclude that De Thomas Financial should compensate Mrs. R for the losses she incurred.

BACKGROUND

- In 1988, Mrs. R and her husband, Mr. R, began investing with Mr. DT. Mr. R opened an RRSP. Mrs. R opened an RRSP and a spousal RRSP. They invested in a variety of mutual funds. The RRSPs were later converted to RRIFs. Mr. R was responsible for their household financial and investment decisions.

- In September 1997, Mr. R passed away. After Mr. R's death, Mrs. R continued investing with Mr. DT and Mr. R's RRIF investments were transferred into Mrs. R's RRIF account. At the time, Mrs. R was 71 years old.

- In October 1998, Mrs. R opened a non-registered account and deposited approximately $10,000 which was invested in a mutual fund.

- By December 31, 1999, Mrs. R's RRIF account was worth $312,093 and her non-registered account was worth $10,882, for a total of $322,975.

- In June 2000, when Mrs. R was 74 years old, Mr. DT recommended she borrow money to invest (often referred to as a leveraged investing, or a leverage strategy). At Mr. DT's direction, Mrs. R obtained a $150,000 investment loan through a bank. The loan proceeds were deposited in her non-registered account with De Thomas Financial and invested in a variety of mutual funds on a deferred sales charge (DSC) basis. On Mr. DT's advice, Mrs. R redeemed a portion of her RRIF investments every month, withdrew the proceeds, and allocated a portion of the withdrawal to make the $1,255.76 monthly principal and interest payments on the loan (totalling $15,069 annually).

- On March 21, 2007, when she was 81 years old, Mrs. R decided to provide two of her six children with a General Power of Attorney (POA) as she recognized her mental health was failing.

- In April 2008, Mrs. R's children became concerned about their mother's finances when they discovered unpaid credit card bills in her home. When two of the children attended a meeting at Mrs. R's bank to review her accounts, they discovered the bank loan. Before April 2008, Mrs. R's children were not involved in or aware of her financial affairs beyond some discussion about ownership of Mrs. R's cottage.

- On April 30, 2008, Mr. DT discussed Mrs. R's financial situation with her daughter and POA, Mrs. K. At the time, Mrs. R's RRIF and non-registered account were worth

approximately $213,572, while her loan balance was approximately $86,336.

- On June 9, 2009, Mrs. K wrote Mr. DT asking for information about Mrs. R's investment loan. Later that same month, Mrs. R's children obtained a third-party opinion in an effort to determine the status of her finances and investments. It was from the third-party opinion that they learned the leverage strategy and Mrs. R's investments were risky and unsuitable for her.

- On August 28, 2009, Mrs. R's cottage was sold and the proceeds were used to pay off the investment loan. Several weeks later, on October 14, 2009, a portion of Mrs. R's investments were transferred away from De Thomas Financial in kind. On January 11, 2010, the remaining investments were sold.

COMPLAINT

- In a letter to the MFDA dated July 10, 2009, Mrs. K complained on Mrs. R's behalf that:
  - borrowing to invest was unsuitable for her mother; and
  - her mother's investments were too risky for her moderate risk tolerance.
- Mrs. K did not specify the amount of compensation she was seeking.

DE THOMAS FINANCIAL'S RESPONSE

- In a letter dated July 22, 2009, Mr. DT wrote to Mrs. K in response to the complaint to the MFDA saying:
  - the leverage strategy was first introduced to Mrs. R in 1998 and was discussed again in 2000 to address Mrs. R's concerns about high taxes and Old Age Security (OAS) clawbacks;
  - he offered to include Mrs. R's children in investment meetings, but Mrs. R did not want to do so;
  - Mrs. R's RRIF withdrawals were used to make investment loan payments. She said she had sufficient income from her survivor (employer) pensions, Canada Pension Plan (CPP), and OAS to meet her needs, and she had a 10- to 20-year investment time horizon;
  - over time, Mrs. R sold some of her non-registered investments for gifts and to pay for maintenance on her cottage. He cautioned her that such withdrawals were not part of her original plans, but Mrs. R said her family could not agree on money issues nor decide what to do with the cottage, and she would spend her money as she wished; and

  - the leverage strategy was suitable for Mrs. R's long-term growth, tax reduction, and estate planning objectives.

- De Thomas Financial did not offer Mrs. R any compensation.

OBSI ANALYSIS

In the course of our investigation, we reviewed documents received from the parties. We interviewed Mrs. R and Mr. DT regarding the complaint. When we interviewed Mrs. R, she was 84 years old and had difficulty remembering details of her financial circumstances or the nature of her conversations with Mr. DT. Therefore, we also discussed the complaint with Mrs. K.

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

1. What were Mrs. R's personal and financial circumstances, investment experience and knowledge, investment objectives and risk tolerance?

2. Was leveraged investing suitable and were its risks appropriately disclosed?

3. Were the RRIF investments suitable?

4. If the leveraged investing and/or the RRIF investments were not suitable, did Mrs. R incur financial harm?

5. Who bears responsibility for Mrs. R's financial harm, if any?

Issue 1 – What were Mrs. R's personal and financial circumstances, investment experience and knowledge, investment objectives and risk tolerance?

Personal and financial circumstances

- Mrs. R was widowed in 1997. She was 71 years old at the time and had been a homemaker throughout her marriage. Her husband had previously looked after their household financial and investment decisions. After her husband's death in 1997, Mrs. R lived alone in her family home. She had six adult children, none of whom were dependents. Her children were not directly involved in her financial affairs until a few weeks before Mrs. K met with Mr. DT on April 30, 2008, when Mrs. R was 82 years old.

- Mr. DT prepared documents including Know Your Client (KYC) information for Mrs. R in 2000, 2003, 2004, 2005, 2006 and 2007, and updated forms at other times. The forms themselves changed over time and not all information about Mrs. R's personal and financial circumstances was documented completely or consistently between the forms. Mr. DT has only limited notes about his discussions with Mrs. R. We have

summarized information shown on the various forms and in Mr. DT's notes about Mrs. R's financial circumstances in Table 1 below.

Table 1: Summary of KYC information and Mr. DT's notes about Mrs. R's financial circumstances

	Notes Oct '97	Trade Ticket Oct '98	Notes May '00	KYC Mar '03	KYC Mar '04	KYC Mar '05	KYC Apr '06	KYC Dec '07
Income	$30,000 (pension)	$45,000	-	$45,000	$52,000	$35,000 (pension)	$47,000	$48,000
Liquid Assets		$300,000	$150,000	$8,000	$262,000	$367,000	$256,000	$241,000
Residential Property			$150,000	$125,000	$90,000 - $140,000	$130,000	$200,000	$210,000
Cottage			$140,000	$250,000	$200,000	$210,000	$200,000	$220,000
Liabilities			$20,000	$140,000	$126,000	$116,000	$107,000	$95,000
Total Net Worth		$400,000 +	$420,000	-	$426,000	-	-	-

- Mr. DT's notes and the KYC forms show various income figures for Mrs. R. Mrs. K provided us with copies of Mrs. R's tax returns and T4 and T5 income notices (T-slips). We have summarized this information in Table 2 below. Mr. DT acknowledges that he prepared all of Mrs. R's tax returns up to the 2006 tax year.

Table 2: Mrs. R's Income and RRIF withdrawals

Year[1]	Total Income (CPP/OAS/Pension/RRIF)	RRIF Withdrawals[2]	Income excluding RRIF withdrawals
1999	$53,509	$20,023	$33,486
2000	$65,085	$28,353	$36,732
2001	$72,989	$37,200	$35,789
2002	$62,254	$27,200	$35,054
2003	$53,436	$18,000	$35,436
2004	$50,014	$13,755	$36,259
2005	$49,580	$13,140	$36,440
2007	$50,573	$13,140	$37,433

- According to her tax returns and T-slips, Mrs. R's income was $53,509 in 1999, shortly before Mr. DT recommended the leverage strategy. From 1999 to 2007, Mrs. R's total income ranged from $49,580 to $72,989, depending on the amount of her RRIF withdrawals. The RRIF withdrawals varied from year to year according to her expenses and were increased in 2000 to make investment loan payments. While the RRIF payments were reduced in 2003, and declined again in 2004 below the $15,069 needed annually for the loan payments, Mrs. K says Mrs. R relied on RRIF income to

[1] Full information for 2006 is not available, so we have excluded 2006 from Table 2.
[2] According to T-slips.

supplement her pensions and that by 2008 she had been struggling to meet her expenses for several years, indicating her income was not sufficient.

- Mrs. R's fixed assets included her home and cottage. The parties have not been able to provide documentary evidence to verify their values. Mrs. K estimates that in 2000, at the time Mr. DT recommended the leverage strategy, her mother's house was worth approximately \$150,000 to \$190,000 and her cottage was worth approximately \$200,000 to \$250,000. Mrs. K says that in 2009, the cottage was sold to a family member for \$285,000 and in 2012, the house was sold for \$187,000, which suggests that Mrs. K's estimate of their values in 2000 is not unreasonable. If we take the mid-point of the estimated real estate values, we find Mrs. R's fixed assets were worth approximately \$395,000 (\$170,000 house + \$225,000 cottage) in 2000. It is likely that the real estate values increased over time and in general, we find the KYC forms are a reasonable reflection of Mrs. R's fixed asset values.

- Mrs. R's liquid assets were in her RRIF and non-registered account at De Thomas Financial. She had no other investments or savings and had only a small amount of cash in her bank account. In 1999, Mrs. R's combined investments were worth \$322,975. In June 2000, she borrowed and invested \$150,000, for no net change in her liquid asset values at the time. However, Mr. DT's meeting notes dated May 18, 2000 indicate that Mrs. R owed one of her daughters \$20,000, essentially reducing her liquid assets to approximately \$302,975 (\$322,975 - \$20,000). While the various KYC forms show a general decline in the liquid asset values, they are inconsistent and not entirely accurate given the decline in the value of Mrs. R's investment values over time. On the other hand, we find the various KYC forms reasonably reflect the declining loan balance after 2000.

- In 1997, Mrs. R was 71 years old and was making investment decisions for her accounts for the first time. Less than three years later, in 2000, Mr. DT recommended she borrow to invest. At the time, her income was \$53,509 and it varied thereafter with her RRIF withdrawals, which Mrs. R needed to supplement her pension income to meet expenses. In 2000, her net worth (value of her home, cottage and investments not including the leveraged investments and loan) was approximately \$697,975 (\$395,000 + \$302,975).

Investment experience and knowledge

- The KYC form Mr. DT prepared in June 2000 shows Mrs. R's investment knowledge as moderate from a choice of fair, moderate, good, and very good. The May 2003 KYC form shows Mrs. R's knowledge as fair to good, while the 2004, 2005, 2006 and 2007 KYC forms show her investment knowledge as fair.

- When we interviewed Mrs. R in September 2010, she was 84 years old and could not recall details of her financial circumstances, her investments, or the discussions she had with Mr. DT. She was also unable to explain basic investment concepts.

- Mrs. K told us that while Mrs. R attended meetings between her husband and Mr. DT for over 15 years, Mrs. R had always relied on her husband, and after his death, on Mr. DT for investment and financial decisions.

- Mr. DT says it is his standard practice to educate clients so they do not rely solely on his advice. In this respect, he says Mrs. R's investment knowledge grew over time as her investments shifted from GICs in 1987 to real estate mutual funds, money market instruments and bonds, and later to balanced and equity mutual funds. He says that Mrs. R experienced volatility in her investment values in both the 1987 and 1994 market downturns, becoming a more knowledgeable investor as a result. Nevertheless, Mr. DT acknowledges that Mrs. R agreed to every investment recommendation he made and did not independently make investment proposals to him.

- Mrs. R spent most of her adult life as a homemaker and had relied on her husband for investment decisions until he passed away in 1997. Therefore, we find it unlikely that Mrs. R was involved in the decisions about her investments or that she was in a position to draw meaningful lessons or knowledge from the market downturns of 1987 and 1994. Mr. DT also acknowledges being involved in many aspects of her financial affairs, including discussing her expenses and income requirements, tax and estate plans, particularly with respect to the cottage, and preparation of her tax returns. His degree of involvement suggests a high degree of trust by Mrs. R. In the circumstances, we find it unlikely that Mrs. R's investment knowledge increased much over time. Further, Mr. DT acknowledges that Mrs. R followed his recommendations and did not make investment suggestions, indicating she did not have the knowledge to independently evaluate opportunities or question his advice. Given her age when she became responsible for her financial affairs and the circumstances overall, we find it likely that Mrs. R had very limited investment knowledge and that she relied heavily, if not entirely, on Mr. DT's advice.

Investment objectives and risk tolerance

- As summarized in Table 3, Mrs. R signed KYC forms, updates and/or trade tickets in 2000, 2003, 2004, 2005 and 2007 showing information about her investment objectives and risk tolerance. The forms do not specify whether the information applied to her non-registered or her RRIF account.

Table 3: Documented investment objective and risk tolerance information

	June 2000	March 2003	October 2004	February 2005	March 2005	December 2007
Age	74	77	78			82
Investment Objectives	Tax Estate	Retirement planning Tax planning	Retirement planning Future growth	5% Safety 15% Income 30% Conservative	3% Safety 57% Conservative growth	Retirement planning Reduce tax 40%

		Estate planning	Tax planning Have RRIF last to 88-90 No tax to estate 6% to 7%	growth 50% Moderate growth	40% Moderate growth	Conservative growth (ROR[3] 7%) 60% Moderate growth (ROR 8%)
Portfolio Mix	Growth with no income	70% Growth & income 30% Growth				
Risk Tolerance	Moderate	80% Medium 20% High	10% Low 80% Medium 10% High	Moderate	Moderate	Low to moderate
Time Horizon	8+ years	5+ years	5+ years			

- The various KYC forms are inconsistent, but in general they indicate Mrs. R's investment objective was primarily growth at a moderate risk level.

- Mrs. K says that her mother's main concern was to meet her day-to-day living expenses, travel once a year to see her brother in South America, and to pay for the upkeep of her home and cottage. She says her mother also wanted to keep her cottage for her family to use.

- Mr. DT says Mrs. R's main concern was estate taxes on both her RRIF and her cottage. Mr. DT's notes dated October 22, 1998 indicate they discussed a strategy to lower her taxes by borrowing to invest. His notes dated May 18, 2000 indicate he discussed the taxes that would be payable on Mrs. R's cottage at her death, and how borrowing to invest could meet her estate goals and result in her paying no taxes on RRIF withdrawals, while still allowing her sufficient cash flow to meet her expenses. Mr. DT calculated a potential tax liability to the estate from the cottage of $23,000.

- While Mr. DT says that Mrs. R's main concern was estate taxes on her RRIF and her cottage, based on our review of Mr. DT's meeting notes, it appears Mrs. R's main

[3] Rate of return.

contributions to their investment review meetings was to discuss day-to-day issues such as her health and her family. Given Mrs. R's limited investment knowledge, that she had previously relied on her husband to manage their financial affairs and that she relied on Mr. DT for financial advice, we find it unlikely that Mrs. R could articulate estate tax concerns or that based on the $23,000 potential liability that Mr. DT calculated, she was raising estate taxes as her main concern.

- Mr. DT also told us that after Mr. R died in 1997, Mrs. R wanted to take the same approach to investing as her husband had, believing it had worked well in the past. Mr. DT acknowledges that he did not discuss or advise Mrs. R that a different approach might be appropriate given her changed circumstances. We find it very unlikely in the circumstances that Mrs. R fully understood how her husband had invested their accounts, or that she was equipped to independently determine whether any particular approach would be suitable. In any event, our review of the information we have received about Mr. R's investments indicates they were generally medium-risk balanced mutual funds (providing exposure to both income and growth investments).

- On the other hand, Mr. DT says Mrs. R was a 18% high-risk growth and 82% medium-risk growth investor. In other words, not balanced like her husband's investments had been. Mr. DT bases his figures on Mrs. R's holdings in 1996 before Mr. R died and his accounts were combined with Mrs. R's. In particular, Mrs. R held the AGF Asian Fund and the AGF Canadian Balanced Fund in 1996 before her accounts were combined with her husband's.

- While we agree the AGF Asian Fund was a high-risk growth fund, the AGF Canadian Balanced Fund that Mrs. R held in 1996 was a medium-risk balanced fund. According to its prospectus, the fund would invest in bonds, money market investments and equities, and its objective was to provide superior returns through a combination of capital growth, dividend income and interest income.

- We can accept a balanced portfolio at no more than medium risk would have been suitable in Mrs. R's circumstances. Balanced investments could provide income to supplement Mrs. R's pensions, as she required, and provide the opportunity for some growth to meet extra expenses she might incur and to address potential estate taxes on the cottage. However, at her age, given her level of knowledge and her need for income, we cannot agree that she knowingly agreed to growth-oriented investments at higher risk levels as Mr. DT suggests.

Conclusion

In 1997, Mrs. R was 71 years old, widowed and making investment decisions on her own for the first time. Her husband had previously looked after their financial affairs. Mrs. R trusted Mr. DT to help her with almost all aspects of her financial affairs. In all of the circumstances, we find it highly likely that Mrs. R had very limited investment knowledge and that she relied entirely on Mr. DT's advice.

In 1999, around the time that Mr. DT recommended borrowing to invest, Mrs. R had approximately $697,975 in net assets, of which approximately $322,975 was invested in her accounts at De Thomas Financial. Mrs. R relied on her RRIF withdrawals to supplement her pension income and meet occasional expenses such as house and cottage repairs and travel. At her age and in her financial situation, we find it reasonable that she would have invested in a generally balanced fashion for income and potential growth at no more than a medium level of risk. We are not persuaded that mainly growth-oriented investments or any amount of high-risk investments were appropriate, or that Mrs. R understood or intended to invest in this manner.

Issue 2 – Was leveraged investing suitable and were its risks appropriately disclosed?

- In June 2000, on Mr. DT's advice, Mrs. R arranged a $150,000 investment loan (secured by the related investments) through a bank. The loan proceeds were invested in a variety of mutual funds in her non-registered account. On Mr. DT's advice, Mrs. R used RRIF withdrawals to make the $1,255.76 monthly principal and interest payments on the leverage loan ($15,069 per year).

- Leveraged investing is generally considered to be a higher-risk strategy suitable for investors with a higher risk tolerance who can accept and afford the magnified losses that can occur in a declining market, who can afford to pay the loan from other income or assets if the strategy fails, and who may be able to maximize the potential tax benefits of borrowing to invest. Therefore, it is important that investment advisors and firms carefully assess the suitability of the strategy for individual investors.

- De Thomas Financial did not have any leverage suitablity assessment guidelines before the MFDA published suitability guidelines in April 2008. Rather, Mr. DT says his only practice was to provide clients with a risk disclosure statement.

- In 2000, leverage suitability assessment practices in the investment industry typically included guidelines that:

  - the investor have a higher tolerance for risk;
  - the investment loan should be no more than 50% of the investor's total net worth (known as the loan to net worth ratio);
  - the investment loan payments combined with other debt payments should be no more than 35% of the investor's gross income (known as the total debt service ratio, or TDSR);
  - the investor have at least good investment knowledge;
  - the investor be provided with risk discloure.

- While an investor may meet one or more guideline, an overall assessment of these factors is important in evaluating the suitablity of a leverage strategy.
- Given that De Thomas Financial did not have suitability guidelines in place in 2000, we assessed the suitability of Mr. DT's leverage recommendation based on general industry practices at the time.

Risk tolerance

- As discussed above, we can accept that a balanced portfolio up to medim-risk would have been suitable for Mrs. R. Since leveraged investing is considered a higher-risk strategy which maginfies the risks of the underlying investments, we find the leverage strategy was not suited to Mrs. R's medium risk tolerance.

Loan to net worth

- Mrs. R's $150,000 loan represented 21% ($150,000/$697,975*100) of her total net worth in 2000, within the 50% parameter typically used by the industry at the time. However, the loan to net worth ratio is an indicator and is not determinative of affordability in and of itself.
- For example, while Mrs. R's total net worth in 2000 was approximately $697,975 her home and cottage were worth approximately $395,000, and they were illiquid. Mrs. R lived in her home, providing important financial and continuity benefits for her, and she wanted to preserve the cottage for her family. Therefore, neither could be relied on to help pay off the loan if the leverage strategy failed.
- Furthermore, while her non-leveraged and RRIF investments (worth approximately $302,975 after repayment of her $20,000 debt to her daughter) were liquid, they were intended to supplement her pension income, to meet expenses and arguably would be used for her care as she aged. Since the loan represented approximately 49% ($150,000/$302,975*100) of her liquid assets, we find they could not be considered as a means to repay the loan without inappropriately jeopardizing her financial stability as she aged.
- Therefore, although Mrs. R's loan to net worth ratio fell within standard guidelines at the time, repayment of the loan would have inappropriately put her financial situation at risk if the strategy failed. We conclude the loan was not affordable given her asset base and circumstances.

Total debt service ratio (TDSR)

- Mrs. R had annual loan payment obligations on the $150,000 investment loan of approximately $15,069 ($1,255.76 * 12), representing approximately 28% ($15,069 ÷ $53,509) of her gross income in 1999, shortly before Mr. DT recommeded the leverage strategy. While the TDSR falls within the standard 35% industry guideline, like the loan

to net worth ratio, it is an indicator and is not determinative of affordability in and of itself.

- Further, she was using RRIF withdrawals to make her loan payments when she needed the RRIF income to meet her day-to-day expenses. In fact, for two years at the beginning of the strategy she was taking extra RRIF withdrawals for loan payments on Mr. DT's advice, risking depleting her RRIF without any assurance that her leveraged investments would grow at the same or higher rate. Around the time the RRIF withdrawals were reduced in 2003 and 2004, we understand Mrs. R began to have trouble making ends meet. Therefore, we find it clear that Mrs. R needed her RRIF income for her living expenses and could not afford to make the loan payments if the strategy failed without inappropriately jeapardizing her income and financial stability.

- Mr. DT says that Mrs. R could have reduced her loan payments to $9,000 per year representing only interest costs and, given that interest costs were tax deductible and Mrs. R's marginal tax rate was 35%, the net cost of the loan to Mrs. R could have been approximately $6,000 per year or 11% of her gross income. However, if Mrs. R paid only interest with no principal reduction, and the investment values fell contrary to Mr. DT' growth projections, she would run an even greater risk that her home or cottage would be lost to repay the loan.

- In her circumstances, we cannot conclude that the leverage strategy was affordable for Mrs. R.

Investment knowledge and risk disclosure

- As discussed above, we believe Mrs. R had limited investment knowledge, lower than the industry standard required for leveraged investors.

- Leverage is more complex and its risks can be more difficult to understand than for investments made without borrowed money. The complexity of a leverage strategy is even higher when it involves RRIF withdrawals for the purpose of moving money into a potentially tax-preferred non-registered form (the combination is commonly referred to as a RRIF meltdown strategy).

- Mr. DT says he discussed the leverage strategy with Mrs. R on several occasions and believes she understood it.

- Mr. DT's notes indicate that he first recommended borrowing to invest on October 22, 1998, about a year after Mr. R died. The notes indicate that he discussed how RRIF withdrawals could pay the loan costs and, since loan costs were tax deductible, a portion of Mrs. R's RRIF withdrawals would be tax free. At her death, gains on the investments made with the borrowed money would be taxed at the capital gains rate, which would be lower than the rate that would apply if the total value of her RRIF was taken into income at her death. We note there is no reference in Mr. DT's notes to the potential for a loss on the investments and a remaining loan debt.

- Mr. DT's notes dated May 18, 2000 indicate he discussed with Mrs. R that taxes would be payable on her cottage at her death. He again recommended borrowing to invest, explaining how it could result in her paying no taxes on RRIF withdrawals, while still allowing her sufficient cash flow to meet her expenses. Mr. DT calculated a potential tax liability to the estate from the cottage of $23,000. He provided an investment growth projection assuming an 11% rate of return over 18 years, showing a future investment value of $1,145,122. Mr. DT also provided projections of the payment streams Mrs. R might expect from her $300,000 RRIF based on rates of return of 8% and 10%. There is no evidence that Mr. DT provided an illustration to show potential negative outcomes.

- Mr. DT says he provided Mrs. R with photocopies of his handwritten notes taken during their meetings where he explained the leverage strategy. Mrs. R says she took the photocopies home and put them away without reviewing them and did not discuss them with anyone or get a second opinion on the strategy. Mrs. K concurs that Mrs. R did not discuss the leverage strategy with her. While Mr. DT provided copies of his notes to Mrs. R, they were not written in a fashion that she was likely to have understood or with enough clarity that she could have sought additional advice from her family or others.

- On June 26, 2000, Mrs. R signed a document on De Thomas Financial letterhead titled Borrowing Money to Buy Investment Funds (Leveraging), De Thomas Financial's only leverage strategy requirement. We also reviewed the bank's documents, but found no risk disclosure among them.

- While Mrs. R signed a disclsoure document, we have seen no evidence that Mr. DT provided Mrs. R with a balanced presentation including illustrations of the potential downsides to leveraging. There is also no evidence that Mr. DT showed her the potential outcome or implications to her estate if she should die before the loan was repaid, or that he discussed the nature or risks of the investments he proposed for the strategy. Rather, the only illustrations we have seen show only positive results over a long-term, 18-year time frame, at which point Mrs. R would have been 92 years old.

- Given Mrs. R's limited investment knowledge, we do not believe she understood the strategy or the risks she was exposed to despite signing the risk disclosure document. She relied on Mr. DT's advice and was not in a position to independently assess or question the complex leverage proposal and its risks or implications. Further, while she received loan and investment account statements, we do not believe she was equipped to independently monitor or assess how the strategy was performing in its entirety.

Conclusion

We find the risks of the leverage strategy exceeded Mrs. R's risk tolerance. In addition, if it failed it posed a serious risk to Mrs. R's financial stability since she needed her pension and RRIF income just to meet regular expenses. Further, she lived in her home and wanted to pass the cottage to her family, so neither could be considered as a means to repay the loan. At her age and in her circumstances, we conclude the leverage strategy was not affordable.

Further, Mr. DT did not provide Mrs. R with a balanced presentation about the leverage strategy including illustrations of the risks and potential downside scenarios. Given the incomplete presentation and her limited investment knowledge, we do not believe she understood or appreciated the risks of the strategy despite the disclosure document she signed. For all of these reasons, we find the leverage strategy was unsuitable for Mrs. R.

Issue 3 – Were the RRIF investments suitable?

- We analyzed Mrs. R's RRIF holdings at annual intervals from the beginning of 1998, shortly after Mr. R died, to the end of 2009, shortly before Mrs. R's RRIF investments were sold or transferred away. Our analysis is summarized in Table 4 below.

Table 4: RRIF Risk and Asset Allocation analysis

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009[4]
Asset Allocation												
Income	-	-	-	-	-	-	-	-	-	-	-	-
Balanced	100%	75%	29%	30%	34%	33%	33%	45%	17%	18%	20%	-
Growth	-	25%	71%	70%	66%	67%	67%	55%	83%	82%	80%	100%
Risk Allocation												
Medium	100%	100%	83%	83%	85%	86%	86%	100%	51%	54%	100%	100%
Medium-high	-	-	17%	17%	15%	14%	14%	-	49%	46%	-	-

- From shortly after Mr. R died in 1997 through December 1998, Mrs. R's RRIF account was 100% invested in medium-risk balanced mutual funds, which were suited to her medium-risk balanced investment objective.

- However, from 1999 through 2009 Mrs. R's RRIF account was allocated 25% to 100% to growth-oriented mutual funds that were not suited to her balanced investment objective.

- In addition, we note the balanced funds in the accounts would typically include about 40% in income-type investments and 60% in growth investments. Given this allocation, the balanced funds did not provide enough exposure to income investments to "balance" the overall portfolio with the specifically growth-oriented funds. For example, even when the balanced fund component was highest in 1999 at 75%, only approximately 29% (75% * 40%) of Mrs. R's RRIF was in income investments, while the remainder was in growth investments. As the allocation to balanced funds declined, the income allocation declined so that by 2006, only about 7% (17% * 40%) of the RRIF was allocated to income investments.

[4] In December 2009, Mrs. R had two medium-risk growth funds at De Thomas Financial. Her balanced funds were transferred away in October 2009. The two growth funds were rated as medium-high risk until the fall of 2008.

- Further, during most of the period from 1998 to 2007, some of Mrs. R's growth investments were higher than medium-risk, making the portfolio materially too risky at times given her medium risk tolerance.

- Mr. DT says he uses a portfolio approach to achieve a medium risk level overall. He says that a medium-risk portfolio could have held some high-risk investments and some low-risk investments, but that if the majority of the holdings were medium-risk, the portfolio would be deemed to have a medium level of risk overall. To support his argument, Mr. DT says that the AIM Invesco Global Equity Fund is considered a moderate risk fund, yet it still invests 18% of its assets in high-risk emerging market indices. Mr. DT also says that, while some investments might have been higher than medium-risk, Mrs. R's portfolio was constructed to provide as much diversification as possible to lower the actual overall risk.

- Although Mr. DT says he uses a portfolio approach to manage risk, we have not seen supporting documents (such as an asset allocation plan) or any evidence that such an approach was discussed with Mrs. R. We also do not believe that Mrs. R understood and intended to invest in higher-risk investments and, given her limited investment knowledge and experience, we do not believe that she could have independently determined that her portfolio contained some higher-risk investments and questioned Mr. DT about it. Finally, we note that there were no lower-risk investments in Mrs. R's accounts that may have helped to achieve an overall medium risk level when combined with the medium and higher-risk investments.

Conclusion

Based on our analysis, we find that Mrs. R's RRIF account investments were not aligned with her medium-risk balanced investment objective after 1998. From 1999 to 2009, her RRIF held between 25% to 100% growth-oriented mutual funds, several of which exceeded her medium risk tolerance. As such, we find between 1999 and 2009, Mrs. R's RRIF was unsuitably invested overall.

Issue 4 – If the leveraged investing and/or RRIF investments were not suitable, did Mrs. R incur financial harm?

Leverage strategy

- To determine if Mrs. R incurred financial harm as a result of the leverage strategy, we have considered the leveraged investment performance and the loan interest between June 26, 2000 when the strategy was implemented, and October 14, 2009, when the last leveraged investments were transferred to another investment firm. Our calculations are shown in Table 5 below.

Table 5: Financial harm to October 14, 2009 – Leverage strategy

Investment of the loan proceeds	$150,000
Less: Net withdrawals from the leveraged investments	$8,716
Net capital invested	$141,284
Less: Ending investment value	$113,365
Investment loss	$27,919
Plus: Loan interest payments	$58,677[5]
Financial harm	**$86,596**

- We calculate that Mrs. R suffered financial harm of $86,596 as a result of the leverage strategy.

RRIF

- To determine if Mrs. R incurred financial harm on her RRIF investments, we calculated the actual performance of her RRIF investments from December 31, 1999 to January 11, 2010, when the last RRIF investments were sold, and compared it to the performance of a suitable balanced portfolio allocated 40% to the DEX Universe Bond Total Return Index to represent income investments up to medium-risk and 60% to the S&P TSX Composite Total Return Index to represent medium-risk growth investments.

- In our calculations, we accounted for the amount and timing of the RRIF withdrawals. We also adjusted the performance of the TSX Composite Total Return Index by 2.31% and the DEX Universe Bond Total Return Index by 1.31% to account for managed expenses that Mrs. R would likely have incurred in a suitable mutual fund portfolio. However, we have not deducted the full amount of the deferred sales charges (DSC) Mrs. R incurred in her RRIF from the suitable benchmark calculations. Of the $5,195 of DSC fees incurred, $3,496 was on transactions where Mr. DT sold a mutual fund and purchased another at a different mutual fund company. Not only were several of the new mutual funds unsuitable, but switches to similar and/or suitable funds could have been made in the same fund family at no cost. Therefore, we have deducted only the remaining $1,699 ($5,195 - $3,496) in DSC fees from the suitable benchmark calculations. While we do not believe DSC-based mutual funds were necessarily appropriate for Mrs. R given her age and her RRIF income requirements, we note that the DSC funds likely existed at the time Mrs. R's RRIF was combined with her husband's.

---

[5] Interest payments calculated to August 2009.

Table 6: Financial harm on Mrs. R's unsuitable RRIF investments

	Actual performance	Suitable benchmark portfolio
Net Capital invested	$90,231	$90,231
Less: Ending market value	$22,561	$178,891
Investment Gain (Loss)	($67,670)	$88,660
Less: DSC fees	$5,195	$1,699
Gain (Loss)	($72,865)	$86,961
Financial harm	**$159,826**	

- Mr. DT does not agree with our approach to financial harm calculations for Mrs. R's RRIF account. Specifically, Mr. DT questions any allocation to bonds in our notional portfolio since he says Mrs. R never asked for bond investments.

- Mrs. R was not knowledgeable enough to ask for bond investments, and instead relied on Mr. DT's recommendations. Further, her balanced investment objective implies a combination of income-generating securities with growth-oriented securities. For example, balanced mutual funds typically include approximately 40% bonds and 60% equities.

- Given our view that Mrs. R had a balanced investment objective, but she held no bond mutual funds and she had insufficient balanced funds to provide enough income investments, we believe it is entirely reasonable to calculate how her portfolio would have performed if it had been suitably invested with 40% in bonds and 60% in equities. On this basis, we calculate that Mrs. R suffered financial harm of $159,826 as a result of her unsuitable RRIF investments.

Conclusion

We calculate that Mrs. R suffered total financial harm of $246,422 ($86,596 + $159,826) as a result of Mr. DT's unsuitable recommendations.

Issue 5 – Who bears responsilbity for Mrs. R's financial harm, if any?

Vicarious Liability

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

> Vicarious liability is arguably fair in this sense. The employer puts in the community an enterprise which carries with it certain risks. When those risks materialize and cause injury to a member of the public despite the employer's reasonable efforts, it is fair that the persons or organization that created the enterprise and hence the risk should bear the loss. This accords with the notion that it is right and just that the person who creates a risk bear the loss when the risk ripens into harm.

- In this case, it is clear that Mr. DT recommended unsuitable investments and an unsuitable leverage strategy that caused Mrs. R losses. We believe De Thomas Financial is responsible to compensate Mrs. R for the losses caused by Mr. DT's unsuitable advice. However, we also considered whether Mrs. R should be held responsible for a portion of her loss.

Client Responsibility

- Mr. DT contends that Mrs. R signed disclosure forms, and therefore must have known of and accepted the risks associated with the leverage strategy in particular.

- However, Mr. DT had an obligation to ensure his recommendations were appropriate for Mrs. R's circumstances. In Re Lamoureux, (2001) ASCD N0. 613, the 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 PartVI (B) 1, it states "Similarly, the probative value of a signed acknowledgement may vary greatly, depending upon the sophistication of the investor, the content of the acknowledgement and the circumstances under which it was signed."

- Mrs. R had limited investment knowledge. There is no evidence that she received a full and balanced presentation about the leverage strategy, including an explanation of the risks and potential consequences if it failed. We believe she had little, if any appreciation of the risks and we do not believe she was equipped to have independently assessed them.

- Further, we do not believe Mrs. R knew or could have independently determined that her RRIF investments were not suitable and that the additional amounts being withdrawn from her RRIF to pay for the leverage loan was putting her financial well being at risk.

- Consistent with her lack of understanding and her reliance on Mr. DT, we also see no evidence that Mrs. R questioned the performance of her investments. In addition, there is no evidence that Mr. DT provided Mrs. R with an assessment of how the leverage strategy or her RRIF investments were performing relative to the projections he had described to her in 2000 and whether the leverage strategy was meeting her goals. Since

Mrs. R was unaware of any problems, we find she was never in a position to have taken steps to limit her losses.

- In 2006, Mrs. R and her children began planning to transfer ownership of the cottage. They, and their family's legal and new tax advisors, were asking questions of Mr. DT about the transfer. To this end, Mrs. R signed an Authorization and Direction form on October 26, 2006 instructing Mr. DT to provide her financial statements and tax information to her lawyer, Mr. M. We have not seen evidence of the nature of information, if any, that was provided to Mr. M at that time. However, Mr. DT acknowledges that in October 2006, neither Mr. M nor Mrs. K asked about Mrs. R's investments or made any reference to the investment loan, but only asked him questions related to Mrs. R's cottage.

- Mr. DT says he had further discussions with Mrs. R's family beginning in late 2007 about the cottage. On February 21, 2008, Mr. DT received a request from Mr. M for the 1994 valuation of Mrs. R's cottage and her 2006 tax return to prepare the transfer of the ownership of Mrs. R's cottage to her children. The next day, Mr. DT faxed the 1994 cottage valuation to Mr. M, but directed him to Mrs. R for her tax returns.

- In April 2008, Mrs. R's children became concerned about their mother's finances having discovered unpaid credit card bills in her home. Two of the children attended a meeting at Mrs. R's bank to review her accounts and discovered the bank's investment loan. Although they asked Mrs. R for information about the loan, Mrs. K says Mrs. R was unsure what they were talking about and she sent them to Mr. DT for information.

- Mr. DT and Mrs. K agree they met at Mrs. R's home on April 30, 2008 to discuss the bank loan the children had recently discovered. On the same day, Mr. M requested that Mr. DT provide him with all of Mrs. R's financial information. We have not seen evidence of a response to this request. Mr. DT's notes of April 30, 2008 indicate that Mrs. R's children were concerned because her cash flow was tight. According to the notes, Mr. DT recommended they review Mrs. R's bank book and revisit the family's approach to dealing with the cottage. His notes also indicate he illustrated the leveraged loan strategy to Mrs. K and the negative consequences of redeeming investments in the leverage strategy.

- Mrs. K says that she left the April 30, 2008 meeting very confused about the leverage strategy. She says that she and her five siblings were trying to figure out Mrs. R's situation, and that they continued discussing options for selling or transferring ownership of the cottage. However, they could not agree about the cottage and she says they were not aware of the nature and risks of Mrs. R's investments and the leverage strategy until her brother's advisor reviewed Mrs. R's accounts in June 2009 to provide another opinion. It was only after receiving the second opinion that they began to understand that Mrs. R was unsuitably invested and concluded they had to sell the cottage to repay the loan. Even then, it seems they failed to fully understand the strategy and Mrs. R's investments.

- While Mrs. K and her siblings became aware of the leverage strategy in April 2008, they reasonably needed some time to discuss the matter, assess the strategy and investments, seek additional information and come to an agreement about what to do with the cottage and how to pay off the loan. We believe they were proactively attempting to understand and address the situation, but we do not believe they were in a position to have taken steps on Mrs. R's behalf to mitigate her losses until after June 2009 when they received the second opinion. The cottage was sold shortly after in August 2009, and the proceeds were used to pay off the loan. In October 2009, a portion of Mrs. R's investments were transferred away from De Thomas Financial in kind. In January 2010, the remaining investments were sold. We find Mrs. R's children took timely steps to limit losses once they became aware of the problems.
- In all of the circumstances, it does not appear to us that there is any basis to impose responsibility on Mrs. R because she does not appear to have acted negligently in following Mr. DT's advice. Mrs. R relied on Mr. DT, in his capacity as an expert advisor, and there is nothing unreasonable about her reliance. To require her to bear responsibility for the financial harm arising from an unsuitable investment strategy and unsuitable investments that she did not know of or understand until her children became involved with her financial matters, is not fair to her.

Conclusion

De Thomas Financial is responsible for the financial harm Mrs. R incurred due to Mr. DT's unsuitable recommendations. Given her limited investment knowledge and her reliance on Mr. DT, we see no basis to apportion part of the losses to Mrs. R.

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 De Thomas Financial compensate Mrs. R $246,422 plus interest of $7,901[6], totalling $254,323.

[6] Interest is calculated using the average 3-month Canadian Treasury Bill yield of 0.85% (as calculated by the Bank of Canada) compounded annually from January 12, 2010 to the date this report becomes final.