Mutual fund firm refuses OBSI recommendation

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TORONTO - The Ombudsman for Banking Services and Investments today announced that Financial Architects Inc., a Toronto mutual fund dealer, has refused to honour a recommendation for compensation made following an investigation into an unresolved dispute between Financial Architects Inc. and a former client.

"For the first time in more than 10 years, a firm in our alternative dispute resolution service will not follow a recommendation made by our office after our thorough investigation of a complaint," said Ombudsman David Agnew.

"We regret that Financial Architects Inc. has chosen this course. The hallmark of a healthy financial services system is consumer recourse to an independent and impartial dispute resolution process, with firms that respect the process by compensating clients who have suffered financial loss because of an error, misleading information or poor advice."

"This client was badly served by Financial Architects Inc. She deserves compensation for unsuitable investments and a risky strategy that failed to provide her with needed income in her retirement."

A 76-year-old widow living on a modest annual income made up of a $179-a-month pension, plus CPP and the Old Age Security, opened an investment account with the advisor in 1999 when he was at another firm. Her life savings consisted of her home and her RRIF. She required income from the RRIF to maintain her standard of living, plus needed to withdraw a required minimum from the RRIF each year.

In 1999, the RRIF was worth about $142,000 and was invested in a combination of medium-risk income and equity mutual funds. Shortly after, funds were sold to shift about 40 per cent of the account into a high-risk mutual fund.

In the summer of 2000, the account transferred to Financial Architects Inc. when the advisor moved firms. The shift to high-risk funds continued, and trades were made that raised the client's exposure to high-risk funds to 60 per cent in a few months.

By this time, all the funds in the account were equity-based, and none paid regular distributions. This meant units of potentially high volatility funds had to be redeemed to meet the client's income and RRIF requirements regardless of their declining net asset value.

Despite the client's age, the new funds were purchased with deferred sales charges, or DSCs. Only small redemptions were allowed for seven years or the client would face penalties.

"This unsophisticated investor was relying on her advisor," Agnew said. "There is no evidence to suggest that any strategy was explained to her, and we do not believe she was aware of the downsides she faced with this risky advice. Leading a widow in her late 70s living on a limited income into a portfolio containing 60-per-cent high risk mutual funds, with DSCs, is simply unacceptable."

With the post-October 2000 market decline, the account dropped to the point where mandatory withdrawals from the RRIF went from more than $10,000 in 2000 to less than $5,000 in 2003. In a bid to preserve the shrinking principal, the client withdrew only the minimum required.

"OBSI found the investments unsuitable, the strategy ill-conceived and the record-keeping unhelpful," Agnew said. "While we found that the client did not respond in a timely way to the firm's requests for information, Financial Architects Inc. could not produce any kind of Know-Your-Client form either on account opening, when the account was transferred or any other time. Nor could we find a written investment plan. The advisor's notes were spotty at best."

Financial Architects Inc. took the position that the transactions were authorized by the client and were suitable for her investment objectives. The firm offered reimbursement of $248.50 in tax penalties for excess foreign content and $180.86 for DSC fees.

OBSI found no evidence Financial Architects Inc. discussed its investment approach with the client or that the client knowingly agreed to accept it. OBSI was not persuaded that the client understood the possible negative consequences of being invested entirely in equities and for the most part in high-risk mutual funds. OBSI recommended that the client receive compensation of $79,797.

The Ombudsman for Banking Services and Investment is an independent dispute resolution service that investigates unresolved disputes for customers of more than 600 financial services firms in Canada, including banks, credit unions and investment firms. As an alternative to the legal system, OBSI will recommend compensation or other measures if it finds a firm has made an error, gave misleading information or offered poor advice leading to a loss or harm to a client.

OBSI's findings are not binding on either the client or the firm. However, if a firm does not accept the recommendation of OBSI, OBSI makes public the name of the firm, the recommendation and the circumstances of the case.

For more information on OBSI, visit the website at www.obsi.ca.

For further information: Diane Bélanger, 1-888-451-4519, ext 2225,
Public Affairs Manager