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**CONFIDENTIAL &
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# INVESTIGATION REPORT

**Date:** May 29, 2014
**Client:** Small Business Co. (Mr. B)
**Firm:** Byron Capital Markets Ltd. (Byron Capital)

## 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. W | |
| **Issue:** | ▪ Investment suitability | |
| **Period:** | ▪ April 2005 to October 2010 | |
| **Key Conclusions:** | ▪ Mr. B wanted income from his investments and was not willing to purchase investments that were above medium-risk.<br>▪ Mr. W recommended two investments that were higher than medium-risk and therefore unsuitable for Mr. B's corporate account.<br>▪ Mr. W did not adequately disclose to Mr. B the risks and features of the unsuitable investments.<br>▪ Byron Capital is responsible for compensating Mr. B for the losses he incurred as a result of Mr. W's unsuitable recommendations. | |
| **Recommendation:** | $40,033 | Compensable losses |
| | $1,116 | Interest |
| | $41,149 | 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 such as 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

Mr. B began investing with Mr. W in 1989. Along with his corporate account, Mr. B had an RRSP account and a margin account at Byron Capital. Mr. B and Mr. W agree that Mr. B was a low- to medium-risk investor whose primary concern was the stability and continuity of income distributions from his investments.

Mr. W invested Mr. B's corporate account in various income-oriented investments including treasury bills, commercial paper, income trusts and preferred shares. In April 2005 and March 2006, Mr. W recommended that Mr. B purchase two high-risk, complex structured products that were unsuitable for Mr. B given his risk tolerance. Mr. W did not accurately disclose the risks associated with these investments. Although he had good investment knowledge, Mr. B reasonably relied on Mr. W's characterization that these were medium-risk investments and was, therefore, not aware they were higher-risk. Mr. B incurred $40,033 in compensable losses as a result of the unsuitable investments.

For the reasons outlined in this report, we conclude that Byron Capital should compensate Mr. B for his losses.

## BACKGROUND

- Mr. W became Mr. B's investment advisor in 1989. When Mr. W transferred to Byron Capital in 2001, Mr. B followed him. On September 10, 2001, Mr. B opened an RRSP account at Byron Capital.
- On March 21, 2005, Mr. B opened a corporate account for his company, Small Business Co.
- On July 10, 2009, Mr. B opened a Canadian margin account.
- Based on Mr. B's preference for investments that generated consistent income, Mr. W recommended many income-oriented securities for each of Mr. B's accounts.
- In January 2009, Mr. B began transferring his RRSP to another firm and by July 27, 2009, all of Mr. B's RRSP investments had been transferred out.
- In October 2010, Mr. W decided to terminate his business relationship with Mr. B and advised him to seek a new advisor. In response, Mr. B sold all of the investments in his margin and corporate account and transferred the proceeds away from Byron Capital.

## COMPLAINT

- In a letter dated June 22, 2011, Mr. B complained to Byron Capital saying:
  - his objectives at all times were the safety and security of his invested principal and the continuity of interest and/or dividend payments;
  - Bayshore Floating Rate Trust Units (Bayshore), Faircourt Split Trust Units (Faircourt), Flaherty and Crumrine Investment Grade Fixed Income Fund, Brompton Advantage Tracker, Top 10 Canadian Financial Trust, Farm Credit Corporation, and Merrill Lynch Financial Extendible Step-Up investments in his margin and corporate accounts were highly speculative and did not meet his investment profile;
  - he was never provided with detailed, printed information about these investments, and therefore, he was unaware of the complexity of the payment calculations, deferred sale charge (DSC) fees, management fees, trailer fees, etc. He also was not informed that these securities allowed for a possible suspension of regular payments, as in fact occurred.
- Mr. B requested compensation of $49,479 for losses in his corporate account and $54,265 for losses in his Canadian margin account.

## BYRON CAPITAL'S RESPONSE

- In a letter dated September 19, 2011, Byron Capital responded saying that:
  - Mr. W had been Mr. B's investment advisor since September 1989. Since 1989, Mr. B frequently requested investment position reports that Mr. W, or his staff, promptly provided;
  - in October 2010, Mr. W terminated his long-standing business relationship with Mr. B. On October 7, 2010, Mr. B emailed instructions to Mr. W to sell all of the securities in his accounts. The securities sold at a loss are now the subject of his complaint;
  - securities legislation requires Byron Capital to provide prospectuses for new issues to investors, which it did for Mr. B. Prospectuses describe the chief features of an investment so that investors can make informed decisions;
  - if Mr. B had a concern at the time he purchased the subject securities, he could have cancelled the transactions at no charge, or sold the securities thereafter;
  - the subject securities are consistent with Mr. B's overall investment objectives and, with the exception of Bayshore, the losses in the accounts were triggered by Mr. B's instructions to sell specific securities.
- Byron Capital did not offer compensation.

## OBSI ANALYSIS

In the course of our investigation, we reviewed materials received from Mr. B and Byron Capital. In addition to interviewing Mr. B regarding the complaint, we interviewed Mr. W and Mr. L, Byron Capital's former Chief Compliance Officer.

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

1. What were Mr. B's personal and financial circumstances, investment knowledge and experience, and what were the investment objectives and risk tolerance parameters for Mr. B's margin and corporate accounts?

2. Were the investments suitable and were the characteristics and risks appropriately disclosed?

3. If the investments were unsuitable, did Mr. B incur financial harm?

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

## Issue 1 – What were Mr. B's personal and financial circumstances, investment knowledge and experience, and what were the investment objectives and risk tolerance parameters for Mr. B's margin and corporate accounts?

### Personal and financial circumstances

- In March 2005, when Mr. B opened his corporate account at Byron Capital, he was 57 years old and worked in [redacted]. He also owned his own business providing general business consulting services. In July 2009, Mr. B opened a margin account. He was 61 years old at the time, was still employed with [redacted], and still operated his own business.

- Mr. B signed a New Client Application Form (NCAF) in March 2005 for the corporate account and a NCAF in July 2009 for his margin account which included the following information:

*Table 1: Corporate information on the March 21, 2005 NCAF*

| | |
|---|---|
| Type of business | [redacted] |
| Annual Earnings | $5,000 |
| Liquid Net Worth | $65,000 |
| Fixed Net Worth | $0 |
| Net Worth | $65,000 |

*Table 2: Personal information on the July 10, 2009 NCAF*

| | |
|---|---|
| Type of business | [redacted] |
| Occupation | [redacted] |
| Annual Earnings | $45,000 |
| Liquid Net Worth | $260,000 |
| Fixed Net Worth | $400,000 |
| Net Worth | $650,000+ |

- According to Mr. B, the corporate and personal income and net worth information on the NCAFs is accurate. He says that his personal assets consisted primarily of his mortgage-free home and the money in his personal investment accounts. We understand that he had investment accounts at firms other than Byron. He says that while his investment focus was always on receiving stable interest and/or dividend payments, he did not require the income from his investments to supplement his employment income.

### Investment experience and knowledge

- Both the March 2005 and July 2009 NCAFs show Mr. B's investment knowledge as "good" with experience investing in common stock, preferred stock, bonds, rights, warrants, RRSP and RRIF accounts, mutual funds and new issues.

- During our interview, Mr. B agreed that his investment knowledge was good. He said he had been investing for over 30 years, 20 years of which he had invested with Mr. W. He said he would discuss his investments with Mr. W anytime that an opportunity to buy or sell an investment arose. Mr. B said that he initiated the conversations 80% of the time because he was seeking investment recommendations from Mr. W on what to buy or sell in his accounts. During our interview, we found that he has a good understanding of investment concepts such as risk versus return, the effects of interest rate movements on income trusts and fixed income investments and the risk profiles of different asset classes.

- Byron Capital says that emails between Mr. W and Mr. B show that Mr. B has significant investment knowledge, put forward his own investment ideas and sometimes declined Mr. W's advice.

- We agree that the email correspondence we reviewed shows that Mr. B was in almost daily contact with Mr. W, that he closely monitored his accounts, that he was quick to identify any discrepancies in his holdings, interest and/or dividend payments and that he rejected some of Mr. W's investment recommendations. However, Mr. B's concerns and questions were almost always about the income stream of his investments and preference for monthly income payments. When Mr. B inquired about new investments opportunities, he had the knowledge to ask Mr. W the correct questions about their risks and structures, but we see no evidence that he independently verified the information Mr. W provided. Rather, it is clear based on the email evidence that Mr. B relied on Mr. W's description of the structure and risks of the investments he recommended without questioning it. Therefore, although we agree that Mr. B had good investment knowledge, we also believe that he relied on Mr. W to make investment recommendations and provide investment advice.

**Investment objectives and risk tolerance**

- Mr. B's March 2005 NCAF for the corporate account and the July 2009 NCAF for his margin account show his investment objectives and risk tolerance as follows:

*Table 3: Corporate investment objective and risk tolerance information on March 2005 NCAF*

| | |
|---|---|
| Investment Objectives | 100% Income |
| Risk Tolerance | 40% Low<br>60% Medium |

*Table 4: Personal investment objective and risk tolerance information on July 2009 NCAF*

| | |
|---|---|
| Investment Objectives | 75% Income<br>15% Long-term capital gains<br>5% Medium-term capital gains<br>5% Short-term capital gains |
| Risk Tolerance | 100% Medium |

- Mr. B says he was not a risk-taker and that his concern for both of his accounts was always the security of the principal and the continuity of interest and/or dividend payments. However, he also acknowledges that he understood the investments he was purchasing had some risk because he saw their values fluctuating and understood that his investments were not guaranteed.

- Mr. W agrees that Mr. B was not a high-risk investor and therefore, he would not recommend any investments to Mr. B above medium-risk. He says Mr. B wanted as much income as possible, within his risk profile, and always withdrew the income that was generated from his investments, leaving the principal invested.

- Email correspondence shows that when Mr. B and Mr. W discussed securities or strategies that Mr. W categorized as high-risk, Mr. B did not invest in them. For example, on November 8, 2005, when Mr. B suggested using his $170,000 line of credit to invest, Mr. W responded "I still am very hesitant about going into debt for investing (actually, borrowing money for investing by definition is NOT investing. It is speculating. Two very different terms)." Mr. B responded "ok" and never used borrowed money to invest. In another example, Mr. B emailed Mr. W on January 10, 2008 expressing curiosity about flow-through investments and whether flow-through pools (holding flow-throughs from various industries) bear less risk than industry-specific flow-throughs. Mr. W responded "Yes, with the pools, the 'risk' is spread out amongs (sic) many different companies. Either way, these types of investments are definitely considered high risk because of the nature of the investments." Based on this information, Mr. B did not invest in any flow-throughs.

- The parties agree that Mr. B was not interested in higher-risk investments and that his primary investment objective was to obtain the highest amount of monthly income within his risk tolerance. Therefore, we find the NCAFs accurately reflect Mr. B's risk tolerance and investment objectives for his corporate and margin accounts.

## Conclusion

Mr. B had good investment knowledge, monitored his accounts closely and was in frequent contact with Mr. W. Although Mr. B understands investment concepts such as risk versus return, interest rate effects and asset classes, he relied on Mr. W to provide investment recommendations and advice and generally only questioned Mr. W regarding the income amounts and payment frequencies of his investments.

Mr. B had stable and sufficient employment income and did not require additional income from his investments. Nevertheless, Mr. B and Mr. W agree, and the email evidence confirms, that Mr. B was primarily seeking income-generating investments and that he was not willing to invest in higher-risk securities. Therefore, we have assessed the suitability of his investments against the objectives and risk parameters documented on the NCAFs for each account.

### Issue 2 – Were the investments in the margin and corporate accounts suitable and were the characteristics and risks adequately disclosed?

**Suitability**

- Mr. B complained to Byron Capital saying that several investments in his margin and corporate accounts were highly speculative and were not suited to his objectives and risk tolerance parameters. In contrast, Byron Capital says that the securities in Mr. B's accounts were consistent with Mr. B's overall investment objectives.

- We conducted a detailed analysis of all the investments in Mr. B's corporate and margin accounts between March 2005, when Mr. B opened his corporate account and October 2010, when Mr. B closed his accounts at Byron Capital. Our analysis shows that Mr. B's margin account was suitably invested in income-oriented securities ranging from low- to medium-risk, in keeping with his 100% medium risk tolerance parameter.

- In the corporate account, Mr. B's investments were similarly income-oriented and in keeping with his income objective. In addition, for the most part, he held low- and medium-risk investments, with the lower-risk investments often representing the majority of his holdings. However, we found that two investments, Bayshore and Faircourt, were higher than medium-risk and too risky relative to Mr. B's 40% low and 60% medium-risk tolerance parameters. Further, the investments represented a material portion of the corporate account holdings at their purchase. In particular, at April 30, 2005, just after its purchase, Bayshore represented 32% of the corporate account holdings. At March 31, 2006, just after its purchase, Faircourt represented 9% of the corporate account holdings, and together Bayshore and Faircourt represented 18% of the account holdings at that time.

- Mr. W disagrees with our risk assessments of Bayshore and Faircourt. He says he classified them as medium-risk securities based on the risk analysis that he completed with Mr. L, Byron Capital's former Chief Compliance Officer. Mr. W, Mr. L, nor Byron Capital was able to locate copies of this original analysis. Byron Capital contends that OBSI discounted its medium risk assessment, simply because it could not provide documentary evidence of the original risk analysis. At our request Mr. L reconstructed the analysis in accordance with the information he says he would have considered at the time of the purchases. Mr. L says that he considered Faircourt and Bayshore to be medium-risk investments because:

    - they were both professionally managed by established investment managers;

    - the Bayshore portfolio was diversified and limited to "Senior Floating Rate Loans" with reasonable restrictions as to portfolio content. While he acknowledges there were provisions for considerable portfolio leverage, he believes “the potential risk exposure was mitigated…by the senior floating rate composition of the portfolio thus avoiding rate mismatch”; and,

  - the Faircourt portfolio was composed of a diversified portfolio of “Income Fund” and “dividend equity” securities and limited by reasonable investment restrictions including only exchange-listed securities and limited leverage ability.

- While we have carefully considered it, we cannot agree with Mr. L’s assessment of the risk profile of these securities. Specifically, according to its prospectus, Bayshore was an investment trust that provided exposure, via a swap agreement, to an underlying floating rate debt portfolio, on a 2:1 leveraged basis. The underlying debt portfolio consists primarily of adjustable-rate senior secured loans, but is not restricted to investment grade loans. In fact, the underlying portfolio could have consisted entirely of high-yield debt with a credit rating of BB or lower (commonly referred to as junk bonds).

- On its own, exposure to a portfolio of high-yield debt instruments could be considered medium-risk or higher. However, Bayshore was also allowed to operate with a debt-to-equity leverage ratio of approximately 2:1, or a total assets-to-equity ratio of 3:1, through the use of swaps. Since the underlying portfolio was already medium-risk or higher, the ability to leverage on a 2:1 basis made Bayshore a higher-risk investment.

- Consistent with our view, below we list a few of the risk factors outlined in the Bayshore prospectus:

  - Distributions: “There is no assurance that the Fund will be able to pay monthly distributions.”

  - Leverage: By adding additional leverage, there is the potential to enhance returns but it also involves additional risks. There can be no assurance that the leveraging strategy will enhance returns. The use of leverage may reduce returns (both distributions and capital) to unit holders. If the instruments in the floating rate portfolio suffer a substantial decrease in value, the leverage component will magnify the decrease in value of the Company Shares.

  - Investing in below investment grade loans: “Lower grade senior loans may be regarded as predominantly speculative with respect to the Borrower’s continuing ability to meet principal and interest payments.”

- According to its prospectus, Faircourt has a dual security structure offering preferred shares and capital units. Mr. B held only the capital units in his corporate account. As noted in the prospectus, the split structure of the trust means that holders of the capital units will be subject to a form of leverage such that any capital appreciation or depreciation in the portfolio will be magnified. At issuance, the capital units of

Faircourt had a leverage factor of 1.67[1]. In addition to the leverage inherent in the structure, Faircourt could also borrow up to 10% of the total assets. The Faircourt prospectus lists the risk associated with the leverage related to the structure of the investment and the leverage from the loan facility as primary risk factors for the capital units. In our view, Faircourt's underlying portfolio of "income fund securities" (meaning generally, income trusts) and dividend-paying equities may be medium-risk investments, but the leverage inherent in the split share structure and the potential for additional borrowing, increased the risk of the capital units of Faircourt to higher than medium.

- Consistent with his email to Mr. B of November 8, 2005 describing borrowing to invest as speculative, during our interview Mr. W acknowledged that leverage increases the risk of any investment because "it did not matter what investment a client invested in, as soon as you use leverage, it becomes high risk." In correspondence to OBSI during the course of our investigation, Byron Capital said "the use of leverage doesn't automatically make the investment high risk, but can add to the risk of an investment." It also said that the global credit crisis of 2008 exacerbated the risks of these investments and exposed investors to a greater risk of loss.

- While we agree with Byron that the use of leverage may not automatically make an investment high-risk, it does, in every case, magnify the potential for gain or loss. Since the underlying securities in both Faircourt and Bayshore were medium-risk or higher, we find it clear that the use of leverage increased their risk level above medium.

- Byron Capital also says a portfolio that blends investments at various risk levels can meet an investor's risk tolerance parameters. It says a risk assessment should be made on the combined holdings, not individual securities. It also argues that Faircourt and Bayshore only represented slightly over 10% of the capital deployed in the account.

- We accept that it may be possible to employ a portfolio approach when selecting investments such that the overall account meets the client's risk tolerance and investment objectives. However, Byron Capital has no evidence to support its claim that Mr. W employed a portfolio approach or that this approach was communicated to and agreed upon by Mr. B. Byron Capital's NCAFs require its clients and advisors to allocate a specific percentage to low, medium or high risk categories. Mr. B's NCAFs did not indicate any allocation or tolerance for higher-risk investments and all the parties agree that Mr. B did not want higher-risk investments. In all of the circumstances, we do not find that the higher-risk investments can somehow be considered suitable in the context of the overall holdings. Rather, we conclude that Bayshore and Faircourt were too risky and unsuitable for Mr. B's corporate account.

[1] Net Assets Per Unit = 25; Redemption Value/Preferred Share = 10; Market Price/Capital Share = 15; Leverage Factor = 1.67 (Net Assets Per Unit/Market Price)

**Disclosure**

- Mr. B had experience investing in treasury bills, commercial paper, income trusts and preferred shares and did not require a high level of disclosure for additional purchases of these types of investments. However, Bayshore and Faircourt were more complex, structured products that used derivatives and leverage. Mr. B had no experience investing in derivatives or with leverage.

- During our interview, Mr. B said he did not receive printed information or prospectuses about Bayshore or Faircourt, from Mr. W or Byron Capital in advance of the purchases, and therefore, he was not able to make a "relatively intelligent decision." He says Mr. W told him about the payment amounts and frequencies but he was unaware of the complexity of the payment calculations and the possibility of payment suspensions. He says that the only information he recalled receiving was the proxy statements and annual reports that are sent to shareholders.

- During our interview, Mr. W said that he did not keep client file notes of any of his discussions with Mr. B, but he was sure Mr. B would have received prospectuses from him before every purchase of a new issue. He says that the standard process at Byron Capital was to order a supply of prospectuses from issuers to give to clients before a purchase. He says that if Mr. B reviewed the prospectus after they discussed a recommendation, there was a 50/50 chance that he would change his mind and decide against making a purchase. Mr. W says clients would also receive another copy of the prospectus directly from the issuer after the purchase. In particular, Mr. W recalls that he gave a Mr. B a Faircourt prospectus.

- It is likely that Mr. B received the prospectuses for Bayshore and Faircourt, if not before, certainly after their purchase. However, while Mr. W says Mr. B changed his mind after reading the prospectus 50% of the time, the emails exchanged between Mr. W and Mr. B do not indicate Mr. B ever changed a decision to invest based on reading a prospectus. The emails show that Mr. B always relied on Mr. W to provide information pertinent to each investment. Based on all the evidence, we believe that Mr. W knew or should have known that Mr. B did not read prospectuses but instead relied on Mr. W's description of investments risk and features.

- Mr. W says in addition to giving Mr. B a Faircourt prospectus, he also explained that Faircourt had a split share structure. However, there is no reference in the email exchange about the leverage inherent in the capital units. In particular, in an email exchange on February 28, 2006, Mr. W presented the opportunity to invest in Faircourt because it was an "excellent vehicle" and that the issuer had done several issues in the past that had done "extremely well." In the email, Mr. W says "Units hold a pool of trusts and Faircourt is split between capital units (initially paying 7.25% on a monthly basis) and preferred shares, paying a 5.75% dividend." Mr. B replied asking for additional information about the split between the capital units and preferred share units and if he should buy Faircourt as a replacement for other investments. Mr. W responded by explaining that the capital units would pay 7.25%

monthly and these payments would be largely a return of capital. Mr. W recommended purchasing the capital units with the cash balance in the corporate account.

- In addition, although Mr. W accurately explained to us in our interview that a decline in Faircourt's underlying portfolio value would be at the expense of the capital units, his February 28, 2006 email to Mr. B did not disclose this additional risk over the preferred shares. Mr. W also inaccurately explained to Mr. B that Faircourt's distributions would be largely return of capital when the prospectus says distributions would be a mixture of taxable income, dividends and capital gains and non-taxable return of capital.

- Byron Capital was not able to provide emails dated before July 2005 because it has changed email providers. Since the purchase of Bayshore occurred in March 2005, we were unable to review any email correspondence about the Bayshore purchase. In our interview, Mr. W said he could not recall what he discussed with Mr. B before he bought it.

- Mr. W did not maintain client file notes and we find insufficient evidence that the risks of Bayshore and Faircourt were adequately disclosed. Further, since Mr. W and Byron Capital say they rated these investments as medium-risk, we cannot conclude that Mr. W would have advised Mr. B that these were in fact higher-risk investments. As discussed above, while Mr. B often questioned Mr. W about the investments he recommended, he relied on Mr. W to answer any questions and there is no evidence that Mr. B conducted his own research on Faircourt or Bayshore to independently verify the information Mr. W provided. Further, even if Mr. B received the prospectuses, Bayshore and Faircourt were complex structured products and he had never invested in derivatives or leveraged investments before. We find it reasonable that he would have relied on the information he received from Mr. W about these investments.

## Conclusion

Bayshore and Faircourt were higher-risk securities and were unsuitable for Mr. B's corporate account given his 40% low and 60% medium risk tolerance parameters and the fact that he did not want to invest in anything above medium risk. Mr. W assessed Bayshore and Faircourt as medium-risk when they are higher-risk investments and we see no evidence to show that Mr. W fully or adequately explained the risks of these investments to Mr. B. In the circumstances, we do not believe Mr. B's knew of or accepted this higher level of risk.

### Issue 3 – If the investments were unsuitable, did Mr. B incur financial harm?

- On April 18, 2005, Mr. B invested $21,000 in Bayshore. On March 16, 2006, he invested $22,500 in Faircourt. Both were purchased in his corporate account. He received $5,152 and $4,153 in total monthly distributions, respectively. On March 27, 2009, his Bayshore shares were redeemed by the issuer for $895 and on October 31, 2010, Mr. B sold his Faircourt shares for $7,118. Therefore, his total loss on these investments $26,182 [(895 + 7,118, + 5,152 + 4,153) – (21,000 + 22,500)].

- To determine if Mr. B incurred financial harm, we compared his loss on the Bayshore and Faircourt investments to the returns on suitable investments. In our calculations, we used the S&P TSX 60 Total Return index to represent suitable medium-risk dividend/income-producing investments. Since Bayshore and Faircourt were actively managed trusts, we reduced the performance of the index by an active management fee of 1.00%. Our calculations show that instead of losing $26,182, suitable investments would have gained $13,851. Therefore, Mr. B incurred financial harm of $40,033 ($26,182 + $13,851) in his corporate account.

### Conclusion

Mr. B incurred a financial harm of $40,033 due to Mr. W's unsuitable Bayshore and Faircourt recommendations.

### Issue 4 – Who bears responsibility for Mr. B's financial harm, if any?

**Vicarious Liability**

- The caselaw 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 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 this case, Mr. W recommended unsuitable investments to Mr. B. While Byron Capital is vicariously liable for financial harm Mr. B incurred as a result of Mr. W's unsuitable recommendations and lack of disclosure, we also considered whether Mr. B bears any responsibility for his losses.

**Client Responsibility**

- Byron Capital says there is evidence in the emails that Mr. B was quick to point out any errors in the analysis provided by Mr. W and that he raised questions regarding his investments. Byron Capital also says that Mr. B has some idea of risk, and if Bayshore and Faircourt were outside of his risk tolerance, he could have raised this as an issue or could have instructed Mr. W to sell these positions, or any other position for that matter, in his accounts. Mr. W also says that about a year or a year and a half after purchasing Bayshore in 2005, he recommended that all of his clients sell it. He says all of them, except Mr. B, agreed and sold. For these reasons, Byron believes that Mr. B should be responsible for the losses he incurred on Bayshore and Faircourt.

- Mr. B received his account statements and trade confirmations and, during our interview acknowledged that he read them. Mr. B and Mr. W exchanged emails frequently and it is clear that Mr. B watched all of his investments closely. Mr. W also provided regular cash flow statements, rates of return and income information on all of Mr. B's accounts. However, as discussed above, Mr. B's primary concern was always the amount and frequency of his income distributions and his questions were generally centered around these elements. Mr. B received all monthly distributions for Bayshore and Faircourt until the fall of 2008. Therefore, although he watched his statements closely and knew when an income payment was missed, he relied completely on Mr. W for information about the structure and risks of his investments. Since there was never a missed payment from Bayshore and Faircourt until October 2008, there was no reason that Mr. B would have suspected that the information Mr. W provided about each was inaccurate and that they were in fact more risky than Mr. W had indicated.

- We agree that Mr. B understands the concept of risk and that large fluctuations may have alerted him to problems with his investments. Bayshore and Faircourt's prices remained fairly stable until 2008 and their distributions were consistent until they were discontinued in the fall of 2008. On this basis, it is reasonable that Mr. B would have trusted Mr. W's description of these investments as being medium-risk until then. On November 14, 2008, Mr. B promptly took appropriate steps to mitigate his losses by asking Mr. W if he should sell both investments. Mr. W advised him to continue holding and Mr. B followed his advice as always.

- Mr. W suggests he recommended Mr. B sell Bayshore a year or a year and a half after he purchased it. Mr. B disagrees and says that Mr. W never recommended selling Bayshore. Mr. W does not have any notes to substantiate his discussion with Mr. B. Byron Capital provided a transcription of Mr. W's contact records which indicate in general that Bayshore sales were made in December 2006 and April 2007, but the text of the notes is not specific to any particular client, are in past tense and appear to have been added after the fact. In addition, Byron Capital's trade blotters show that only two of thirteen clients sold their Bayshore shares in December 2006 and three of eleven sold in April 2007, which does not support Mr. W's claim that all of his clients, except Mr. B, sold their Bayshore shares. We also do not find any references to Mr. W's recommendation to sell Bayshore in the emails exchanged between Mr. W and Mr. B. Finally, in its response to OBSI's settlement proposal, Byron Capital says that Mr. B was interested in selling his investments at or above original cost, but never at a loss. While Mr. B may not have wanted to sell investments at a loss, we cannot conclude that he was advised to sell Bayshore. In fact, email evidence in April 2007 shows that Mr. W was advising Mr. B not to change anything in his corporate account. For these reasons, we cannot conclude that Mr. B made an independent decision to hold Bayshore contrary to Mr. W's advice.

## Conclusion

Byron Capital is responsible for the financial harm Mr. B incurred as result of Mr. W's unsuitable recommendations. Mr. B did not know about the risks or characteristics of Bayshore or Faircourt when he purchased them and there was nothing about their performance that would have caused him to be concerned until the fall of 2008 when their prices had fallen considerably and the distributions were discontinued. In November 2008, Mr. B asked Mr. W's advice on whether to sell Bayshore and Faircourt or continue to hold and Mr. W recommended that he continue holding. In all of the circumstances, we cannot find a basis to attribute responsibility for his losses to Mr. B.

## 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 Byron Capital compensate Mr. B $40,033 plus $1,116[2] in interest, for total compensation of $41,149.

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[2] Interest is calculated using the average 3-month Canadian Treasury Bill yield of 0.94% (as calculated by the Bank of Canada) compounded annually from the date of the complaint to the date the report is final.