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CONFIDENTIAL &
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INVESTIGATION REPORT

Date: March 20, 2014
Clients: Mr. H and Ms. W
Firm: Monarch Wealth Corporation (Monarch)

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INVESTIGATION SUMMARY

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<tr><td>Investment Advisor:</td><td colspan="2">▪ Mr. Z</td></tr>
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<tr><td>Period:</td><td colspan="2">▪ December 2007 to March 2010</td></tr>
<tr><td>Key Conclusions:</td><td colspan="2">▪ Mr. Z implemented a leverage strategy for Mr. H and Ms. W at another investment firm. The leverage strategy was unsuitable for Mr. H and Ms. W when it was implemented and was even more unsuitable by the time their accounts were transferred to Monarch.
▪ Mr. H and Ms. W had very limited investment knowledge and did not understand the risks of leveraged investing. They trusted and relied on Mr. Z's advice and his assurances that they would not lose any money.
▪ Monarch is responsible for 50% of the financial harm Mr. H and Ms. W suffered as a result of the leverage strategy.</td></tr>
<tr><td>Recommendation:</td><td>$51,454
$7,782
$2,021
$61,257
$30,628</td><td>Financial harm to March 2010
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Interest
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STANDARD OF REVIEW

OBSI is obligated to assess and resolve complaints using a fairness standard, as set out in OBSI's Terms of Reference:

> The Ombudsman shall make a recommendation or reject a Complaint with reference to what is, in the Ombudsman's opinion, fair in all the circumstances to the Complainant and the Participating Firm. In determining what is fair, the Ombudsman shall take into account general principles of good financial services and business practice, law, regulatory policies and guidance, professional body standards and any relevant code of practice or conduct applicable to the subject matter of the Complaint.

While OBSI considers the rules and standards developed by other bodies, including regulatory bodies like the Investment Industry Regulatory Organization of Canada (IIROC) and the Mutual Fund Dealers Association of Canada (MFDA), the focus for OBSI is on what is fair between the parties in the particular circumstances. Therefore, OBSI's conclusions will not necessarily be the same as conclusions drawn by another body bound by specific rules or subject to a different standard.

OBSI member firms are the parties to complaints made by their clients. As such, any recommendations we make are made against the firms, not against the individual advisors employed by the firms. While we can and do generally rely on the law of vicarious liability for the relationship between firms and the individual advisors, the general fairness standard in our mandate and the fact of membership in OBSI is the basis upon which our recommendation is made.

OVERVIEW

Ms. W met her and her husband's investment advisor, Mr. Z, in 2006 through her church. They share the same cultural background and she trusted him given their shared church affiliation.

In 2007, when Mr. Z was at another firm, he recommended that Mr. H and Ms. W borrow money to invest (referred to as leveraged investing or a leverage strategy). Mr. H and Ms. W told Mr. Z they were not interested because they were about to purchase their first home and have their first baby. Nevertheless, in the summer of 2007, Mr. Z implemented the strategy. Mr. Z told Mr. H and Ms. W that he processed the loans and investments by mistake and that things could not be undone without them incurring costs. He also assured them they would not have any losses.

In December 2007, after Mr. Z changed firms, the leveraged investments were transferred from Mr. Z's previous firm to Monarch. Mr. H and Ms. W say they did not know about the transfer and did not sign any forms for the transfer. We find the signatures on the transfer forms are not consistent with the signatures on their driver's licenses. Similarly,

information on other forms, including new account applications and loan documentation is inaccurate and there are signature irregularities on these documents as well.

In any event, given their personal and financial circumstances, the leverage strategy was unsuitable, both before and at the time they transferred to Monarch. Mr. H and Ms. W have very limited investment knowledge and minimal investment experience and they did not understand the risks of leveraged investing. Although they had material changes in their personal and financial circumstances in 2007 (they purchased a house and Ms. W went on maternity leave), Mr. Z did not review the leverage strategy or advise Mr. H and Ms. W that the leverage strategy was unsuitable when their accounts transferred to Monarch. Rather, he continued to reassure them that they would not incur any losses. In addition, although Monarch received complaints from other clients involving Mr. Z about unauthorized transactions, including leveraged investment transactions, falsified signatures, and inaccurate documents, Monarch did not contact Mr. H or Ms. W about their accounts. If either Mr. Z or Monarch had taken these reasonable steps, they could have advised Mr. H and Ms. W to unwind the strategy with no, or very little, loss. By failing to do so, they caused Mr. H and Ms. W to incur financial harm.

For the reasons outlined in this report, we conclude that Monarch should compensate Mr. H and Ms. W for 50% of the financial harm they incurred on the leverage strategy.

BACKGROUND

- Mr. H and Ms. W say they came to Canada from China in 2001 and had no family or friends here at the time. They say they studied computer science and computer engineering at university and took English courses because their English was poor. They say they had no investment experience and were living on student loans until they graduated in 2005 and started working.

- Ms. W says she first met Mr. Z, and his assistant, Ms. S, in 2006 at a church they all attended. She says she initially started going to church to meet new people and make friends. She says that in September 2006, Mr. Z and Ms. S introduced her to a charity donation program to claim tax credits.

- Mr. H and Ms. W got married in December 2006.

- Mr. H and Ms. W say that Mr. Z and Ms. S came to their apartment in March 2007 to prepare their tax returns. They say that during this meeting, Mr. Z discussed borrowing to invest, which is often referred to as leveraged investing or a leverage strategy.

- Mr. H and Ms. W say they were not interested in the leverage strategy because they were planning to purchase their first house and were expecting a baby. They say Mr. Z and Ms. S asked them to sign blank forms (including loan application forms) in case they wanted to proceed with the strategy at a later date. They say they signed the blank forms because it was getting late and they wanted Mr. Z and Ms. S to leave their apartment. Mr. H and Ms. W say they called Mr. Z and Ms. S shortly after and told them to discard the forms. Mr. Z and Ms. S assured them not to worry saying nothing could be done without their consent.

- Mr. Z became registered as an investment advisor at Firm A Investments Inc. (Firm A) on or about May 7, 2007.

- In May and July 2007, a $100,000 investment loan with Trustco #1 was taken out in Ms. W's name and two $50,000 investment loans, one with each of Trustco #1 and Trustco #2, were taken out in Mr. H's name. The proceeds of the loans were invested in AGF Management Ltd. (AGF) and Stone & Co. Limited (Stone & Co.) mutual funds. "Mr. MS" was listed as the advisor on the applications. However, Mr. H and Ms. W say they never met Mr. MS and do not know who he is.

- On or about June 29, 2007, Mr. Z transferred his registration from Firm A to Monarch.

- In July 2007, Ms. W started seeing some irregular transactions in her bank account. She contacted her bank and was told the transactions were from a loan and a mutual fund company. Mr. H and Ms. W say they contacted Mr. Z who said the loans had been accidentally processed due to a miscommunication with Ms. S, but if they

cancelled them, they would have to pay large redemption charges. They say Mr. Z assured them that the investments would increase in value or he and Ms. S would cover any losses.

- On December 7, 2007, Request for Dealer Change forms and New Account Application Forms (NAAFs) were completed to transfer Mr. H and Ms. W's AGF and Stone investments to Monarch with Mr. Z. The investments had a market value of $205,380 at the time. Mr. H and Ms. W say that the signatures on the transfer forms and the NAAFs were forged and that they did not know about the transfer to Monarch until some time later.

- Mr. H and Ms. W say they did not receive investment or loan statements until after they called the "loan and mutual fund companies" in December 2007. They learned that the address the mutual fund companies had on file was their apartment where Mr. Z and Ms. S had visited them in March 2007 when the blank forms were signed, but Mr. H and Ms. W had moved in May 2007. They gave the companies their new address and began receiving account statements in January 2008.

- Mr. H and Ms. W say that during the market decline of 2008, they contacted Mr. Z and Ms. S again with their concerns about the leverage strategy and again Mr. Z and Ms. S assured them the investment values would recover or they would cover any losses.

- Ms. W says she received a letter from Canada Revenue Agency (CRA) in August 2009 stating that the charitable donation program in which she participated in 2006 was not legitimate and she was asked to repay $8,731. Mr. H and Ms. W say they contacted Mr. Z about it and he came to their house with a letter for them to send to CRA stating that they did not agree with its findings and wanted to appeal. They say they decided to pay CRA in the meantime because they did not want to incur further interest charges in case they lost their appeal.

- Mr. H and Ms. W say that in September 2009 they received a letter from Stone & Co. stating that one of the funds they were invested in was switching from Series B to Series T8. They say they contacted Mr. Z to ask him what the letter meant and that he told them the return of capital from the previous fund was too high and their capital had decreased a lot, but not to worry. Mr. H and Ms. W say it was at this point they realized they did not understand the investment structure or return. Mr. H and Ms. W say they became very concerned and were suspicious about Mr. Z's advice and actions after receiving the letters from CRA and Stone & Co.

- Mr. H and Ms. W say that in October 2009, Mr. Z and Ms. S came to their house and asked them to sign transfer forms because they were moving to another firm. They say this was the first time they realized their accounts were held at Monarch. Before this, they thought they were just dealing with Mr. Z and Ms. S and did not understand they were associated with an investment dealer (Mr. H and Ms. W did not receive Monarch account statements because Monarch had their previous address on file.

Since they did not know about Monarch, they did not contact it with correct address information). Mr. H and Ms. W say they refused to sign the transfer forms in October 2009. At this point, they were very concerned and called Trustco #1 and Trustco #2 to ask for copies of their application forms. When they received copies of the documents they realized their signatures had been forged on some documents and others had been changed without their knowledge and were inaccurate.

- In March 2010, Mr. H and Ms. W transferred their accounts away from Monarch. Their investments had a market value of $158,724 at the time.

COMPLAINT

- In an email dated February 2, 2010, Mr. H and Ms. W complained to Monarch saying:
  - they did not authorize the $200,000 worth of investment loans. They signed some blank forms. Other signatures were forged and the documents were altered and inaccurate. They could not afford the loans given their personal and financial situation;
  - they never filled out any KYC documents and their financial goals were never discussed;
  - they had no idea about the interest on the loans or how the loan proceeds would be invested. They believe the investments were extremely high risk;
  - they only ever met with Mr. Z and Ms. S. They never met Mr. MS, who signed the Firm A documents as their advisor; and,
  - they did not complain sooner because Mr. Z promised to cover any losses and because he acknowledged accidentally processing the loans without their authorization.
- Mr. H and Ms. W asked for an explanation of what happened and for unspecified financial compensation.

MONARCH'S RESPONSE

- In a letter dated May 28, 2010, Monarch responded saying:
  - all of the loans were processed through another financial institution. Therefore, it cannot address whether Mr. H or Ms. W agreed to borrow money to invest or whether they received proper risk disclosure at the time. However, they signed leverage risk disclosure documents when they transferred their accounts to Monarch in December 2007;

  - it compared the allegedly falsified signatures to those considered to be authentic but is unable to validate Mr. H and Ms. W's concerns about forged signatures;
  - the leverage strategy and investments are suitable given Mr. H and Ms. W's stated KYC parameters; and,
  - they had investment losses, but in the context of the global market decline, the investments performed relatively well.

- Monarch did not offer compensation.

OBSI ANALYSIS

In the course of our investigation, we reviewed documents received from Mr. H and Ms. W and from Firm A and Monarch. In addition to interviewing Mr. H and Ms. W regarding the complaint, we interviewed Ms. B, Monarch's Chief Compliance Officer. We were unable to interview Mr. Z as he is no longer registered in the industry.

Mr. H and Ms. W complained that Mr. Z and Ms. S asked them to sign blank forms for leveraged investing and that the forms were processed without their authorization. They also say they did not authorize the transfer of their accounts from Firm A to Monarch. They say their signatures were forged and various documents were altered and/or inaccurate. We reviewed the documents and we find that the signatures are significantly different than the signatures on their driver's licenses and on the forms they acknowledge signing. The documents also include inaccurate personal information such as their address, occupation, marital status, income, assets, and liabilities. On the balance of evidence, we accept Mr. H and Ms. W's contention that some documents were falsified and that they did not authorize the implementation of the leverage strategy nor the transfer of their investments to Monarch. Nevertheless, since the strategy was in place when Mr. Z transferred the leveraged investments to Monarch, we have focused our investigation on the following key issues in respect of Mr. H and Ms. W's complaint:

1. Was the leverage strategy suitable?

2. If not suitable, did Mr. H and Ms. W incur financial harm?

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

Issue 1 – Was the leverage strategy suitable?

- Monarch's 2007 Leverage Suitability Guidelines indicate that an investor should have:

  - a net worth at least two times the borrowed amount;
  - sufficient net income to service debt payments;
  - a minimum investment time horizon of five years, but preferably 10 years or more;
  - at least good investment knowledge, but preferably sophisticated; and
  - a minimum risk tolerance of medium, but preferably high.

- In 2007, many dealer policies on leverage suitability included similar guidance regarding net worth as an affordability measure but expressed a different way. Dealer policies often said that investors should not borrow to invest more than 50% of their net worth. Regarding income, many dealers used the guideline that clients should not borrow to invest if the loan payments would cause their total debt service ratio (TDSR) to go beyond 35%. TDSR is the percentage of an investor's gross income dedicated to making debt payments. We used 50% net worth and 35% TDSR measures for our suitability analysis.

- Since Monarch's leverage suitability guidelines are not as specific as typical industry guidelines were at the time, we have used both Monarch's and the typical industry guidelines in our leverage suitability assessment.

Personal and financial circumstances

- When Mr. H's and Ms. W's investments were transferred to Monarch in December 2007, Mr. H was 39 years old and Ms. W was 33 years old. They had their first baby in October 2007 and purchased their first home in May 2007. Ms. W was on a one-year maternity leave from her employment as a software engineer. Mr. H was employed as an IT consultant.

- Mr. H and Ms. W's December 2007 Monarch NAAFs, which they say they did not sign, stated their incomes as $50,000 - $100,000 each. Mr. H's CRA Notices of Assessment show his 2006 total income as $27,320 (his first year of employment) and his 2007 total income as $24,999. Ms. W's CRA Notices of Assessment show her income as $51,705 in 2006 when she first started working and $48,797 in 2007. Using their 2006 income information (since the 2007 tax year was not yet complete in December 2007 when the accounts were transferred to Monarch), they had a combined monthly gross income of $6,585 (($27,320 + $51,705) / 12). However, Ms. W went on maternity leave for a year in October 2007 and her income was reduced to monthly Employment Insurance (EI) payments of approximately $1,625. As a result, their combined monthly income in December 2007 was approximately $3,902 (($27,320 + $19,500) / 12).

- On the December 2007 Monarch NAAFs, Mr. H and Ms. W's net worth is listed as $200,000 - $500,000. They have provided us with documents including bank statements, mortgage statements, and investment statements, which show their combined net worth was approximately $200,000. Specifically, as of December 2007, they had total assets of approximately $684,606 and total debt of approximately $484,993. Their assets included their $400,000 home, which they purchased in May 2007, vehicles worth $12,000, RRSP investments worth $18,575, the leveraged investments worth $205,381, other non-registered investments worth $38,650, and $10,000 in cash. Their debts included a $284,993 mortgage and $200,000 in investment loans. The mortgage payments were $1,816 per month and the investment loan payments totaled $1,094, for total monthly debt payments of $2,910.

- If we consider Ms. W's full income, we calculate Mr. H and Ms. W's TDSR as being approximately 44% ($2,910 / $6,585), materially in excess of the 35% guideline used by many dealers at the time. The situation is even more serious when we consider that Ms. W was on maternity leave when their leveraged investments were transferred to Monarch. We calculate Mr. H and Ms. W's TDSR as 75% ($2,910 / $3,902) in the one-year period from October 2007 when Ms. W was on EI. Their TDSR would be even higher if property taxes and other housing costs are included in the TDSR calculation in keeping with typical lending practices.

- Further, we calculate that Mr. H and Ms. W had borrowed to invest an amount equal to 100% of their net worth (($200,000 / $200,000) * 100), far in excess of both Monarch's and typical industry guidelines at the time. Moreover, a large portion of their assets was in their home and was illiquid. Mr. H and Ms. W had non-leveraged, liquid assets of approximately $48,650 ($10,000 in cash and $38,650 of other non-registered investments), far less than would be required to pay off the $200,000 in leverage loans if the strategy failed.

- Our calculations show the leverage strategy was unsuitable for Mr. H and Ms. W when their accounts were transferred to Monarch in December 2007. With very little in cash and non-registered savings, they could not afford to repay the leverage loans if the strategy failed without jeopardizing their new home and their financial stability. Further, Mr. Z knew or should have known that Mr. H and Ms. W had started a family and had purchased a house by December 2007. Therefore, it would have been reasonable for him to know that their household income had temporarily decreased with Ms. W's maternity leave while their expenses had and/or would increase for mortgage, property tax, child care and other family related expenses. There is no evidence that Mr. Z evaluated the affordability of the leverage strategy.

Investment experience and knowledge

- The Monarch NAAFs indicate Mr. H and Ms. W had good investment knowledge.

- Mr. H and Ms. W say they did not have any investment experience when they moved to Canada and that it was only after they started working in 2006 that they started

saving some money, purchased GICs and made some RRSP contributions which were invested into GICs and mutual funds. At most, they had held GICs and mutual funds for approximately 18 months before the leverage strategy was implemented and two years before the leveraged investments were transferred to Monarch.

- Mr. H and Ms. W say they never took any investment-related courses. Rather, they studied computer science and computer engineering in university and work in the information technology field.
- From our conversations with Mr. H and Ms. W, we find they had minimal investment knowledge. They cannot describe and do not understand what sort of mutual funds they held or how risky they were. They say they assume they were risky because they lost a lot of money on them. They say they did not understand their investment statements when they first began to receive them and they had to contact Trustco #2 to get help with reading them. They say they only knew to contact Trustco #2 because someone at their bank told them about the "loan and mutual fund" companies when Ms. W saw unusual transactions in her bank account. Further, they do not understand the characteristics or risks of the leverage strategy and even now, with first-hand experience with losses on the leverage strategy, they cannot accurately describe how investment gains or losses are magnified by borrowing to invest.
- They say they met Mr. Z through Ms. W's church and he is of the same cultural background. They say they trusted him when he said the strategy would perform well and assured them that they would be reimbursed for losses, if any.
- Given Mr. H and Ms. W's minimal investment experience and based on our interviews with them, we conclude they had, and still have, very limited investment knowledge, well below Monarch's leverage policy parameter for a minimum of good, but preferably sophisticated investment knowledge. Mr. H and Ms. W did not understand the risks associated with the leverage strategy and trusted Mr. Z and Ms. S, relying on their advice and reassurances. Mr. H and Ms. W's trust and reliance on Mr. Z and Ms. S was reasonable, particularly given their relationship through their church. To Mr. H and Ms. W, Mr. Z was the investment professional and in their circumstances they were justified in believing that the advice and assurances Mr. Z or Ms. S provided were accurate and appropriate, and they could rely on them without needing to verify them.

Investment Objectives, Risk Tolerance and Investment Time Horizon

- The Monarch NAAFs indicate that Mr. H and Ms. W had long-term growth investment objectives and a high risk tolerance.
- Mr. H and Ms. W disagree. They say they had no investment objectives and were not willing to take any risk. They say they were not interested in pursuing the leverage strategy and did not intend to implement it. Rather, in 2007 they were expecting their first child and were planning to buy a house. In fact, they purchased their first home

in May 2007 and had their first baby in October 2007, shortly before their accounts were transferred to Monarch. Mr. H and Ms. W say they never discussed investment objectives or risk tolerance with Mr. Z.

- Although they were young and arguably had a long-term investment time horizon before they would retire, Mr. H and Ms. W were just starting a family and their financial position was not well established. They had a modest family income, increasing expenses and limited assets. In these circumstances, while it might have been reasonable for them to invest for long-term growth, we find it clear that they could not afford to take a high degree of risk and could not tolerate the potentially large losses the leverage strategy posed if it failed.

- Monarch points to leverage risk disclosure documents it says were signed when the accounts were transferred in. However, the signatures on the Monarch leverage risk disclosures appear to us to be significantly different from Mr. H and Ms. W's actual signatures. In addition, it is questionable whether Mr. H and Ms. W received adequate leverage risk disclosure when their investment loans were initially taken out through Firm A, particularly since Mr. H and Ms. W say that Mr. Z admitted to them that the loans were processed by mistake. In all of the circumstances and given their very limited investment knowledge, we do not believe they understood the risks associated with leveraged investing.

- Finally, as noted earlier, Mr. H and Ms. W say they were not given and did not sign the Monarch NAAFs and that their signatures were forged. In all of the circumstances, we conclude that Mr. Z completed their NAAFs to reflect the risk of the leverage strategy he continued at Monarch rather than their actual willingness or ability to tolerate risk.

Conclusion

Mr. H and Ms. W met none of Monarch's or the investment industry's typical guidelines for leveraged investing. They did not have sufficient income to pay the loan interest and they did not have sufficient net worth or liquid net worth to pay off the leveraged investment loan if the strategy failed. They also did not have sufficient knowledge or experience to appreciate the risks of the leverage strategy, and their personal and financial circumstances were such that they could not afford or tolerate its risks. For these reasons, we find Mr. Z's recommendation, whether explicit or implicit, to continue the leverage strategy at Monarch was unsuitable.

Issue 2 – If not suitable, did Mr. H and Ms. W incur financial harm?

- Mr. H and Ms. W's accounts were transferred to Monarch in December 2007. They transferred their accounts away from Monarch in March 2010. As shown in Table 1 below, we calculate their investment losses and the interest on the investment loans caused them financial harm of $51,454 from transfer in to transfer out.

Table 1: Calculation of losses on leverage strategy to transfer out

	Mr. H	Ms. W	Combined
Transfer-in Value	$97,862.25	$107,519.17	$205,381.42
Less: Distributions paid in cash	$15,391.77	$105.05	$15,496.82
Less: Transfer-out Value	$72,131.45	$85,753.97	$157,885.42
Net Investment Losses	$10,339.03	$21,660.15	$31,999.18
Plus: Interest on the investment loans	$9,012.85	$10,441.68	$19,454.53
Financial harm	**$19,351.88**	**$32,101.83**	**$51,453.71**

- Mr. H and Ms. W say that when they transferred away from Monarch, they could not afford to pay the difference between the investment and the loan values and the deferred sales charge (DSC) fees they would incur to sell the investments. Nevertheless, by this time, Mr. H and Ms. W understood they had a problem with Mr. Z's recommendations, even if they could not accurately characterize it, and it would have been reasonable for them to have sold the investments and paid down the loans to limit further costs and losses.

- If Mr. H and Ms. W had sold the investments and paid down the loans in March 2010 they would have been left with loan balances totalling approximately $50,467 ($198,352 approximate remaining loan balances - $157,885 investment values + approximately $10,000 in DSC fees). After March 2010, Mr. H and Ms. W would have continued to owe interest on the remaining loan balance which they should not have incurred. We estimate the continuing interest payments represent $7,782[1] in additional financial harm to March 2014 as a result of the leverage strategy, for total financial harm of $59,236 ($51,454 + $7,782)[2]

Conclusion

When Mr. H and Ms. W's accounts were transferred to Monarch, Mr. Z should have known that borrowing to invest was not suitable for them and recommended that they collapse the strategy. By failing to do so, he caused them to incur financial harm of $58,984 on the leveraged investment.

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[1] Calculated as [(0.75*4.5% interest on Trustco #1 loan) + (0.25%*3% interest on Trustco #2 loan)] from March 31, 2010 to September 1, 2012 + (3% interest on consolidation of Trustco #1 and Trustco #2 loans at Bank #1) from September 1, 2012 to March 20, 2014*$50,467 remaining loan balance if investments had been redeemed in March 2010].

[2] Interest paid on the outstanding loan balances net of the investment values at transfer out in March 2010 will be calculated to the date this report becomes final. Therefore, this amount will change.

Issue 3 – Who bears responsibility for the 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. Z, a Monarch advisor, transferred in and, whether explicitly or implicitly, recommended continuing a leverage strategy in Mr. H and Ms. W's accounts which he knew or should have known was unsuitable. The strategy caused financial harm for which Monarch is responsible.

Suitability Review

- In the course of our discussions with Monarch to resolve this matter, Monarch said that in December 2007, when Mr. H and Ms. W's accounts were transferred in, MFDA rules did not require it to ensure the suitability of the investments or leverage strategy. Therefore, it contends it is not responsible for the suitability of the strategy for Mr. H and Ms. W or the losses caused by it.

- However, Mr. Z was aware that the investments were leveraged and he knew or should have known that Mr. H and Ms. W's circumstances had materially changed since July 2007 when the strategy was implemented, likely without their consent or authorization. We find it would have been fair and reasonable for him to have reviewed the suitability of the strategy at the time of the transfer to Monarch and to have advised Mr. H and Ms. W that it was not suitable given their circumstances by that time, if it had ever been suitable. If he had done so, Mr. H and Ms. W could have sold the investments at a small gain and wound down the strategy with only a small loss after deferred sales charge (DSC) fees. By failing to do so, he missed an important opportunity to help Mr. H and Ms. W understand the situation and to limit their losses.

- We note that on December 31, 2007, there were several transactions (switches between mutual funds) in the leverage account. However, Monarch did not review the suitability of the leveraged investments at that time.

- Further, we are aware that in the spring of 2008, there were similar complaints against Mr. Z by other Monarch clients who said that Mr. Z asked them to sign blank forms (including forms for leveraged investment strategies), forged their signatures on other forms, and misstated information on the forms. Monarch agreed to compensate these clients for DSC fees and their investment losses. In light of these issues, Monarch had reason and opportunity to have questioned Mr. Z and to have investigated his other clients' accounts. If Monarch had taken steps to review the accounts of other clients, to verify the information and signatures on the forms it received and, with respect to Mr. H and Ms. W, to have assessed the suitability of the leverage strategy in their accounts, it could have helped them limit their losses. However, it did not contact Mr. H or Ms. W to review their situation or to verify the information on the NAAFs for their accounts. Therefore, it missed an important opportunity to identify and correct the leverage suitability problem before there were losses, or at least before large losses developed in the summer and fall of 2008. In the circumstances, we find that Monarch is not only vicariously liable for Mr. Z's unsuitable recommendations, but also directly responsible for failing to investigate and identify similar problems in Mr. H and Ms. W's accounts after receiving serious complaints about Mr. Z in early 2008.

- While Monarch is vicariously liable for Mr. Z's actions, we find it is also directly responsible for Mr. H and Ms. W's financial harm.

Client Responsibility

- In 2007, Mr. H and Ms. W had minimal investment experience and very limited investment knowledge. They were not familiar with the Canadian investment industry and terminology and, in fact, during our telephone interviews Mr. H and Ms. W had trouble understanding our questions and would often ask us to repeat them.

- Mr. H and Ms. W say they completely trusted Mr. Z because Ms. W had met him at her church and he was of the same cultural background. They say they believed him when he said it was a misunderstanding that caused the loans to be processed in July 2007. They say they did not redeem the investments and pay off the loans when they found out about them because Mr. Z told them they would incur DSC fees, which they could not afford. They say Mr. Z told them to wait until the fees schedule expired and at that point, if there were any losses, he would cover them. When they raised concerns with Mr. Z in the fall of 2008 and early 2009, they say he similarly assured them they would not have any losses, or if they did, he would cover them.

- As further illustration of the high level of trust they had in Mr. Z, Mr. H and Ms. W say that in October 2007, they invested $19,000 US in real estate in the Bahamas through Mr. Z. They say they made the investment because Mr. Z said it was good and because they had some US cash that they did not want to convert to Canadian

dollars because the exchange rate was not good at the time. They say when they later felt uncomfortable about the real estate investment, Mr. Z gave their money back in December 2007, reinforcing his assurance and their confidence that they would not incur losses on the leverage strategy.

- Mr. H and Ms. W did not begin to receive investment statements until January 2008. They only began to receive them because a bank employee told them the unusual transactions in Ms. W's bank account were by "loan and mutual fund companies." They called the companies and determined they had their old address on file. Even when they began to receive statements, they did not know how to read them and they had to call Trustco #2 for help.

- Even then, despite that Monarch was shown on the account statements as the "dealer", it was not until October 2009 when Mr. Z asked them to sign a dealer change form that Mr. H and Ms. W realized Mr. Z was affiliated with an investment firm. Until then, they were under the impression that they could only deal with Mr. Z with regards to the leveraged and other investments he had advised them on. They filed their complaint with Monarch in February 2010 shortly after realizing Mr. Z was associated with it.

- By not selling the investments and paying down the loans to limit further costs and losses when they realized there was a problem with the leverage strategy, Mr. H and Ms. W are responsible for the investment losses they incurred after transferring their accounts away from Monarch in March 2010.

- Mr. H and Ms. W were fairly new to Canada, had minimal experience and very limited investment knowledge, and trusted Mr. Z because he was a member of Ms. W's church. They raised their concerns and reasonably relied on Mr. Z's repeated assurances that they would not have any losses on the leveraged investments. In the circumstances, we cannot see what more they could have done and we do not find any basis for Mr. H and Ms. W to share responsibility for their losses up to March 2010. Beyond March 2010, they could have sold the investments.

Apportioning Responsibility Between Firms

- While we were attempting to resolve this matter with Monarch, it wrote to us saying that the courts, at a minimum, would apportion liability among the three parties involved: Firm A where the strategy originated, Monarch, and the firm to which Mr. H and Ms. W transferred in March 2010.

- We have calculated that Mr. H and Ms. W's total losses on the leverage strategy were $58,984. This amount takes into consideration our conclusion that Mr. H and Ms. W should have sold the leveraged investments to pay down the investments loans as much as possible when they transferred their investments away from Monarch in March 2010. Therefore, we do not believe that the firm they transferred to in March 2010 is responsible to compensate them.

- Where more than one firm is involved in a client complaint, our approach is to apportion compensation based on what is fair and reasonable in the particular circumstances. As for apportioning responsibility for losses between Firm A and Monarch, we considered several factors. The main factors we considered were that the leverage strategy was implemented while Mr. H and Ms. W were at Firm A but that almost their entire loss happened when they were at Monarch. We also considered that there was trading in the leveraged accounts shortly after they were transferred to Monarch, and that Monarch could have limited their losses if it had taken action in the spring of 2008 when it received complaints from other clients about Mr. Z's conduct.

- In the end, we agreed with Monarch that it would be fair to apportion some responsibility to Firm A. Firm A reached a settlement with Mr. H and Ms. W during the course of our investigation.

- We also believe it would be fair that Monarch compensate Mr. H and Ms. W for at least 50% of the losses they incurred on the leverage strategy.

OBSI Membership

- Quite apart from vicarious liability, however, firms are also responsible for the conduct of their advisors, employees, and representatives by virtue of their membership in OBSI.

- Monarch is a member of the MFDA, whose rules require that member firms participate in OBSI. As such, it is subject to the rules under which OBSI operates.

- OBSI's mandate is in respect of its participating firms, not advisors. Once OBSI decides that a client should be compensated, based on its mandate of fairness, the party responsible for compensating the client is the firm, not the individual advisor.

- It is therefore Monarch that is the party liable for the recommendations that OBSI makes with respect to the clients of Monarch.

- Whether the firm then goes back to the advisor to try to recover any compensation paid is a business decision for the firm to make and is not part of OBSI's process.

Conclusion

Monarch is vicariously liable for the financial harm caused by Mr. Z's unsuitable leveraged investment recommendation and advice while Mr. H and Ms. W's accounts were held at Monarch. It is also responsible for missing key opportunities to have identified the problem and to have corrected the situation before Mr. H and Ms. W incurred losses.

Mr. H and Ms. W had very limited investment knowledge and trusted Mr. Z. In all of the circumstances, we find no basis for Mr. H and Ms. W to bear responsibility for their losses up to March 2010. Beyond that, they could have sold the investments in March 2010 when they transferred away from Monarch to partially reduce the outstanding loan balances and subsequent interest charges.

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 Monarch compensate Mr. H and Ms. W for at least 50% of their losses being $59,236 plus interest of $2,021[2] for total compensation of $30,628.

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[2] Interest is calculated using the average 3-month Canadian Treasury Bill yield of 0.88% (As calculated by the Bank of Canada) compounded annually from March 2010 to the date OBSI's report is final.