



INVESTIGATION REPORT

Date March 16, 2020
Consumer Mr. J
Participating Firm Becksley Capital Inc. (Becksley)

Overview

In 2010, Mr. J borrowed \$60,000 on a line of credit to invest in an exempt market product, through Becksley, called Jaymor Diversified Limited Partnership (Jaymor). Mr. J did not meet the accredited investor requirements and therefore did not qualify to purchase Jaymor.

Mr. J signed the Becksley account opening forms and Jaymor purchase agreements with his family friend and financial planner, Mr. K. Mr. K was not employed by Becksley and was not licensed to sell exempt market products. Mr. K acted as an agent of Becksley and Becksley relied on him to provide Mr. J with advice and recommendations about Jaymor. Mr. K knowingly completed false documentation about Mr. J's assets to enable him to appear accredited.

Mr. K provided Mr. J's completed and signed documents to Mr. Q, a registered Becksley dealing representative, who then opened Mr. J's Becksley account and processed the Jaymor purchase without taking any steps to verify that the information recorded on the documents was accurate.

Mr. J cannot sell or redeem his \$60,000 investment and he has paid \$19,638 to service the line of credit. He has also received \$24,461 in tax benefits. Mr. J complained to Becksley, was unsatisfied with the firm's response to him, and brought his case to OBSI. We began our investigation in July 2019.

Key Findings

Becksley improperly delegated its know-your-client obligations to an unregistered referral agent who falsified documentation in order to sell Mr. J an investment that was unsuitable for him and that he was not qualified to buy. Becksley is partially responsible for his resulting losses.

Mr. J shares responsibility for his losses. He had an opportunity to independently review the Jaymor investment information and signed documentation falsely confirming that he had assets of over \$1,000,000. Mr. J is 40% responsible for his loss.

Recommendation

\$33,055

To prepare this report, we considered and investigated the concerns Mr. J raised and the counterarguments from Becksley. This report outlines our decision which is based on five key findings. We note that Becksley disagrees with our findings on these issues. The Appendices contain the documented Know-Your-Client (KYC) information compared to Mr. J's actual financial information and a summary of the financial harm calculations.

Primary consumer issues

Mr. J asked Becksley to compensate him for his \$60,000 loss on Jaymor because Becksley:

- took no steps to verify he was an accredited investor
- relied entirely on the documents his financial planner completed to open the account and purchase Jaymor

Becksley's primary objections

Becksley refused to compensate Mr. J and believe him to be entirely responsible for his loss because they say:

- Mr. J waited over seven years after his purchase to complain about Jaymor, so they consider this matter to be outside OBSI's six-year limitation period
- Becksley fulfilled its suitability obligation to review and approve the trade
- Becksley confirmed the investment was suitable by relying on Mr. J's signed accredited investor documents
- Mr. J read the Offering Memorandum (OM) and made an informed decision to invest

Our recommendation

We recommend that Becksley compensate Mr. J \$33,055, because:

1. The complaint is within OBSI's six-year limitation period
2. Becksley failed to know its client
3. Jaymor was unsuitable for Mr. J
4. Mr. J incurred financial harm because of the leveraging strategy and unsuitable investment in Jaymor
5. Becksley is 60% responsible and Mr. J is 40% responsible for his loss

Finding one – The complaint is within OBSI's six-year limitation period

We find that the complaint is within OBSI's six-year limitation period because Mr. J did not discover that he was not qualified to purchase Jaymor until 2017.

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Section 5.1 of our Terms of Reference (TORs) which describes OBSI's limitation period, says the complainant must complain to the firm no more than six years after the "Complainant knew or reasonably ought to have

known about the problem or issue giving rise to the Complaint, having regard to what a reasonable person in the Complainant's circumstances, with the Complainant's abilities and limitations ought to have known".

Becksley says that Mr. J knew Jaymor was intended for accredited investors in 2010 when he signed the agreements to purchase it. Becksley says Mr. J also knew about the possibility of a future capital call in 2010. It says that Mr. J only complained in 2017 because he received a capital call from Jaymor, was unwilling to invest more money and it was convenient for him to claim he did not know about the accredited investor requirement as a means to get out of the investment. Becksley believes that Mr. J is misleading OBSI.

Mr. J acknowledges he signed the documents, but says he only signed at Mr. K's direction to "sign here". He told us he did not read or review the information in the documents because he trusted his financial planner, who was also a family friend. We were unable to speak to Mr. K as he passed away in 2016. There is no independent evidence about what Mr. J and Mr. K discussed. Mr. J says he initialed where directed by Mr. K without reading or questioning the Accredited Investor Certificate or any of the documents and there was no discussion about qualifying to buy this product.

Mr. J says he did not find out that he did not qualify to purchase Jaymor until 2017 when the capital call notice arrived. At that time, since he had been assured by Mr. K and Jaymor that capital calls would be highly unlikely, he sought advice from a securities lawyer. The lawyer advised him that he never qualified to purchase Jaymor in the first place. He says this is the first time he heard the term "accredited investor".

We place little weight on Mr. J's unsupported statements about the discussions he had with Mr. K. However, we disagree with Becksley that because he signed the Jaymore purchase documents, Mr. J knew about the accredited investor requirement or that Becksley was not fulfilling its regulatory obligations. Rather, we find that Mr. J was not in a position to independently know what the requirements were for purchasing Jaymor in 2010 and therefore was not aware at any time prior to 2017 of Becksley's regulatory obligations or that he was not qualified to purchase the Jaymor investment because:

- there is no evidence that Becksley or Mr. K had a fulsome and meaningful conversation with Mr. J about suitability or determined whether Mr. J met the accredited investor requirements in 2010 nor anytime thereafter. No one from Becksley met with Mr. J at the time he signed the documents
- prior to Jaymor, Mr. J had never purchased an exempt market product
- it is not reasonable to expect a consumer with no exempt market investing experience to independently understand the meaning of being an accredited investor or to understand the regulatory obligations of registrants
- it is reasonable to expect registered firms and registered dealing representatives to comply with applicable regulations and make reasonable inquiries to verify whether a consumer qualifies as an accredited investor
- the capital call notice Mr. J received in October 2017 includes a note in his handwriting with the name and contact information of the Ontario securities lawyer referred to him by the Law Society of Ontario

Finding two — Becksley failed to know its client

We find that:

- Becksley had a responsibility to know its client
- Becksley failed to know its client

Becksley had a responsibility to know its client

Know-Your-Client (KYC) and suitability obligations are essential obligations owed by registrants to their clients and form the basis of Canada's investor protection regime. This obligation cannot be delegated, and registrants may not rely entirely on KYC forms, or other forms, to fulfil their KYC obligations.

Canadian securities regulators have made it clear that it is the registrant's responsibility to take reasonable steps to know its client and ensure the client meets the accredited investor eligibility requirements. National Instrument 31-103 (NI 31-103), in force when Mr. J signed the Jaymor purchase documents on September 7, 2010, said:

- registrants may not delegate their suitability obligations to anyone
- a registrant must take reasonable steps to ensure it has sufficient information regarding the client's financial circumstances (among other information) to make a suitability determination
- before it accepts an instruction from a client to buy a security, a registrant must take reasonable steps to ensure the purchase is suitable for the client
- if the registrant recommends prospectus exempted securities, the registrant should determine whether the client qualifies as an accredited investor

Becksley failed to know its client

The Becksley KYC form, line of credit application, Jaymor subscription agreement and Accredited Investor Certificate (the Documents) Mr. J signed to purchase Jaymor were completed by Mr. K. Mr. K was not licensed to sell exempt market products nor was he an employee of Becksley.

Becksley said that it fulfilled its KYC obligation by relying on the acknowledgements Mr. J signed with Mr. K stating that he had enough financial assets to qualifying him as an accredited investor. It said that given the time that has passed, Mr. Q's recollection of the events is understandably limited, but that does not equate to a failure to know his client. It also says that Mr. K was trustworthy – he had referred many clients to Becksley – and he would have completed the necessary due diligence before recommending Jaymor to Mr. J.

We disagree that Becksley fulfilled its KYC obligations because:

- Becksley breached its regulatory obligations by delegating its KYC obligations to Mr. K, an unregistered person
- Mr. K had known Mr. J personally for many years and was described by Mr. J as a "family friend". As his financial planner, Mr. K would have known that Mr. J was not an accredited investor, yet encouraged him to purchase this exempt market product, and knowingly completed false documentation about Mr. J's assets to enable him to appear accredited

- the KYC document completed by Mr. K had some inconsistencies that should have led to further inquiries by Becksley: for example, Mr. J's KYC form says that he was a tradesman earning between \$50,000 to \$99,999 a year with a personal net worth of over \$1 million. It is unclear whether this information, even if accurate, would have qualified him as an accredited investor without further inquiry into his spouses' income and the nature of his assets and associated liabilities. Additionally, his listed objective of tax savings is inconsistent with his modest income
- in our interview the Becksley dealing representative, Mr. Q told us:
 - he did not meet or discuss Jaymor with Mr. J before Mr. J signed any of the Documents
 - his role was like an administrator in that he simply reviewed the Documents and relied on the declarations in them to process the Jaymor purchase
 - he normally would approach meetings with Mr. K's clients with his guard down. He says these relationships were different because there was a "pre-screening". He relied on the relationship Mr. K had with his clients and acknowledged that he should not have
 - he was not aware that Mr. J had borrowed money to invest in Jaymor
 - he agreed that the inconsistencies in the KYC information would have prompted him to ask for more information, but could not recall what discussions, if any, he had with Mr. J.
- the KYC should have been approved and signed by a Becksley compliance officer or head office representative, but it was not

In order to fulfill his KYC requirements, Mr. Q, as the registered dealing representative, should have:

- completed the Documents with Mr. J
- had a meaningful conversation about Mr. J's personal and financial circumstances, investment objectives, risk tolerance and time horizon, instead of relying on previously completed and signed forms
- made inquiries about what financial assets qualified Mr. J as an accredited investor
- understood the source of the funds being used to purchase Jaymor

By his own admission, Mr. Q did not meet these requirements and relied only on the Documents completed by a person not licensed to sell exempt market products. Further, there is no evidence that Becksley reviewed or approved the account and KYC information. Had Becksley fulfilled these obligations, the inaccuracy of the information could have been exposed and the trade rejected.

Since Becksley fully relied on Mr. K to fulfill its KYC obligations, we find that Mr. K was acting on behalf of Becksley and therefore Becksley is responsible for Mr. K's actions. Given this, we find that Becksley failed to know its client.

Finding three — Jaymor was unsuitable for Mr. J

We find that Jaymore was unsuitable for Mr. J because he was not an accredited investor and did not have sufficient risk capacity to purchase the Jaymor investment.

Mr. J was not an accredited investor and did not qualify to purchase the Jaymor investment

The accredited and eligible investor exemption is intended to protect investors from the potential loss associated with exempt market products. The accredited and eligible investor requirements are in place to ensure that investors in exempt products are:

- sophisticated enough to understand the investment and its risks
- financially able to withstand the potential loss of all the money they invest in the exempt market product

In 2010, Mr. J was 37 years old and had worked for 15 years as a tradesman. The highest education he completed is high school. Mr. J had annual income of \$69,495 in the 2010 tax year and total financial assets of \$31,136. He had RRSP investments of \$17,000 at the bank and the remainder was in a defined contribution plan through his employer that invested in mutual funds.

In July 2006, through Mr. K, Mr. J started a leveraged strategy with mutual and segregated funds, which he liquidated at a small profit to purchase Jaymor. Mr. J says Mr. K recommended he change his leveraged investment to Jaymor for a higher potential return, less fees than mutual funds, and additional tax benefits. Mr. J says he was also persuaded by the 5 to 7-year time horizon on Jaymor, whereas his current mutual and segregated fund leverage strategy had no end date.

Appendix A below sets out further information on Mr. J's documented KYC information compared to his actual financial circumstances.

We find Mr. J did not meet any of the criteria to qualify for the accredited investor exemption, was not financially able to withstand the potential loss of all the money he invested, and that Jaymor was therefore an unsuitable investment for him.

Finding four — Mr. J incurred financial harm because of the unsuitable investment in Jaymor

We find that Mr. J incurred financial harm of \$55,091 from the 2010 unsuitable investment in Jaymor.

Mr. J incurred financial harm of \$55,091 from the 2010 unsuitable investment in Jaymor

OBSI's financial harm calculations are intended to put the consumer back in the position he would have been in had the unsuitable investment not been made. To reach a reasonable recommendation, we have made certain assumptions. We calculated Mr. J's financial harm to be \$55,091 because:

- we assigned Jaymor a market value of \$0 in our financial harm calculations because Mr. J cannot sell or redeem Jaymor and we cannot verify the value of this exempt market product. To date, Becksley has been unable to provide a market value for Jaymor and says: "as there is no secondary market in which Exempt Market Products can be traded and therefore these Limited Partnership Units are an illiquid asset and there (sic) value may not be accurate by simply applying the prorate value of the real-estate to the LP units"

- To prevent any potential double recovery, as part of the resolution of this dispute we recommend that Mr. J transfer ownership of the Jaymor units to Becksley so that they may recover any possible residual value.
- he invested \$59,862 in Jaymor and received no dividend payments, resulting in a cash loss of \$59,862
- he borrowed from a line of credit to invest, adding interest costs (less related tax deductions) of \$16,690
- we calculated that he gained a total of \$21,461 for the tax benefits he received from Jaymor tax deductions, net of the additional taxes for capital gains Jaymor passed onto its limited partners in 2016 and 2018

Finding five — Becksley is 60% responsible and Mr. J is 40% responsible for his loss

For the reasons outlined above, Becksley is responsible for Mr. J's losses. The relationship and obligations between firms and investors are not equal. Regulatory rules are in place to ensure that registrants know their clients and recommend only suitable investments and strategies to investors. Becksley cannot contract out of its compliance obligations and is responsible for any deceptions facilitated by or bad advice provided by third parties it authorizes to act on its behalf.

Mr. J should not have been presented with the opportunity to invest in the unsuitable exempt market products and should not have been encouraged to falsely declare his financial position in order to make such investments. Reasonable steps should have been taken to verify his financial information and Becksley did not take these steps.

However, we find that Mr. J shares significant responsibility for his losses because:

- he had previously borrowed to invest and was aware of and willing to continue accepting the risks of leverage to purchase Jaymor
- he either negligently or knowingly signed documents falsely confirming that he had financial assets of \$1,000,000 by initialling directly beside this option on the Accredited Investor Certificate
- he signed the Documents, which described the risk of the investments, and he should have ensured that he understood them before signing. The Documents were brief and sufficiently clear that he should have understood their purpose and meaning
- based on our discussions with him, Mr. J had the capacity to identify the risk acknowledgements and accredited investor representations on the forms he signed and inquire about them, and he in fact did so. Prior to purchasing Jaymore, Mr. J independently reviewed sections of the OM, researched Jaymor online, and reviewed the OM in sufficient detail to identify the possibility of future capital calls. After he read about the possibility of capital calls, he called Mr. K and Jaymor to learn more about the likelihood because he could not afford to invest more money

Mr. J has acknowledged his responsibility for signing and initialing documents that he says he did not read. He says he is disappointed in himself for trusting Mr. K and being "gullible". He acknowledges that he should have scrutinized the documents he signed to ensure they were accurate.

In view of the findings above, we find Mr. J and Becksley share responsibility for Mr. J's losses. On balance, we consider Becksley's responsibility somewhat greater in light of its professional obligations. Therefore, we find Mr. J responsible for 40% of his loss and recommend that Becksley pay him \$33,055.

Appendix A: Mr. J's documented KYC information compared to actual financial information

There was no place on the Becksley's KYC for Mr. J's date of birth or financial assets.

	KYC (September 2010)	Actual Information
Date of Birth	n/a	October 2, 1973
Occupation	Tradesman*	Tradesman*
Annual Income	\$50,000 - \$99,999	\$69,495
Financial Assets	n/a	\$31,136
Personal Net Worth	Over \$1,000,000	\$99,964
Investment Knowledge	Good	Fair
Time Horizon	Long (over 10 years)	Long (over 10 years)
Risk Tolerance	High	High
Investment Objectives	Growth	Growth
Other Objectives	Tax Savings, Retirement Planning, Estate Planning, Portfolio Diversification	Tax Savings, Retirement Planning

*Anonymized equivalent occupation