

INVESTIGATION REPORT

Date: September 25, 2014
Clients: Mr. and Mrs. S
Firm: FundEX Investments Inc. (FundEX)

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 them. 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:	<ul style="list-style-type: none"> ▪ Mr. H 							
Product:	<ul style="list-style-type: none"> ▪ Medallion Business Centre Development Corp. (Medallion Mortgage investment) 							
Period:	<ul style="list-style-type: none"> ▪ November 2007 to November 2009 							
Key Conclusions:	<ul style="list-style-type: none"> ▪ Mr. H recommended and facilitated Mr. and Mrs. S' \$100,000 investment in the Medallion Mortgage investment in his capacity as their FundEX advisor. ▪ Mr. and Mrs. S reasonably believed that the investment was approved by and made through FundEX. ▪ The Medallion Mortgage investment has lost all of its value. ▪ FundEX is responsible for the losses incurred by Mr. and Mrs. S as a result of Mr. H's recommendation. 							
Recommendation:	<table border="1"> <tr> <td>\$102,763</td> <td>Compensable losses</td> </tr> <tr> <td>\$3,360</td> <td>Interest</td> </tr> <tr> <td>\$106,123</td> <td>Total Recommendation</td> </tr> </table>	\$102,763	Compensable losses	\$3,360	Interest	\$106,123	Total Recommendation	
\$102,763	Compensable losses							
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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 such as the Investment Industry Regulatory Organization of Canada (IIROC), the Mutual Fund Dealers Association of Canada (MFDA), and the securities commissions that form the Canadian Securities Administrators, 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's member firms are the parties to complaints made by their customers. 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 the 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 recommendations are made.

OVERVIEW

In 2007, Mr. and Mrs. S moved from Alberta to Saskatchewan. After purchasing a new home, they had \$100,000 to invest and they asked their FundEX advisor, Mr. H, for his advice. On his recommendation they invested the money in the Medallion Mortgage investment in November 2007. The money raised from investors was used to secure a second mortgage on the Medallion Executive Business Centre development project in Calgary. The investment was presented as having a two-year term and a 10% rate of return. In November 2009, two years after making the investment, Mr. and Mrs. S tried to redeem their investment in Medallion Mortgage. In February 2011, Mr. and Mrs. S were notified that they would not recover their investment. They also received no interest.

FundEX contends that Mr. and Mrs. S knew that the Medallion Mortgage investment was not the business of FundEX and says it had no responsibility for it. We disagree. Mr. and Mrs. S have limited investment knowledge and their investment experience includes only mutual fund investments made entirely on the recommendation of Mr. H. When Mr. H recommended and facilitated the Medallion Mortgage investment, Mr. and Mrs. S reasonably believed it was like the other investment recommendations he had made in the

past. There was nothing about it that was out of the ordinary to them. They reasonably believed Mr. H had the authority to sell it and that it was approved by and made through FundEX as all of their other investments had been. In fact, FundEX has acknowledged that Mr. H never advised Mr. and Mrs. S that the Medallion Mortgage investment was not the business or responsibility of FundEX.

FundEX is responsible for Mr. H's securities-related business and investment recommendations. For the reasons outlined in this report, we find it clear that FundEX should compensate Mr. and Mrs. S for the losses they have incurred as a result of Mr. H's advice.

BACKGROUND

- Mr. S became a client of Mr. H at another investment firm in 1994 when Mr. S's mother gave him \$1,300 to invest in an RRSP. Mr. S was 33 years old at the time Mr. H recommended Mr. S invest his money in mutual funds. Mr. S also started a monthly pre-authorized mutual fund investment plan (also known as a pre-authorized contribution plan, or PAC) in his RRSP.
- In 2003, Mr. H transferred to FundEX and Mr. S followed him by transferring his RRSP account. At the time of the transfer to FundEX, the value of Mr. S's mutual fund investments was about \$20,000.
- Between 2003 and 2007, the PAC in Mr. S's RRSP continued. Mr. and Mrs. S say they otherwise had limited interaction with Mr. H until the summer and fall of 2007.
- In August 2007, Mr. and Mrs. S moved from Alberta to Saskatchewan after Mr. S left his job in Calgary. Mr. H was not registered to sell or advise on investments in Saskatchewan. Nevertheless, Mrs. S says he advised them he could remain their principal advisor while Mr. S's accounts would be assigned to an associate in his office who was registered in Saskatchewan.
- Shortly after the couple moved to Saskatchewan, Mr. S opened a locked-in retirement account (LIRA) with FundEX, deposited \$80,000 from his previous employer's pension fund and invested in mutual funds on Mr. H's recommendation.
- In September 2007, after purchasing a new home in Saskatchewan, Mr. and Mrs. S had \$100,000 remaining from the sale of their home in Alberta. They asked Mr. H for investment ideas. In a handwritten letter on FundEX letterhead dated September 28, 2007, Mr. H recommended splitting the \$100,000 evenly into two investments:
 - Bearspaw, which he noted would have a big upside within four years; and
 - Medallion Mortgage, about which Mr. H wrote "2 years with a 10% per annum fixed return → end of term."
- The Medallion Mortgage investment was a second mortgage on the Medallion Executive Business Centre Project in Calgary for which Certified Financial Savings and Mortgage Corporation (Certified) was raising funds from investors.
- Mrs. S says Mr. H contacted them on November 5, 2007 and urged them to make a decision about the Medallion Mortgage investment as it was selling out quickly. On November 6, 2007, Mr. and Mrs. S arranged for a bank draft in the amount of \$100,053 payable to Certified which they couriered to Mr. H's FundEX office.
- Mrs. S says Mr. H faxed them the Medallion Mortgage documents, which they signed and faxed back to his office. Mr. H signed as witness to Mr. and Mrs. S' signatures on

the faxed documents on November 8, 2007. Copies of the documents were mailed to Mr. and Mrs. S a few weeks later along with a welcome letter from Certified. According to the Client Payout Report sent by Certified to Mr. and Mrs. S, \$100,000 was deposited to the Medallion Mortgage investment on November 8, 2007.

- Mr. and Mrs. S say that in November 2007, at Mr. H's request, they signed a FundEX representative change form. The new representative was Mr. K, Mr. H's supervising FundEX branch manager. Mr. and Mrs. S say Mr. H told them he would still be their main advisor and Mr. K was only involved to manage the mutual funds in Mr. S's RRSP and LIRA accounts.
- From 2007 to 2009, the PACs in Mr. S's RRSP continued and there were occasional transactions in the RRSP and LIRA switching between different mutual funds.
- On November 2, 2009, two years after the purchase, Mrs. S emailed Mr. H saying they wanted to cash out their Medallion Mortgage investment. On November 4, 2009, Mr. H contacted Certified. On November 6, 2009, Mr. H forwarded to Mr. and Mrs. S an email from Certified attaching a client payout report and a general release-of-mortgage document, which Mr. and Mrs. S signed and faxed back to Mr. H on the same day. Mrs. S also emailed Mr. H on November 6, 2009 asking when they could expect receipt of their money.
- On November 9, 2009, Mrs. S emailed Certified, using the contact information she found in the November 6, 2009 email Mr. H forwarded from Certified. In her email she inquired about the logistics of the mortgage redemption. Certified responded saying it had 180 days to make the payout. The payout was not made at the end of the 180-day period.
- In early December 2010, Certified sent a letter to all Medallion Mortgage investors indicating a court-appointed receiver had taken over the building on which Certified had the second mortgage. The building was eventually sold for a price that did not even cover the first mortgage. In February 2011, Certified notified Mr. and Mrs. S that they would not recover their \$100,000 investment.
- On April 9, 2011, in discussion with Mr. K about Mr. S's RRSP and LIRA accounts, Mr. and Mrs. S mentioned the situation with their Medallion Mortgage investment. FundEX says that it placed Mr. H on strict supervision on June 22, 2011 due to unapproved outside business activities, which included his involvement with Medallion Mortgage.
- On March 8, 2012, FundEX advised Mr. H it intended to terminate his registration for cause on April 9, 2012, citing Mr. and Mrs. S' and other clients' complaints and an unapproved referral arrangement. On April 5, 2012, Mr. H submitted his resignation to FundEX.

COMPLAINT

- In a letter to FundEX dated April 19, 2011, Mr. and Mrs. S:
 - summarize their version of the events around the purchase of the Medallion Mortgage investment;
 - say they trusted Mr. H as a representative of FundEX to recommend suitable investments; and
 - ask FundEX to compensate 100% of their loss plus interest.
- Mr. and Mrs. S also filed a complaint with the Mutual Fund Dealers Association of Canada (MFDA) on April 19, 2011.

FUNDEX'S RESPONSE

- In a letter dated September 15, 2011, FundEX responded to Mr. and Mrs. S' complaint saying:
 - FundEX associates are prohibited from offering any investment advice, commenting on the merits or expected returns of, or making investment recommendations on products or services that are not on the FundEX approved list of suppliers;
 - FundEX requires all securities-related business be conducted through FundEX and prohibits associates from personally engaging in the sale or referral of any investments that would be considered securities under applicable legislation, or selling or advising on such investments through any entity other than FundEX;
 - FundEX was not aware of Mr. H's activities regardless of its direct questioning in reference to outside activities during annual audit procedures and did not approve the outside activity;
 - Mr. H did not disclose to Mr. and Mrs. S that his activities related to Certified were not the business of FundEX and not the responsibility of FundEX.
 - Upon discovery of Mr. H's activities, he was immediately placed under close supervision. The MFDA also conducted an investigation into Mr. H's business activities.
- FundEX did not offer any compensation.

MUTUAL FUND DEALERS ASSOCIATION

- On May 29, 2013, the MFDA announced that it had commenced disciplinary proceedings in respect of Mr. H. The MFDA alleged in its Notice of Hearing that:
 - “Between October 2007 and September 2010, Mr. H engaged in securities related business that was not carried on for the account and through the facilities of the Member by selling, recommending and facilitating the sale of or making referrals in respect of investment products totaling at least \$6,346,000 to clients outside of the Member, contrary to MFDA Rules 1.1.1(a), 2.4.2(b) and 2.1.1”.; and
 - “Between October 2007 and September 2010, Mr. H had and continued in another gainful occupation which was not disclosed to and approved by the Member by selling, recommending, facilitating the sale of or making referrals in respect of investment products totaling at least \$6,346,000 to clients outside the Member, contrary to MFDA Rules 1.2.1 (c) and 2.1.1.”
- In its Decision and Reasons dated August 12, 2014, an MFDA Hearing Panel found that “both allegations had been proven well beyond a balance of probabilities as required”. The Panel said that “[t]he seriousness of the conduct is at the very high end of the scale”. It imposed a permanent prohibition on Mr. H from conducting securities related business with any MFDA Member and a global fine in the amount of \$250,000 along with costs.

OBSI ANALYSIS

In the course of our investigation, we reviewed documents provided to us by FundEX and Mr. and Mrs. S. We interviewed Mr. and Mrs. S regarding their complaint. We contacted Mr. H, but due to illness he was not available for an interview. While we posed detailed questions to him in writing, he did not include answers to most of our questions and the responses he provided were very brief. We also discussed this matter with FundEX representatives Ms. L, Assistant Chief Compliance Officer – Complaints, Ms. W, Vice President and Chief Compliance Officer, and Mr. C, President.

OBSI examined the following key issues in respect of Mr. and Mrs. S’s complaint:

1. Did Mr. and Mrs. S reasonably believe that the Medallion Mortgage investment was approved by and made through FundEX?
2. Did Mr. and Mrs. S incur financial harm on the Medallion Mortgage investment?
3. Who bears responsibility for the financial harm, if any?

Issue 1 – Did Mr. and Mrs. S reasonably believe that the investment in Certified was approved by and made through FundEX?

- FundEX says in its response to Mr. and Mrs. S’ complaint that advisors at FundEX are prohibited from selling or recommending investments that are not approved by FundEX and that all securities related business must be processed through FundEX.
- In its August 28, 2012 letter to OBSI, FundEX calls Mr. and Mrs. S “competent and intelligent adults with decision making authority over their investments and accounts.”
- In its October 30, 2012 letter to OBSI, FundEX says that the following facts can only lead to a conclusion that it was not reasonable for Mr. and Mrs. S to believe that their Medallion Mortgage investment with Certified was approved by FundEX:
 - Mr. H’s recommendation to invest in Certified was not made on “standard” FundEX letterhead;
 - the bank draft taken out by Mr. and Mrs. S was made out directly to Certified and not to FundEX;
 - FundEX was not a party to the Certified agreement signed by Mr. and Mrs. S;
 - Mr. and Mrs. S received separate account statements from Certified;
 - Mr. and Mrs. S’ investments in Certified did not appear on their FundEX statements;
 - Mr. and Mrs. S were experienced investors, should have been wary of the promised guarantee and high rate of return, and should have made inquiries into the nature and risks of the Medallion Mortgage Investment; and
 - Mr. and Mrs. S raised no concerns about the Medallion Mortgage investment with FundEX.
- We do not agree with FundEX’s views and we address each of its points in the following sections.

Investment Experience and Knowledge

- FundEX contends that Mr. and Mrs. S were experienced investors. It says they were competent and intelligent adults with decision making authority over their investments, implying that they were knowledgeable investors. It also says they should have made inquiries about the Medallion Mortgage investment and its rate of return.

- Although we requested it, FundEX has not provided us any Know Your Client documentation for Mr. or Mrs. S, or any evidence as to why it finds Mr. and Mrs. S to be experienced or knowledgeable investors. We also understand FundEX has never interviewed Mr. and Mrs. S.
- In 2007, when the Medallion Mortgage investment was made, Mr. and Mrs. S were 46 and 41 years old respectively. Mr. S had worked on the Calgary oil pipelines as a journeyman trades welder for a number of years. Mrs. S was a stay-at-home mother taking care of their autistic son who was 12 years old. Mr. S has a technical certificate as a journeyman trades welder and Mrs. S has a bachelor's degree in recreational studies.
- Mr. and Mrs. S say that before meeting Mr. H in 1994, they had \$4,000 in RRSPs at a local bank, which they used to help make their first home purchase. They say they had never invested in anything except bank deposits and GICs before 1994 when Mr. S received \$1,300 from his mother to invest in a RRSP account. Since they had never invested with an investment advisor, and knew nothing about investments, they did not know what to expect and say they were only concerned with keeping their money safe. They say that in general Mr. H would recommend investments giving them a brief explanation, assuring them he would keep them in low- to medium-risk investments and they would just agree. Mr. and Mrs. S say they always followed his recommendations.
- During our interview, Mr. and Mrs. S could not explain the difference between low-, medium- or high-risk investments, or the difference between a mutual fund and a stock. While they understood that markets go up and down, they could not explain basic investment concepts like the relationship between risk and return. Mr. and Mrs. S said that Mr. H was their sole source of investment information and advice. They said they did not do independent research or reading and they trusted and relied on Mr. H to take care of their investments.
- From 1994 until 2007, the mutual funds in Mr. S's RRSP were their only investment beyond deposits at their bank. They say there was very little contact with Mr. H over the years and the contributions to Mr. S's RRSP were just automatically taken from their chequing account and invested each month with no discussion or involvement. In our discussions with Mr. and Mrs. S, we found they could not tell us what type of mutual funds they held or describe their characteristics and risks. Therefore, although they had been exposed to mutual funds for some time, they were passive investors who relied on Mr. H and we find they had very little investment knowledge.
- When Mr. H approached Mr. and Mrs. S about the Medallion Mortgage investment, they had just moved away from Calgary where from 2003 to 2007 the housing market had boomed – they say houses could not be built fast enough to accommodate demand and they knew people who were making fortunes on real estate. In this context, the 10% return offered by the Medallion Mortgage investment at the time did

not seem excessive, and they found nothing about it that raised any concern or that they thought was out of the ordinary.

- In these circumstances, we cannot agree with FundEX's view that Mr. and Mrs. S were experienced or knowledgeable investors, or that the return offered on the Medallion Mortgage investment should have given them any reason to question the investment.

FundEX Letterhead

- FundEX says that the recommendation to invest in the Medallion Mortgage investment was not made on "standard" FundEX letterhead, suggesting that Mr. and Mrs. S knew or should have known that and therefore, should have known the Medallion Mortgage investment was not approved by and made through FundEX.
- It appears clear to us that the written investment recommendation Mr. and Mrs. S received from Mr. H in September 2007 was on FundEX letterhead. It shows FundEX's logo with the words "FundEX Investments Inc." in large and prominent text. In addition, Wealth Planners Financial Planning Services is printed in the header, and Mr. H's FundEX office address and contact numbers are printed in the footer. Based on our review of the letter, we cannot find any reason Mr. and Mrs. S would have known or could have identified the letterhead as not being standard.
- In our view, it was entirely reasonable for Mr. and Mrs. S to believe the written recommendation from Mr. H to purchase the Medallion Mortgage investment was on FundEX letterhead and that their FundEX investment advisor was authorized to use the FundEX letterhead to make the recommendation. Therefore, we cannot agree that it provided any indication that the Medallion Mortgage investment was not approved by or made through FundEX.

Medallion Mortgage Investment Documents and Bank Draft

- FundEX says that it was not a party to the Medallion Mortgage investment agreement Mr. and Mrs. S signed.
- We agree that FundEX was not a party to the Medallion Mortgage investment agreement. However, FundEX is frequently not a party to agreements its clients sign when they purchase investments. For example, FundEX is not a party to agreements between a client and mutual fund companies when clients open a "client name" account that is held and administered by the mutual fund company. Therefore, we see no reason how this could be interpreted as a signal to Mr. and Mrs. S that the Medallion Mortgage investment was not approved by FundEX.
- Further, Mr. H provided Mr. and Mrs. S with the Medallion Mortgage investment documentation, they signed it and faxed it back to him, and he signed it as witness. They did not question any of the paperwork they were asked to complete and sign, in

part because they did not know what to ask, but more importantly because nothing seemed unusual or out of the ordinary in the process.

- Other than his initial investment of \$1,300 in 1994 (thirteen years before the Medallion Mortgage investment), Mr. S invested in his RRSP through automated PAC payments from their chequing account. The money in his LIRA came directly from Mr. S's employer. For these reasons, Mr. and Mrs. S would reasonably not have known that writing a cheque directly to Certified was not customary. They also sent the money for the investment to Mr. H at his request and he facilitated payment of the funds to Certified.
- In the circumstances, and given Mr. and Mrs. S's limited investment experience, we see nothing about the Medallion Mortgage investment documentation or the bank draft Mr. H asked them to make payable to Certified that would have indicated to them that this was not an investment like any other they had made with Mr. H, or that would have suggested it was not approved by or made through FundEX.

Account Statements

- FundEX says that Mr. and Mrs. S knew the Medallion Mortgage investment was not a FundEX approved investment, because it did not appear on their FundEX account statements.
- Mr. and Mrs. S say it never occurred to them that it was a problem or that they should be concerned that the investment did not appear on their FundEX statements. They received Certified statements which were similar to the semi-annual mutual fund company statements they also received, all of which showed Mr. H as their advisor until November 2007, after which Mr. K's name appeared on the mutual fund statements. But they were not surprised by this change because Mr. H had told them it would happen. Rather, the Certified statements, which continued to show Mr. H's name as their advisor, confirmed to them he was still their FundEX advisor, with primary care of their investments, other than their mutual fund investments, as he had explained and assured them.
- In any event, the question about account statements speaks to what Mr. and Mrs. S might have known *after* the Medallion Mortgage investment was already made. FundEX provided us with copies of annual statements for Mr. S's accounts beginning in 2008. Given that the Medallion Mortgage investment was made in November 2007, it would have been more than two months before the first FundEX statement arrived in January 2008. Even then, the Certified statements arrived at regular intervals, and there was nothing about the information on them that would have caused any concern.
- In their circumstances and given their limited investment experience and knowledge, we cannot conclude that the FundEX or Certified statements gave Mr. and Mrs. S any

indication that the Medallion Mortgage investment was not approved by or made through FundEX.

Mr. H's Registration and Recommendation

- In its response to Mr. and Mrs. S' complaint, FundEX points out that its advisors are prohibited from selling or recommending investments that are not approved by FundEX and that all securities related business must be processed through FundEX. It implies that since Mr. H was only registered to sell mutual funds, Mr. and Mrs. S knew the Medallion Mortgage investment was not approved or made through FundEX.
- However, Mr. and Mrs. S do not appear to have known that Mr. H's registration was limited to certain products, nor should they be expected or required to. They did not check, or even know how to check his registration status. Registration and the limitations imposed by certain categories is a matter for the compliance and enforcement regimes at firms and regulators to control, not investors who are buying investments from someone being presented by a firm as qualified to sell them. Therefore, we cannot see that his registration can be considered to have any bearing on Mr. and Mrs. S' belief that they were making an investment approved by and made through FundEX.
- Further, Mr. and Mrs. S say that Mr. H never told them that the Medallion Mortgage investment was a separate investment from FundEX or that he was not licensed to sell it. They made no distinction between Mr. H and FundEX and they understood the Medallion Mortgage investment was no different than any other investment he had recommended to them. Consistent with Mr. and Mrs. S' assertion, FundEX acknowledges in its written response to Mr. and Mrs. S' complaint that Mr. H did not disclose to Mr. and Mrs. S that his activities relating to the Medallion Mortgage investment were "not the business of FundEX and not the responsibility of FundEX."

Conclusion

To Mr. and Mrs. S, the Medallion Mortgage investment was no different than any other investment Mr. H had recommended. He was their long-term, trusted advisor and they followed his advice as they always had. Mr. H facilitated the investment paperwork and the payment. As noted in the Background section above, Mr. H also followed up on their questions and provided information about the investment after it was made.

Mr. and Mrs. S have limited investment experience and knowledge. We find there is nothing about the FundEX letterhead Mr. H used to make his written recommendation, the documentation they signed, the bank draft or account statements that would have caused concern or indicated to Mr. and Mrs. S that the Medallion Mortgage investment was not approved by or made through FundEX.

Further, Mr. H made no disclosure to separate the Medallion Mortgage investment from his FundEX activities or to specify that it was not the business of FundEX. Mr. and Mrs. S had no idea that he was not registered to sell it, did not know to question his registration and they made no distinction between FundEX and Mr. H. He was their FundEX advisor.

In all of the circumstances, we find it was entirely reasonable for Mr. and Mrs. S to have believed that Mr. H was authorized by FundEX to recommend and sell the Medallion Mortgage investment and that it was approved by and made through FundEX.

Issue 2 – Did Mr. and Mrs. S incur financial harm on the Medallion Mortgage Investment?

- On November 8, 2007, Mr. and Mrs. S invested \$100,000 in the Medallion Mortgage investment.
- On November 2, 2009, Mrs. S emailed Mr. H saying they wanted to cash out their Medallion Mortgage investment. Mr. H forwarded their email to Certified. Mr. and Mrs. S received, signed and returned a Client Payout report and a general release of mortgage document in November 2009. However, Certified said that it had an additional 180 days to pay the contract out in full. Mr. and Mrs. S did not receive payment at the end of the 180-day period.
- In early December 2010, Certified sent a letter to all Medallion Mortgage investors indicating a court-appointed receiver had taken over the building on which Certified had the second mortgage.
- In an email dated February 17, 2011, Ms. R, Investment Manager at Certified said to Mr. S that since the offer it received to purchase the building was less than the first mortgage, the loss to the second mortgage holders “will be complete.” Mr. and Mrs. S were among the investors who were the second mortgage holders. Therefore, according to the information Mr. S received from Certified, Mr. and Mrs. S have lost their entire \$100,000 investment. To date, Mr. and Mrs. S have not received any of their investment back.
- Mr. and Mrs. S say that if not for Mr. H’s recommendation to invest in the Medallion Mortgage investment, they would have purchased a GIC with the \$100,000. They invested in the Medallion Mortgage investment based on Mr. H’s assurance it was as safe as a GIC but with a better return.
- If Mr. and Mrs. S had invested in a short-term GIC on November 8, 2007, they would have received \$2,763¹ in interest at maturity along with repayment of their principal. Therefore, we find Mr. and Mrs. S have incurred \$102,763 (\$100,000 + \$2,763) in financial harm as a result of the Medallion Mortgage investment.

¹ Bank of Canada average 1-year GIC rate from November 2007 to November 2009 is 1.37%.

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

Vicarious Liability

- The case law is clear that mutual fund dealers and investment dealers 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 dealers 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.

- However, FundEX argues that selling the Medallion Mortgage investment was outside Mr. H's scope of authority and therefore it should not be held responsible for the losses Mr. and Mrs. S incurred.
- *Bazley v. Curry*, [1999] 2 S.C.R. 534 (S.C.C.) is the leading case in Canada concerning vicarious liability for actions that may be outside an agent's literal scope of employment, but that nevertheless are sufficiently connected to the employer's operations to justify the imposition of vicarious liability. In *Bazley*, McLachlin J. (as she then was) said we should "openly confront the question of whether liability should lie against the employer, rather than obscuring the decision beneath semantic discussions of 'scope of employment' and 'mode of conduct'." She went on to say that the "fundamental question is whether the wrongful act is sufficiently related to conduct authorized by the employer to justify the imposition of vicarious liability. Vicarious liability is generally appropriate where there is a significant connection between the creation or enhancement of a risk and that wrong accrues therefrom, even if unrelated to the employers' desires.... Once engaged in a particular business, it is fair that an employer be made to pay the generally foreseeable costs of that business. In contrast, to impose liability for costs unrelated to the risk would effectively make the employer an involuntary insurer."
- Given that Mr. H was providing investment advice and selling securities when he recommended and facilitated the Medallion Mortgage investment for Mr. and Mrs. S, there was, as McLachlin, J, said in *Bazley*, "a significant connection between the creation of the risk" (registering Mr. H and employing him to sell securities) "and the wrong that accrued from it" (recommending and selling unapproved securities). Put

another way, but for Mr. H's registration through FundEX to sell securities, he would not have been in a trusted position to have been able to recommend the Medallion Mortgage investment to Mr. and Mrs. S. Therefore, FundEX should be held vicariously liable for Mr. and Mrs. S' loss.

- FundEX disagrees with OBSI's interpretation of the *Bazley* decision and the law on vicarious liability. FundEX says that vicarious liability does not apply in this case because there is not a sufficient connection between Mr. H's acts and the conduct authorized by FundEX, as outlined in the *Bazley* case. FundEX also asserts that in accordance with *Bank Leu AG v. Gaming Lottery Corporation et al* [2003] O.J. No. 3213 (leave to appeal to the SCC denied), Mr. H was acting in his personal capacity, outside the conduct authorized by FundEX, and outside the scope of Mr. H's registration category as a mutual fund salesperson. Therefore, FundEX argues it cannot be held vicariously liable. FundEX raised the following points to support its position:
 - FundEX did not afford Mr. H any opportunity to abuse his position;
 - the wrongful act did not further FundEX's aims;
 - the wrongful act was not related to any friction, confrontation or intimacy inherent in FundEX's enterprise;
 - no power was conferred on Mr. H in relation to Mr. and Mrs. S; and
 - Mr. and Mrs. S were not vulnerable to the wrongful exercise of Mr. H's power.
- We disagree with FundEX's position on the interpretation of the *Bazley* decision. In fact, in the recent Ontario Superior Court of Justice decision in *Straus Estate v. Decaire*, 2011 ONSC 1157, upheld on appeal to the Court of Appeal for Ontario, 2012 ONCA 918 (a case which involved a FundEX advisor) the court confirmed that in circumstances where an investment advisor is registered only to sell a certain type of investment product and in the course of their dealings with their clients recommends and sells another investment product which they are not registered to sell, the investment dealer is vicariously responsible for the activities of its investment advisor.
- We find that Mr. H was acting in the capacity of a FundEX advisor and with apparent authority when he recommended and facilitated the purchase of the Medallion Mortgage investment for Mr. and Mrs. S. While Mr. H may not have been licensed to sell such an investment, when he solicited and advised Mr. and Mrs. S for the purpose of investing, he was doing exactly what FundEX hired him to do. Therefore, we find FundEX is responsible for the losses Mr. and Mrs. S incurred in connection with the Medallion Mortgage investment.

Client Responsibility

- In FundEX's view, Mr. and Mrs. S contributed to and are responsible for any losses they have suffered as a result of the Medallion Mortgage investment.
- In the Alberta Court of Queen's Bench in *S. Maclise Enterprises Inc. v. Union Securities Ltd.*, [2008] 12 W.W.R. 539 the trial judge said "Courts should avoid a single element theory such as "unusual transaction" or "to whom the check was made", or "activity outside of the employer's license", as these concepts are overly simple and do not properly engage in the *Bazley* analysis." Therefore, in considering whether responsibility ought to be apportioned to Mr. and Mrs. S, we have considered the whole context of Mr. H's dealings with Mr. and Mrs. S and the Medallion Mortgage investment.
- As detailed above in Issue 1, we considered all of the elements FundEX raises to draw its conclusion that Mr. and Mrs. S knew the Medallion Mortgage investment was not approved by and made through FundEX. None of these points leads us to agree with FundEX's conclusion. Rather, we see nothing about these elements or the circumstances that would have or should have raised concern or indicated to Mr. and Mrs. S that the investment was not approved by and made through FundEX.
- In addition, we have considered the context around Mr. H's recommendation. In September 2007, when Mr. and Mrs. S sold their Calgary home, they had \$100,000 remaining after the sale and they sought Mr. H's advice about how to invest it. They wanted to earn some interest so they could do some renovations on the older home they had purchased in Saskatchewan. Mr. and Mrs. S say that Mr. H told them that with the Medallion Mortgage investment they would get their money back in two years but with a better return than on a GIC. Mr. S says Mr. H assured them it was a safe investment and that he had dealt with this investment company before. He says Mr. H went on to explain that Certified would use the money raised from the Medallion Mortgage investment to build a building and once it was sold, they would be the first to be paid out from the sale proceeds. They say he gave them no indication that there was any risk to the investment. Although we asked for it, FundEX has not provided any notes or other evidence from Mr. H to suggest otherwise.
- FundEX says case law indicates that investors have a responsibility to make reasonable inquiries with respect to their investments and to limit their investment losses. While case law may indicate that investors have a responsibility to make reasonable inquiries and to limit their losses, the case law also indicates that the investors' knowledge and experience will direct what is reasonable in the circumstances. Mr. and Mrs. S were not experienced investors and have limited investment knowledge. They say they always followed Mr. H's advice and did not ask many questions, in part because they did not know what to ask. In their circumstances, we find nothing inappropriate or unusual about their reliance on Mr. H and if they asked no questions it was not as a result of negligence on their part but

rather because they did not know what to ask and because they saw nothing that seemed out of the ordinary or caused them concern.

- Finally, we have not seen any evidence to suggest that Mr. and Mrs. S had any indication or reason to believe there was any risk or any problem with the Medallion Mortgage investment until after they tried to cash it in. On November 2, 2009, Mrs. S emailed Mr. H saying they wanted to cash out their Certified investment. Mr. H contacted Certified on November 4, 2009 and on November 6, 2009, Mr. H forwarded an email from Certified containing a Client Payout report and a general release of mortgage document, which Mr. and Mrs. S signed and faxed back to Mr. H on the same day. Mrs. S emailed Mr. H on November 6, 2009 asking when they could expect receipt of their money. Mr. H was unable to provide Mrs. S with a response. On November 9, 2009, Mrs. S directly emailed Certified, using the contact information she found in Mr. H's previously forwarded email. In her email to Certified, she inquired about the logistics of the mortgage redemption. In its November 10, 2009 response, Certified says it had 180 days to make the payout. Mrs. S says that Mr. H was unaware of the 180-day payment provision and since he had not been able to answer her questions about the payout and Certified was responding to her, she continued to correspond with Certified by email directly. Until April 30, 2010, Certified continued to represent that Mr. and Mrs. S would be paid in full. The payout was not made at the end of the 180-day period. Mrs. S continued to correspond with Certified about when they could expect to receive payment. Between May 31, 2010 and December 2010, Certified sent various letters to mortgage-holders advising about the problems it was encountering and that it was evaluating a restructuring plan.
- In December 2010, Mr. and Mrs. S received notice that a court-appointed receiver had taken over the building on which Certified had the second mortgage. The building was eventually sold for a price that did not even cover the first mortgage. In February 2011, Mr. and Mrs. S were advised their investment was lost. Despite their reasonable steps to redeem their investment, we cannot conclude that Mr. and Mrs. S were in a position to limit their losses at any point.
- In all of the circumstances, we do not believe there is a basis to impose contribution on Mr. and Mrs. S because we cannot conclude their losses were in part their fault.

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.
- FundEX 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 representative.
- It is therefore FundEX that is the party responsible for the recommendations that OBSI makes with respect to the clients of FundEX.
- Whether the firm then goes back to the representative 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

FundEX is responsible, as a member of OBSI, and vicariously, as the employer of Mr. H, for the losses Mr. and Mrs. S incurred due to Mr. H's investment advice and recommendations.

Mr. and Mrs. S are not experienced or knowledgeable investors, they reasonably relied on Mr. H's advice, and reasonably believed the Medallion Mortgage investment was approved by and made through FundEX, like all of the investments Mr. H had recommended and facilitated for them. In the circumstances, we find no basis to attribute any responsibility to Mr. and Mrs. S for their losses.

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 FundEX compensate Mr. and Mrs. S for \$102,763 plus interest of \$3,360² for total compensation of \$106,123.

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 on April 19, 2011 to the date of this report.