

IIROC CLS COMPLIANCE CONFERENCE 2014
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Dealing With Vulnerable Clients

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Agenda

1. Who are vulnerable clients?
2. OSC jurisdiction and approach to vulnerable clients
3. IIROC approach to vulnerable clients
4. Industry approach to vulnerable clients
5. Practical guidance



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1. Who Are Vulnerable Clients?

- Non-exhaustive list
 - investor needs more than normal end of spectrum of investment education/advice
 - due to some personal attribute(s) or life circumstance(s)
 - vulnerability requires special/extra attention and advice
 - how much more attention and advice depends on circumstances
 - practically, it means: (1) legal standard and duties owed to such clients are higher and (2) that benefit of doubt in an investor dispute will be exercised in favor of client (not the broker)

Who Are Vulnerable Clients? continued

- “Vulnerable”
 - *“people...susceptible to being harmed...in need of special care, support, protection because of age, disability or risk of abuse”*
 - *“The circumstances [of a broker-client relationship] can cover the whole spectrum from total reliance to total independence. An example of total reliance is [a 78 year old widow with no business experience who had never dealt with a stockbroker before her husband’s death]” (Varcoe v. Sterling Ont. S.C.J., 1992)”*

Who Are Vulnerable Clients? continued

- “Seniors”
- Mental capacity issues
- Language barriers
- Affinity group exploitation
- Truly unsophisticated investors

2. Vulnerable Client Issues at OSC

- Responsible for oversight of registrants not governed by IIROC or the MFDA, e.g. portfolio managers, exempt market dealers, investment fund managers
- OSC detects vulnerable client issues through investor complaints, compliance examinations, referrals from other regulators

Vulnerable Client Issues at OSC, continued

- Focus on issues related to seniors because
 - Growing as a demographic
 - Rely on investments or income replacement to fund retirement costs
 - Reduced investment time horizon to recover from financial losses
 - Possible diminished mental capacity, and lack of investment or business knowledge may be exacerbated by age

Vulnerable Client Issues at OSC, continued

- *Office of the investor* - what is it?
 - Investing information for seniors includes CSA notice, “Scam artists pursue adults over 50” using:
 - investment seminars with high pressure sales tactics
 - non-complying sales of exempt market products
 - foreign exchange market
 - offshore investments
 - Examples of cases involving older or vulnerable clients, *Re Maple Leaf Investment Fund Corp* (2011) and *Re Sabourin* (2009)
 - Promoted products as high return, low risk
 - Aggressive sales tactics

Vulnerable Client

Issues at OSC, continued

- Members of immigrant communities (affinity fraud)
 - English as second language (or no English language skills)
 - Cultural issues that cause vulnerability (e.g. deference to authority or higher socio-economic strata)
- *R v. Tang*
 - respondent leveraged language and cultural ties in Chinese community to attract investors to his investment fund
 - investment fund was a Ponzi scheme
 - of \$50 million invested, only \$26 million was returned to investors

3. Vulnerable Client Issues at IIROC

- Seniors and other vulnerable clients a strategic priority for IIROC since 2011
- A significant percentage of enforcement activity involve seniors' accounts
- For the period of Jan-Oct. 2014:
 - 35% of Case Assessment files opened
 - 50% of these cases are the result of direct complaints by seniors to IIROC
 - nearly 1/3 of total completed prosecutions relate to claims involving senior clients

Vulnerable Client

Issues at IIROC, continued

Common Themes/Observations

1. Complete Reliance on Advisor
 - due to (1) long-standing professional relationship; (2) limited investment knowledge; (3) change in circumstances – “widow” scenario

2. Desire vs Tolerance of High risk
 - vulnerable agreeing to invest in high risk products to generate desired level of income

3. NAAF updates to justify trading
 - even where no change in circumstances
 - to respond to compliance queries

Vulnerable Client

Issues at IIROC, continued

Some Recent Cases

- In the Matter of *Wasseem Dirani*
 - client was retired and unsophisticated investor
 - needed income to supplement modest pension
 - respondent recommends using borrowed funds to invest in certain securities which would provide the needed income and service the debt
 - eventually principal eroded
 - further income required... additional line of credit obtained and secured against her house to be used for investment purposes

Vulnerable Client

Issues at IIROC, continued

- In the Matter of *David Hayes*
 - respondent accepted trading instructions for client's account from spouse without receiving authorization from account holder
- In the Matter of *Jacques Turenne*
 - respondent borrowed money from client without consent of employer IIROC Dealer Member

Vulnerable Client

Issues at IIROC, continued

- In the Matter of *Daniel Edward Smith*
 - long-standing relationship with elderly couple
 - after husband's passing, widow provided monetary gifts to advisor's children, advisor and wife named as beneficiaries to her will
 - did not disclose conflict to firm



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4. Industry Perspectives Regarding Vulnerable Clients

- Need for effective policies to address seniors-specific issues
- *IIAC Compliance, Supervisory, and Other Practices when Serving Senior Investors*
 - best practices for dealing with seniors
 - certain general statements applicable to seniors:
 - limited ability to replenish capital losses
 - unrealistic expectations and low risk tolerance
 - greater susceptibility to physical and cognitive impairments

Industry Perspectives

Regarding Vulnerable Clients, continued

- *SEC Protecting Senior Investors: Compliance, Supervisory and other Practices used by Financial Services Firms in Serving Senior Investors*
 - provides an overview of existing practices, including communications, supervision, ensuring compliance, training, escalation procedures, determining appropriate investments, etc.

5. Practical Guidance

- Actual examples of (potentially) vulnerable clients:
 - Well educated professional whose spouse recently and without prior illness died, leaving surviving spouse in depressed state where judgment, ability to reason is clouded
 - 70 year old retired professional person who is in excellent health, a life-long growth investor who had high employment income and who has high cost lifestyle but with a modest amount of investment capital and a demand for very high income from it
 - Uneducated (grade 8) middle-aged, self employed person who has very modest income and investments who just came into a large inheritance who has a new lavish lifestyle and wants to “double his money”

Practical Guidance, continued

- 90 year old widow in good health, who reviews her account statements, talks about current events (including business issues) but frequently asks her broker the same questions that have been asked and answered before
- New immigrant to Canada with Ph.D., works at foreign government consulate but has elementary school level ability to read, understand and speak English and who wishes to transfer a \$500,000 investment portfolio from Asia to Canada

Practical Guidance, continued

- Practical Guidance
 - Red flag compliance practice applies – if a “flag” appears that indicates vulnerability, take appropriate compliance measures
 - Compliance measures include assessing whether there is a vulnerability, and if so, its nature and extent by:
 - asking broker
 - speaking with client
 - speaking with clients’ family members

Practical Guidance, continued

- If conclude that there is material vulnerability:
 - determine whether client has capacity to understand advice and provide informed instructions *through materially enhanced broker advice* (which may include translation services if the issue is language skills)...if so, that's the solution but take more detailed notes than usual and actively monitor the situation for degradation in capacity

Practical Guidance, continued

- if client does *not* have such capacity, pursue method to replace client's discretion with a surrogate:
 - trading authority (*note - TAs often don't permit authority to withdraw cash*) *
 - power of attorney (*note - a P of A needs to have sufficient clarity to grant power to deal with brokerage account*) *
 - court application to appoint a guardian

*(*The legal test for having enough capacity to grant a TA or P of A is low – one can be incapable of managing one's property but still have the capacity to grant a TA or P of A.)*

Practical Guidance, continued

- Consider enhanced policies and procedures for dealing with seniors and other vulnerable clients
 - Stipulate requirement for clearer and more detailed communication
 - Provide appropriate training to identify capacity issues
 - Policies and procedures for dealing with senior-specific issues such as aversion to long-term, growth and/or speculative strategies
 - enhanced monitoring and testing of advisors/their accounts who have book concentrated on retirees

Questions/comments?