BANKING ON CORPORATE

BY NEILL MAY

The blame game

Assigning responsibility for bad outcomes can be tricky business. This is particularly so where responsibility is shared and must be allocated in percentage amounts (perhaps in part because it doesn't comport with the "but for" test, which is generally well-ingrained in lawyers but to others must sound like a cute four-member boy band). Allocating blame is also challenging where one party assumes responsibility for itself but fault is nevertheless imposed on another party. These complexities were in play in a recent decision of the B.C. Court of Appeal, which dealt with the responsibility of an investment broker for a client's trading losses.

In *Marlin Investments Inc. v. Moldovan,* the broker's client was experienced and knowledgeable, having held "very senior positions" in investment firms. He also appears to have experienced risk: he was "virtually wiped out" in the 1980s, and made an assignment in bankruptcy in 1988. And the client's KYC or "know your client" form (which asks questions about a client's personal information, financial information, risk tolerance, and investment objectives in order to allow an investment professional to assess the suitability of investment alternatives for it) indicated an estimated net worth of $700,000 and annual income of $50,000. The form also indicated the client's experience in options was "extensive," and one of the forms (there were two copies) stated the investment objective was 100-per-cent "speculative high risk."

In reality, however, the investor had "very few fixed assets" at the time, and was living on government subsidies. He was spending a significant amount of time caring for his ailing wife and had developed health problems of his own, including the loss of sight in his one good eye so he was unable to read a computer screen.

The option investment program implemented for the investor initially made money, but then went south during the 2008 financial crisis. The court concluded the broker clearly did not have a clear sense of its client's financial and physical vulnerability, and had not sufficiently probed into the client's wherewithal. The decision appears to have been influenced by the finding that the broker itself had filled in portions of the KYC forms prior to sending them to the client.Nevertheless, the court imposed a high KYC standard, concluding "an investment strategy must be suitable to the client, not merely conform to the information recorded on an account opening form," requiring due diligence beyond the review of forms "to learn the essential facts of a client's financial circumstances." In fact, the diligence obligation appears, based on this decision, to extend beyond strictly financial circumstances to factors such as the physical health of the client and his or her spouse, which have only an indirect relationship with investment suitability.

Because the client's losses followed gains earned from the same investment strategy (there were no complaints about the option investments while there were profits, not surprisingly), in calculating damages those investment gains were set off against the (larger) losses. As for the incorrect statements of fact in the client's KYC forms, the decision, in creating an obligation to look past those statements and probe directly into elements of a client's life not directly related to its finances, runs counter to trends in other securities regulatory contexts, which rely on investors' self-declarations of net worth, income, and risk tolerance. For example, declarations as to eligibility to participate in private placements and acknowledgments of assumption of investment risks are an important part of practice in financings and continue to be utilized in legislative frameworks. Still, in spite of the high KYC standard, the court concluded the investor client had been contributorily negligent, and apportioned 20 per cent of the fault to Marlin Investments Inc. (by necessity, a somewhat arbitrary figure).

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Maybe it is something about securities cases that makes assigning responsibility challenging. There are certainly times when allocating blame is easier; I recall a time when an old friend visited when my kids were infants and tried to blame the kids for the consequences of his flatulence. In some ways the issue may be a function of the unpredictable peaks and troughs of the capital markets, where no one pays much heed to the niceties of things like KYC forms when everyone's making money, but as soon as losses are triggered it's someone else's fault and time to scrutinize every move they made. In such cases, blame for losses is very rarely easily attributable to a single person or factor. Like a bad smell, it is easily spread, less easily allocated. CL

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