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Insurance Law
The Insured Professional

Professional Liability and the Financial Advisor

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> When called on to account the [financial] advisor is not, of course, answerable as "guarantor", "custodian" or "insurer" ... but only to show that he or she reasonably applied the skill and care appropriate to the task undertaken and to the circumstances of the case. [1]

A financial advisor cannot guarantee the financial success of their professional services. This is certainly the situation with financial advisors over the past 18 months since the banking crisis of 2008. The duties on behalf of a financial advisor will vary along the continuum from order-taker to fiduciary depending on the specific nature of the relationship with the client. Each case is fact specific due to the unique relationship that the advisor has with each client. In most cases, the role is somewhere in the middle on the order-taker-fiduciary continuum, being one of advisor. Where advice is provided, the advisor is obliged to advise with reasonable care, skill and diligence and will be held to an objective standard similar to other professional advisors. This paper will provide an overview of the regulatory and legal obligations of financial advisors and the liability they face in providing their unique services.

Increasingly, clients with various levels of investment experience and risk tolerance rely on the guidance and advice of financial advisors. This is growing exponentially as baby boomers try to maximize their assets as they approach retirement and try to retire earlier. The number and complexity of financial instruments are also increasing dramatically. The 2008 banking crisis and resulting market downturn has also led to greater decreases in portfolio value. It is expected that the combination of these factors will lead to an increase in litigation. When market gains turn to losses, investors are examining if they can or should look to their advisors

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[1] *Rhoads* v. *Prudential-Bache Securities Canada Ltd.*, 1992 CanLII 658 (BC C.A.) at p. 8, quoted in *Davis* v. *Orion Securities Inc.*, 2006 CanLII 26966 (ON S.C.) at paras. 29 and 52.

for compensation and courts are being asked to determine who should bear responsibility for the losses.

THE ROLE OF THE FINANCIAL ADVISOR

The role of the financial advisor can range from taking orders and executing trades without providing any investment advice or trading recommendations to providing investment advice without discretion to discretionary trading. In determining the duties that may be owed by brokers/investment advisors, the case law has recognized that the broker/investment advisor-client relationship is on a continuum from order taker to fiduciary depending on the specifics of the particular relationship. This has been referred to in the cases as the order-taker/fiduciary "continuum" or "spectrum".[2] The Ontario Court of Appeal adopted the following helpful framework:

> [O]ne should consider the broker-client relationship to be a spectrum. At one end is a relationship of full trust and advice. The broker effectively makes all the decisions because of the great reliance and trust reposed in him or her by the client.... This is exacerbated where the account is discretionary, such that the broker has the authority to make trades without the client's consent or even knowledge ... Obviously, there is a fiduciary relationship at this end of the spectrum...
>
> At the other end is a relationship where the broker is merely an "order-taker" for the client, the client does not rely on any advice from the broker, and the broker had no discretion. This was the case in *Varcoe* itself. Relationships at this end of the spectrum lack the elements of a fiduciary relationship.

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[2] *Young* v. *RBC Dominion Securities*, 2008 CanLII 70045 (ON S.C.) at paras. 182(6) and 192(3), *Hunt* v. *TD Securities Inc.*, 2003 CanLII 3649 (ON C.A.) at para. 42, *875121 Ontario Ltd.* v. *Nesbitt Burns Inc.*, 1999 CanLII 14951 (ON S.C.) at paras. 78 and 75, *Varcoe* v. *Sterling* (1992) 7 O.R. (3d) 204 (Gen. Div.) at para. 87, affirmed [1992] O.J. No. 1501 (C.A.), leave to appeal refused [1992] S.C.C.A. No. 440 (S.C.C.).

> Most cases fall somewhere in the middle....[3]

It is clear from the authorities that every brokerage case is fact specific due to the unique relationship that the broker has with each client.[4]

Primarily, a financial advisor's relationship with the client is one of agent and principal. The agent takes instructions from the principal and carries them out with care, skill and diligence.[5] The relationship of financial advisor and client is not *per se* a fiduciary relationship however it may be elevated to a fiduciary level when the client places trust and confidence in the advisor and relies on the advisor's advice in making business decisions. When the advisor seeks or accepts the client's trust and confidence and undertakes to advise, the advisor must do so fully, honestly and in good faith.[6] Even if no fiduciary duty is found, the advisor still owes a duty of care regarding the advice actually given.[7] Additionally, the advisor must adhere to the duties and requirements set out in its governing legislation, professional regulations and/or codes of conduct. The advisor must also abide by the terms of any contract with the client. Breach of these obligations may give rise to an action in contract, negligence and/or breach of fiduciary duty and will be discussed in further detail below.

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[3] *Hunt* v. *TD Securities Inc.*, 2003 CanLII 3649 (ON C.A.) at para. 42, citing *Kent* v. *May* (2001), 298 A.R. 71 (Q.B.) at paras. 51-53, aff'd 2002 ABCA 252 (CanLII), (2002), 317 A.R. 381 (C.A.).
[4] *Robinson* v. *Fundex Investments Inc.*, 2006 CanLII 24459 (ON S.C.) at para. 110.
[5] *Varcoe* v. *Sterling* (1992), 7 O.R. (3d) 204 (Gen. Div.) at para. 89, affirmed [1992] O.J. No. 1501 (C.A.), leave to appeal refused [1992] S.C.C.A. No. 440 (S.C.C.).
[6] *Varcoe* v. *Sterling* (1992), 7 O.R. (3d) 204 (Gen. Div.) at paras. 87 and 90, affirmed [1992] O.J. No. 1501 (C.A.), leave to appeal refused [1992] S.C.C.A. No. 440 (S.C.C.).
[7] *Abrams* v. *Sprott Securities Ltd.*, 2003 CanLII 27136 (ON C.A.) at para. 36 citing *875121 Ontario Ltd.* v. *Nesbitt Burns Inc.*, 1999 CanLII 14951 (ON S.C.) at para. 87.

REGULATORY REGIME

As is the case with other professionals, individuals who provide financial advice are governed by various forms of legislation, regulations, self-governing association rules and standards, codes of conduct and internal policies. It was noted by La Forest J. in *Hodgkinson* v. *Simms*[8] that "... the rules set by the relevant professional body are of guiding importance in determining the nature of the duties flowing from a particular professional relationship". In *Abrams* v. *Sprott*,[9] the Ontario Court of Appeal, citing *Hodgkinso*n, confirmed that professional standards of conduct inform, but do not govern, the standards of care set by the courts for acceptable professional conduct. Referring to various professional rules, regulations, policies and guides, the court in *TechHi Holdings Ltd.* v. *Merrill Lynch Securities Inc.*,[10] stated:

> They establish standards which are not determinative of allegations of negligence, breach of contract or breach of fiduciary duty but which will clearly inform the analysis of whether there has been negligence or a breach of contract or of fiduciary duty on the part of an investment dealer or registered representative with respect to a client.

While a breach of such regulatory standards does not automatically give rise to civil liability, proof of a breach of regulatory standards, causative of damages, is some evidence of negligence and informs the duty and standard of care.[11]

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[8] 1994 CanLII 70 (S.C.C.), [1994] 3 S.C.R. 377 at p. 425.
[9] *Abrams* v. *Sprott Securities Ltd.*, 2003 CanLII 27136 (ON C.A.) at para. 37.
[10] 2004 CanLII 5767 (ON S.C.) at para. 157.
[11] See *Saskatchewan Wheat Pool* v. *Canada* (1983), 143 D.L.R. (3d) 9 (S.C.C.) at 21-25; *Davidson* v. *Noram Capital Management Inc.*, 2005 CanLII 63766 (ON S.C.) at para. 51.

While the regulatory regime of every type of financial advisor or financial planner is beyond the scope of this paper, two of the key industry rules governing investment advisors which figure prominently in investment advisor liability cases are highlighted.

Securities industry professionals, such as investment dealers and their registered investment advisors, are governed by, *inter alia*, securities legislation and regulations, self-regulatory organization rules, the Conduct and Practice Handbook for Security Industry Professionals,[12] as well as internal firm policies. The national self-regulatory organization for investment dealers and investment advisors is the Investment Industry Regulatory Organization of Canada (IIROC).[13] The Dealer Member rules of IIROC set out two of the fundamental rules for securities industry personnel: the "Know Your Client" rule and the related "suitability" of investments rule which are discussed below. They are two of the key tools used by regulators to protect the public, by advisors to show that they complied with their obligations and by investor plaintiffs' counsel to support their case for an advisor's professional liability.

The "Know Your Client" Rule

The "know your client" rule has been called "the cardinal rule of the brokerage business".[14] This rule is reflected in Rule 1300.1 of the IIROC Dealer Member Rules[15] as follows:

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[12] The Conduct and Practice Handbook for Security Industry Professionals is published by financial services educator CSI and is endorsed by regulatory authorities across Canada.
[13] IIROC is a consolidation of self-regulatory organizations including the Investment Dealers Association.
[14] *Varcoe* v. *Sterling* (1992), 7 O.R. (3d) 204 (Gen. Div.) at para. 26, affirmed [1992] O.J. No. 1501 (C.A.), leave to appeal refused [1992] S.C.C.A. No. 440 (S.C.C.).
[15] http://iiroc.knotia.ca

> (a) Each Dealer Member shall use due diligence to learn and remain informed of the essential facts relative to every customer and to every order or account accepted.

The "know your client" rule requires an investment advisor to become knowledgeable about the client's personal and financial circumstances including but not limited to age, employment, marital status, spouse's employer, dependants, assets, income, investment knowledge and experience, investment objectives and risk tolerance.

Rule 2500 of the IIROC Dealer Member Rules mandates that when opening new accounts, investment advisors must complete an account application for each new customer to obtain accurate and complete information on each client. This information is required "to conduct the necessary review to ensure that recommendations made for any account are appropriate for the client and in keeping with [the] client's investment objectives". Typically, the "know your client" information is part of the account application but may be on a separate form. There is no standard form and most investment firms have their own internal version.

Rule 2500 of the IIROC Dealer Member Rules states that it establishes minimum industry standards and that completing proper new account documentation is only the first step towards compliance with the "know your client" rule. It has been held that "The K.Y.C. part is just one piece, although an important piece, of evidence to be considered when determining whether the advisor complied with the Know Your Client rule. … Not every investor fits neatly into the boxes that are outlined in the Know Your Client form and an advisor, in order to properly assess risk, has to look at the investor's overall objectives and profile."[16] Compliance with the "know your client" rule is a process that requires meeting with the client, speaking with the

[16] *Robinson* v. *Fundex Investments Inc.*, 2006 CanLII 24459 (ON S.C.) at paras. 53 and 54.

client, completing the forms, reviewing the transaction and updating client information. In *Davidson* v. *Noram*,[17] the court stated:

> An investment advisor cannot have a process whereby new clients simply sign *pro forma* agreements, neither explained nor understood, as seen in the case at hand. An investment advisor needs a process whereby it can be established objectively that a meaningful explanation of risk has been given, understood and accepted by the client before the advisor commences management of the client's portfolio.

The "Know Your Client" Rule does not end at the completion of the initial interview and opening of the account. The obligation continues throughout the advisor-client relationship as the client's personal and financial circumstances can change. The industry standard set out in the IIROC Dealer Member Rules provides that the advisor must update the information on the application where there is a material change in client information.[18] Loss of or change in employment, marriage, divorce and the addition of dependants are some examples of material changes that would require updating the information on the application. The client's investment knowledge, investment objectives and risk tolerance also change over time and should be updated. While the client has an obligation to advise of a material change in their circumstances, it is the investment advisor's responsibility to remain informed of the client's essential facts and should make periodic inquiries of the client. As stated above, this updated information is required to ensure that the client's investment portfolio and any new recommendations are appropriate for the client and in keeping with the client's investment objectives.

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[17] *Davidson* v. *Noram Capital Management Inc.*, 2005 CanLII 63766 (ON S.C.) at para. 57.
[18] IIROC Dealer Member Rules, Rule 2500.

This leads into the next topic which is the related "suitability" of investments rule. It has been stated that the "know your client" and "suitability" obligations are interwoven obligations.[19]

The "Suitability" of Investments Rule

In *Robinson* v. *Fundex*, the court summed up the "suitability" rule as follows:

> [The] "Know your Client" rule is related to another fundamental duty owed by the financial advisor to the client, which is to ensure that all investments made for the client are suitable for the client and in keeping with the client's investment objectives and risk tolerances. An investment portfolio created by an advisor for his client must be suitable for the client. The advisor must also monitor the ongoing suitability of investments to ensure they continue to remain suitable when there are material changes in the client's personal or financial circumstances, investment objectives or tolerances.[20]

The suitability rule is reflected in Rule 1300.1 of the IIROC Dealer Member Rules as follows:

(a) Each Dealer Member shall use due diligence to learn and remain informed of the **essential facts relative to** every customer and to **every order** or account accepted.

(o) Each Dealer Member shall use due diligence to ensure that the acceptance of any order for any account is within the bounds of good business practice.

(p) Subject to [certain exceptions], each Dealer Member shall use due diligence to **ensure that the acceptance of any order from a customer is suitable** for such customer based on factors including the customer's financial situation, investment knowledge, investment objectives and risk tolerance.

(q) Each Dealer Member, **when recommending** to a customer the **purchase, sale, exchange or holding of any security**, shall use due diligence to **ensure that the recommendation is suitable** for such customer based on factors including the customer's financial situation, investment knowledge, investment objectives and risk tolerance.[21] [emphasis added]

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[19] *Daubney, Re* 2008 CarswellOnt 2552 (Ontario Securities Commission), 31 O.S.C.B. 4817 at para. 16.
[20] *Robinson* v. *Fundex Investments Inc.*, 2006 CanLII 24459 (ON S.C.) at para. 114.
[21] IIROC Dealer Member Rules, Rule 1300.1, (a), (o), (p) and (q).

In addition to the obligation to know the essential facts about the client, Rule 1300.1 (a) requires an investment advisor to know the investment products they are selling and the types of accounts they are opening. The "good business practice" requirement in Rule 1300.1(o) includes, for example, ensuring that the order does not overly concentrate the account in one security or type of security.[22] 1300.1(p) and (q) require that the investment advisor ensure that the investment is suitable for the client (based on the "know your client" factors) whether or not the investment is requested by the client or recommended by the advisor. As a recommendation may be for the purchase, sale, exchange *or holding* of any security, the advisor must ensure that the investments previously purchased remain suitable.

The determination of suitability will depend on the client and the circumstances. In *Parent* v. *Leach*,[23] the court stated: "[s]uitability is not to be understood as having a single or absolute meaning. Its application will depend on the client and the circumstances. It cannot be measured looking backwards." The question of whether or not an investment was suitable will be determined based on a consideration of a number of factors including the new account application/KYC together with any updates, the advisor's recommendations/warnings, the investor's involvement in the trading decisions and the investor's trading experience and risk tolerance.

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[22] *Young* v. *RBC Dominion Securities*, 2008 CanLII 70045 (ON S.C.) at para. 57.
[23] *Parent v. Leach*, 2008 CanLII 26688 (ON S.C.) at para. 132.

CAUSES OF ACTION

There are a number of causes of actions available against financial advisors. The three main causes of action are breach of contract, negligence and breach of fiduciary duty.

Breach of Contract

The relationship between a financial advisor and a client is generally a contractual one. As a matter of course, investment dealers or brokerage houses have their own standardized account agreements which they enter into with clients. These types of contracts may be found to include both written and unwritten terms. The unwritten terms may include express oral representations and/or implied terms. The implied terms are often based on industry standards.

The liability of a broker in contract and in negligence is concurrent.[24]

Negligence

It is well established in the case law that a financial advisor owes a duty of care to the client.[25] At a minimum, the advisor owes a duty to execute instructions and act honestly.[26] Where advice is provided, the advisor also owes a duty of care regarding the advice actually given.[27]

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[24] *Davis* v. *Orion Securities Inc.*, 2006 CanLII 26966 (ON S.C.) at para. 27.
[25] *Parent v. Leach*, 2008 CanLII 26688 (ON S.C.) at para. 88.
[26] *Abrams* v. *Sprott Securities Ltd.*, 2003 CanLII 27136 (ON C.A.) at para. 33.
[27] *Abrams* v. *Sprott Securities Ltd.*, 2003 CanLII 27136 (ON C.A.) at para. 36 citing *875121 Ontario Ltd.* v. *Nesbitt Burns Inc.*, 1999 CanLII 14951 (ON S.C.) at para. 87.

The advisor has a duty to advise with reasonable care, skill and diligence.[28] It has been held that the extent of an advisor's duty to a client, beyond the duty of executing instructions and acting honestly, is a question of fact in each case.[29] The duty on behalf of a financial advisor will vary from that of an order taker to that of a fiduciary depending on the specifics of the relationship.[30]

A duty to warn flows from a duty of care in negligence cases.[31] The content and scope of a broker's duty to warn is defined with reference both to the knowledge and skill of the client and to the nature of the relationship between the client and the broker. In *Robinson* v. *Fundex*,[32] the court summed up the duty to warn as follows:

> In essence also the existence of a duty to warn is dependent on the standard of care owed to a particular client. The specifics of the particular relationship between the advisor and the client must be analyzed to determine whether an advisor has a duty to warn a client and if so the extent of that duty. The content and scope of a broker's duty to warn is defined with reference both to the knowledge and skill of the client and to the nature of the relationship between the client and the broker. A duty to warn does not arise from the mere relationship of broker to client but from the facts in each case.

The duty to warn is not absolute but flexible, depending upon the particular situation. To support this proposition the court in *Parent* v. *Leach* cites the Ontario Court of Appeal decision in *Abrams* v. *Sprott Securities Ltd.* which quotes *Carom* v. *Bre-X Minerals Ltd.*:[33]

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[28] *Davis* v. *Orion Securities Inc.*, 2006 CanLII 26966 (ON S.C.) at paras. 42 and 27.
[29] *Abrams* v. *Sprott Securities Ltd.*, 2003 CanLII 27136 (ON C.A.) at para. 33.
[30] *Supra*, note 2.
[31] *Carom* v. *Bre-X Minerals Ltd.*, 1999 CanLII 14794 (ON S.C.) at para. 238, aff'd (1999), 46 O.R. (3d) 315n (Div. Ct.), rev'd on other grounds 2000 CanLII 16886 (ON C.A.), leave to appeal to S.C.C. denied [2000] S.C.C.A. No. 660.
[32] *Robinson* v. *Fundex Investments Inc.*, 2006 CanLII 24459 (ON S.C.) at para. 56.
[33] *Parent* v. *Leach*, 2008 CanLII 26688 (ON S.C.) at para. 94, citing *Abrams* v. *Sprott Securities Ltd.*, 2003 CanLII 27136 (ON C.A.) at para. 33 quoting *Carom* v. *Bre-X Minerals Ltd.*, 1999 CanLII 14794

> [A] duty to warn does not arise merely because of the broker-client relationship....
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> In essence, the existence of a duty to warn is dependent on the standard of care owed to a particular client. Accordingly, the specifics of the relationship between the broker and the client must be analyzed to determine whether a broker has a duty to warn a client...For example, it cannot be said that the same standard of care exists between [a discount brokerage firm, which does not provide advice, and its client]...as would exist between a broker and a client who relied on the broker to manage a discretionary trading account. Nor can it be said that the standard of care for a client who is interested only in speculating is the same as that for a client who relies upon the broker for advice on a long term investment.
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> ...
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> The standard of care owed by an investment advisor to a particular client is concordant with the services that he advised or undertook to provide to the client, that is, whether the client was to be provided advice as opposed to mere information or whether the advisor was given discretion to trade on behalf of the client.

The standard of care which applies to an inexperienced investor is considerably higher than the standard that exists between a broker and a seasoned investor.[34]

Breach of Fiduciary Duty

While a broker-client relationship is not inherently fiduciary it can become a fiduciary relationship depending on the circumstances of the case. In *Varcoe* v. *Sterling*,[35] Keenan J. stated the following regarding the fiduciary principle in a broker-client relationship:

> The relationship of broker and client is not *per se* a fiduciary relationship. ... Where the elements of trust and confidence and reliance on skill and knowledge and advice are present, the relationship is fiduciary and the obligations that attach are fiduciary. On the other hand, if those elements are not present, the fiduciary relationship does not

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(ON S.C.) at para. 238, aff'd (1999), 46 O.R. (3d) 315 (Div. Ct.), rev'd on other grounds 2000 CanLII 16886 (ON C.A.), leave to appeal to S.C.C. denied [2000] S.C.C.A. No. 660.

[34] *Abrams* v. *Sprott Securities Ltd.*, 2003 CanLII 27136 (ON C.A.) at para. 34.

[35] *Varcoe* v. *Sterling* (1992) 7 O.R. (3d) 204 (Gen. Div.) at paras. 87 and 90, affirmed [1992] O.J. No. 1501 (C.A.), leave to appeal refused [1992] S.C.C.A. No. 440 (S.C.C.).

> exist. … The circumstances can cover the whole spectrum from total reliance to total independence.
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> …
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> The relationship of the broker and client is elevated to a fiduciary level when the client reposes trust and confidence in the broker and relies on the broker's advice in making business decisions. When the broker seeks or accepts the client's trust and confidence and undertakes to advise, the broker must do so fully, honestly and in good faith. … It is the trust and reliance placed by the client which gives to the broker the power and in some cases, discretion, to make a business decision for the client. Because the client has reposed that trust and confidence and has given over that power to the broker, the law imposes a duty on the broker to honour that trust and respond accordingly.

This passage was cited with approval by La Forest J. in *Hodgkinson* v. *Simms*[36] in the context of a financial advisory relationship. He stated:

> In my view, this passage represents an accurate statement of fiduciary law in the context of independent professional advisory relationships, whether the advisers be accountants, stockbrokers, bankers or investment counsellors. Moreover, it states a principled and workable doctrinal approach. Thus, where a fiduciary duty is claimed in the context of a financial advisory relationship, it is at all events a question of fact as to whether the parties' relationship was such as to give rise to a fiduciary duty on the part of the advisor.

The determination of a fiduciary relationship is very fact specific. As such, the court in determining the existence of a fiduciary relationship will examine the specific details regarding the nature of the financial advisor – client relationship. In *Hunt* v. *TD Securities Inc.*,[37] the Ontario Court of Appeal summarized the five interrelated factors to be considered when determining whether financial advisors stand in a fiduciary relationship to their clients:

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[36] 1994 CanLII 70 (S.C.C.), [1994] 3 S.C.R. 377 at p. 420.
[37] 2003 CanLII 3649 (ON C.A.), (2003) 66 O.R. (3d) 481 (C.A.) at para. 40.

1. Vulnerability – the degree of vulnerability of the client that exists due to such things as age or lack of language skills, investment knowledge, education or experience in the stock market.

2. Trust – the degree of trust and confidence that a client reposes in the advisor and the extent to which the advisor accepts that trust.

3. Reliance – whether there is a long history of relying on the advisor's judgment and advice and whether the advisor holds him or herself out as having special skills and knowledge upon which the client can rely.

4. Discretion – the extent to which the advisor has power or discretion over the client's account.

5. Professional Rules or Codes of Conduct – help to establish the duties of the advisor and the standards to which the advisor will be held. [emphasis added]

The court noted that the description of these five factors is not intended to be exhaustive and that the evidence relevant to one factor may be relevant also to a consideration of one or more of the other factors.[38]

In *Robinson* v. *Fundex*,[39] the court stated that a fiduciary duty is clearly owed where the account is a managed account where trading is on a discretionary basis by the broker with the consent of the client. The court further stated that the relationship is clearly not a fiduciary one where the broker is acting as an agent/conduit to effect a trade where no advice is owed.[40] In *Hunt* v. *TD Securities Inc.*, a non-discretionary investment account with a broker was described as, "reflect[ing] the conscious decision of the parties to leave power and discretion in the hands of the investor". [41]

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[38] *Hunt* v. *TD Securities Inc.*, 2003 CanLII 3649 (ON C.A.) at para. 41.
[39] *Robinson* v. *Fundex Investments Inc.*, 2006 CanLII 24459 (ON S.C.) at para. 111.
[40] *Robinson* v. *Fundex Investments Inc.*, 2006 CanLII 24459 (ON S.C.) at para. 111.
[41] *Hunt* v. *TD Securities Inc.*, 2003 CanLII 3649 (ON C.A.) at para. 51; referred to in *Abrams* v. *Sprott Securities Ltd.*, 2003 CanLII 27136 (ON C.A.) at para. 35 (footnote 1).

When the elements of a fiduciary relationship are present, the fiduciary has an obligation to advise carefully, fully, honestly and in good faith and to carry out instructions.[42]

CAUSATION

In order to establish liability against a financial advisor, it is necessary that the client's losses be caused by the advisor's breach.

> ... Causation is an essential component of any claim for breach of contract or negligence. To be recoverable, a loss must be caused by the contractual breach or the breach of duty in question. [43]

It has been held that breach of industry standards, regulations or internal rules, does not, in and of itself, give rise to any liability to the client unless the breach resulted in the damages sustained by the client; there must be a nexus between the breach and the loss.[44] Even if the internal guidelines were part of the contract, or indicated a standard of care for negligence, the plaintiff would still need to prove causation.[45]

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[42] *Varcoe* v. *Sterling* (1992) 7 O.R. (3d) 204 (Gen. Div.) at para. 86, affirmed [1992] O.J. No. 1501 (C.A.), leave to appeal refused [1992] S.C.C.A. No. 440 (S.C.C.).
[43] *Young* v. *RBC Dominion Securities*, 2008 CanLII 70045 (ON S.C.) at para. 236; *Parent* v. *Leach*, 2008 CanLII 26688 (ON S.C.) at para. 142 quoting *820823 Ontario Ltd.* v. *Kagan*, 2003 CanLII 43263 (ON S.C.) at para. 70 .
[44] *Young* v. *RBC Dominion Securities*, 2008 CanLII 70045 (ON S.C.) at para. 238; *Stojanov* v. *Holland*, [2001] O.J. No. 4586 (S.C.J.) at para. 41; see also *Parks* v. *Midland Walwyn Inc.*, 1995 CarswellOnt 3124 (Gen. Div.) at paras. 44 and 48.
[45] *Stojanov* v. *Holland*, [2001] O.J. No. 4586 (S.C.J.) at para. 41.

RECENT APPLICATION OF PRINCIPLES OF INVESTOR LIABILITY

As noted from the case law, the common types of alleged breaches that can lead to claims and ultimate liability against financial advisors for breach of contract, negligence and breach of fiduciary duty include failure to comply with industry standards, failure to comply with duty to "know your client", breach of duty to ensure that investments are suitable for the client and in keeping with the client's investment objectives and risk tolerances, failure to know the investment product, failure to provide adequate advice, failure to adequately explain margin trading, failure to provide adequate warning, failure to recommend a diversified portfolio and/or over-concentration in a specific sector, failure to execute instructions, execution of unauthorized trading and failure to disclose a conflict of interest.

In two recent trial decisions, Ontario courts have dismissed claims brought by clients against their advisors and investment firms where experienced clients pursued high-risk investment strategies despite adequate warnings about the risk from their advisors. Examining what the advisors did right in these cases provides guidance and is instructive on risk management and defensive strategies.

In *Parent* v. *Leach*,[46] after several years of aggressive option trading which resulted in substantial financial losses, the plaintiff sought to recover damages against the defendant advisor and investment firm for breach of duty in negligence and breach of contract. Ultimately, the court found the defendants were not liable for the plaintiff's damages. The parties conceded that the relationship between them was not a fiduciary one. The court noted

[46] 2008 CanLII 26688 (ON S.C.).

that this was consistent with the case law as the advisor maintained no discretion in respect of the various accounts and trading of the plaintiff and everything was done based on the decisions of the plaintiff.

The court held that the plaintiff could not escape his active and decisive role in his investment practices. The plaintiff had been trading in options for over eight years prior to the time that the losses claimed were sustained. During that period, the court found that the plaintiff had been involved in every trade made on his behalf, had made all investment decisions, had lost money, had been warned of the risks of the investments, had been directed to managed investments, had had his margins (loans to buy stock) called and been required to extend his cross-guarantees to meet the demands of his position. In the court's view, it was not reasonable to suggest that the plaintiff was not aware of the risks.

In the court's view, it was also not unreasonable that the defendant did not believe that the trades were "unsuitable" in light of his appreciation of the tolerance for risk consistently demonstrated by the plaintiff's trades. The court determined that the advisor "knew his client" as a result of the length of their relationship and the frequent discussions with respect to the trades being undertaken by the plaintiff. While there was non-compliance with respect to updating the account forms in relation to the Know your Client rule, that breach did not cause the plaintiff's financial losses.

The defendants were able to produce documentation that they had warned the plaintiff about the risk of the trading he was involved in. The court found that the plaintiff received at least

one warning letter from the defendant investment firm which the plaintiff had actually signed and sent back. Despite "too many warnings and too many opportunities to make the necessary changes", the plaintiff continued to trade as before which eventually resulted in substantial financial losses. The court found that the plaintiff was "the author of his own misfortune."

In *Young* v. *RBC Dominion Securities*,[47] the plaintiff, for himself and as estate trustee for his mother, claimed that their advisor and his employer failed to meet the duty of care and were negligent concerning losses sustained by the plaintiffs with respect to investments in Nortel and other tech stocks. The court found that Mr. Young was a knowledgeable investor who was able to take some risks and was looking for investment growth. His account was non-discretionary such that no trade could occur without Mr. Young's consent. Based on trading history, the court found that Mr. Young was "driving the bus" with respect to purchases of technology stocks and the advisor functioned as an order-taker. Mr Young chose to have his holdings concentrated in the technology sector and bought into the high-tech "mania".

Mr. Young's portfolio became overly concentrated in the high technology sector and one of the issues for the court was whether he received adequate warning with respect to the risk associated with this concentration. The court found that the advisor had ongoing discussions with Mr. Young about his holdings, their growth and concentration issues. Mr. Young admitted to three conversations in which the advisor told Mr. Young to lighten up on his high-tech stocks. The advisor also sent him newspaper articles which the court found to be a further caution regarding the concentration in his account. Referring to the case law holding that the extent of the duty to warn depends on the level of sophistication of the client, the court found

[47] 2008 CanLII 70045 (ON S.C.).

that Mr. Young was fully cautioned with respect to the issues of valuation of high technology stocks and concentration and that he declined to follow this advice.

The court further held that Mr. Young was a suitable candidate for the use of margin based on his level of business experience, his investment knowledge and his net worth. As in *Parent*, the court held that the failure to update the Know Your Client forms was not causative of Mr. Young's damages.

With respect to Mrs. Young, the court determined that she was also adequately cautioned about the concentration of Nortel in her portfolio taking into account her investment knowledge and experience. However, she too chose not to reduce her holdings despite being cautioned to do so. Her account was non-discretionary and the documentary evidence established that she directed the advisor with respect to the account. The court also held that the failure to update the Know Your Client forms was not causative of Mrs. Young's damages.

CONCLUSION

The role and responsibilities of the financial advisor are changing daily. They must know and understand and be able to explain to their clients new and more complex financial products. They are also asked to predict the future and provide financial assurance that unfortunately they often undertake. It is important for the financial advisor to recognize that what they may

believe is providing a service to their client could be the foundation for a lawsuit against them when the returns on the investment do not match the client's expectations.