

## A Wave of Investment Advisor Litigation?

If Peter Weinstein is correct, there's a new wave of investment advisor litigation just waiting in the wings, as investors try to assess what damage they may have sustained to their investment portfolios over the past year or two.

Weinstein has seen this wave before. As an investigative and forensic accountant and a chartered business valuator, he's been called in to quantify potential investor damages in numerous situations involving investment advisor litigation over the past five years, mostly relating to the 2000-2001 meltdown.

Now, looking forward, Weinstein, a partner with Stern Cohen LLP in Toronto, suggests that "given what has happened to the stock market over the last year or two, I expect there to be a significant increase in the number of claims involving investment advisors."

He bases his comments on two sources: statistics from the Investment Industry Regulatory Organization of Canada (IIROC), as well as anecdotal conversations with lawyers, some of whom, he says, are reporting an uptick in calls from irate, and sometimes distraught, investors.

According to IIROC, the total number of customer complaints reported by IIROC-regulated firms from January to August 31, 2009 was 1,428. In comparison, the total number for all of 2007 came in at 1,419. For 2008, the total number was 1,992.

### **Real or perceived losses**

Given the dramatic downfall – some investors may categorize recent stock market activity as freefall – looking for a place to apportion blame may be mighty appealing.

Yet Weinstein cautions that often, people think their losses are much higher than they actually are, or, sometimes, there are no losses at all.

"It may be a case of paper gains and then paper losses, rather than actual capital put in and taken out," he says. In his opinion, there's a "real benefit to lawyers in an early assessment that determines actual – or if any – damages have occurred."

For example, how much capital was actually invested? Investors may transfer securities between accounts or make multiple contributions and withdrawals. How much should the capital have grown if invested properly in equities, bonds or a combination? This can be difficult to determine, especially with portfolios containing a mix of stocks and bonds composed of Canadian, US and international investments.

Does a comparison of the portfolio with a relevant index suggest that the portfolio has underperformed? Weinstein cautions that the key words are "comparison with a relevant index," which, he suggests, if not adhered to, can spawn another common – and further – disagreement: whether the portfolio was diversified properly.

Then there's the old saw: management fees and expenses, which clients often resent when the market is sour. Yet "these are necessary and should be tallied and deducted from what would have been earned," says Weinstein. And finally, investors sometimes forget, when calculating their returns, that they withdrew funds from their portfolio.

### **Distraught investors turn to lawyers**

Most financial professionals are careful to follow the policies and rules in this regulated profession, designed to protect the investing public from overexposure to unmanageable risk, says Peter Jervis, a partner in the National Litigation Group with Davis LLP in Toronto.

However, when the markets are very hot and there is money to be made – some, but hopefully very few – relax those standards, says Jervis, a litigator with significant experience in securities litigation and class actions.

“They encourage clients to invest in higher-risk or speculative securities, and often, to incur margin, and to overexpose themselves to extreme risk,” says Jervis, “in order to earn greater returns for the client and greater remuneration for themselves.

“When the cycles turn, as we saw in 1987, 1998, 2000–2001 and 2007–08, many of these clients were significantly overexposed and, in some cases, lost 50–70 per cent, or even all, of their investment equity. These people have been devastated, their only recourse, as they see it, is to turn to a lawyer.”

### **Meritorious concerns**

Morris Cooper is a Toronto litigator who has counselled and acted for a number of investors in situations involving financial advisors.

While he does get calls from investors concerned about real or perceived investment losses, the greatest proportion of calls relate to several issues.

“Primarily, they [investors] express concern about advisors acting as if they had discretionary counsel who did not have this authority; ‘churning’ [buying and selling to increase fees]; and putting them into investments that clearly were the antithesis of their profiles.”

Cooper's take dovetails with IIROC, which reports that “the top two reported violations as of August 31st, 2009 are: unsuitable investments (54%) and unauthorized or discretionary trading (12%).”

“Investors who take the time and trouble to see a lawyer, and incur the expense, are not merely venting,” says Cooper. “They are coming because they sense what happened to them involved more than investment judgment.

“Usually, they correctly recognize that something has gone profoundly wrong,” he continues. “It may or may not be actionable, but generally they have meritorious concerns.”

That's when Weinstein and other professionals in his field come into the equation.

*Bev Cline is a freelance legal and business writer/editor in Toronto.*  
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