Some Investor Protections

By Albert S. Frank, LL.B.

Investment Firm Problems

In one of Woody Allen's movies a stockbroker comments that he invests people's money until it is all gone. Sometimes the stockbroker (investment advisor) or the investment firm does the investor more harm than good.

Sometimes investment advisors lose money by investing contrary to the investor's objectives or instructions. Investment advisors can – though few do – misappropriate the contents of investment accounts. Investment advisors, and even the firms they work for, can go bankrupt or insolvent.

There are some protections, however, against problems with investment advisors and investment firms.

Canadian Investor Protection Fund

The Canadian Investor Protection Fund, "CIPF," is basically a deposit insurance to protect the investor against the insolvency of the investment firm. In other words, if

the firm goes broke and cannot pay back the cash and securities it is supposed to be holding, the investor can be compensated from the CIPF.

Note that the CIPF covers not just the cash balances but also securities such as stocks, bonds, etc. The CIPF covers up to $1,000,000 of securities and cash balances.

The CIPF covers investment accounts, not regular bank accounts. Regular bank accounts are insured through the Canada Deposit Insurance Corporation, up to a maximum of $60,000 per depositor.

The CIPF protects investors if an investment firm becomes insolvent and cannot pay the securities and cash balances back to the investors. But the CIPF does not compensate investors for trading losses, even if those losses were caused by improper trading by the investment advisor.

Investors certainly should not sit back and do nothing if they learn that an investment firm they deal with has become insolvent. Investors have only 180 days from the date of insolvency to file a claim for CIPF compensation.

Discipline Procedures

The stock exchanges and the Investment Dealers Association have discipline procedures under which they can investigate allegations of wrongdoing against investment advisors. If wrongdoing is found, the investment advisor can be fined, or even forced out of the investment industry.

These procedures protect investors by deterring misconduct and by eliminating the worst offenders from the industry. On the other hand the procedures are only for discipline, not compensation. The regulators cannot force an investment advisor or the investment firm to compensate the investor.

Litigation

Investors can generally sue investment advisors for misconduct. This includes, for example, investing contrary to the investor's instructions.

One common problem in suing people is that it can be hard to force the wrongdoer to pay up, even after there is a judgment ordering payment.

So it is very useful if there are multiple individuals or firms that can be sued successfully. In the case of an investment

advisor, the advisor’s firm will likely be equally liable. Under the law of “vicarious liability” firms are generally jointly and severally liable for the misdeeds of their employees and agents. The investment advisor is typically an employee or agent of the investment firm.

One common issue is whether there is vicarious liability where the misdeeds are deliberate. Generally there is vicarious liability so long as the thing done, even though done wrongfully, is the type of thing that the employee or agent was supposed to do. Thus, if the investment advisor was supposed to invest, not just the advisor but also the firm could be liable if the investing was done improperly.

Arbitration

Arbitration procedures have recently been implemented to provide a faster and less expensive way of resolving the smaller disputes. Since arbitration does not offer the full procedural protections of litigating in court, arbitration is more attractive for smaller disputes and less attractive for larger ones.

In recent disputes where $100,000 or less is at stake, the investor has the choice of either arbitrating, with an arbitrator making the ultimate decision, or litigating, with a judge making the ultimate decision.

Before going to arbitration the investor has to make an effort to resolve the dispute directly with the investment dealer (investment firm). The investor then files a summary of the dispute, together with the investor's name, address, and telephone number. The parties pick the arbitrator from a list of potential arbitrators. If they cannot agree, an arbitrator is picked for them.

At the arbitration hearing, an independent arbitrator listens to the facts and arguments of the two sides and then makes a binding decision.

Conclusion

Most investors will never have a major problem with an investment advisor or investment firm, but even so it is good to know that the investor does have some protections.

# # #

The above article first appeared in the July, 2001 issue of ***The Bottom Line.***

# # #

Research has NOT been done to see if this article is still good law. Also, this is general information that might not apply to your particular situation.

# # #

Albert S. Frank is a business and trial lawyer with over 30 years of experience.
His offices are in Toronto's financial district:

The Exchange Tower
130 King Street West, Suite 1800
Toronto, Ontario M5X 1E3

Phone: 416 929 7202
Email: afrank@FrankLaw.ca
Web: www.FrankLaw.ca

Copyright © Albert S. Frank