

Northumbria Research Link

Citation: Lokanan, Mark (2014) The demographic profile of victims of investment fraud. *Journal of Financial Crime*, 21 (2). pp. 226-242. ISSN 1359-0790

Published by: Emerald

URL: <http://dx.doi.org/10.1108/JFC-02-2013-0004> <<http://dx.doi.org/10.1108/JFC-02-2013-0004>>

This version was downloaded from Northumbria Research Link:
<http://nrl.northumbria.ac.uk/21285/>

Northumbria University has developed Northumbria Research Link (NRL) to enable users to access the University's research output. Copyright © and moral rights for items on NRL are retained by the individual author(s) and/or other copyright owners. Single copies of full items can be reproduced, displayed or performed, and given to third parties in any format or medium for personal research or study, educational, or not-for-profit purposes without prior permission or charge, provided the authors, title and full bibliographic details are given, as well as a hyperlink and/or URL to the original metadata page. The content must not be changed in any way. Full items must not be sold commercially in any format or medium without formal permission of the copyright holder. The full policy is available online: <http://nrl.northumbria.ac.uk/policies.html>

This document may differ from the final, published version of the research and has been made available online in accordance with publisher policies. To read and/or cite from the published version of the research, please visit the publisher's website (a subscription may be required.)

www.northumbria.ac.uk/nrl



Introduction

Investment fraud is pervasive in Canada. In 2007, a study conducted by the Canadian Securities Administrators (CSA) noted that roughly “one-in-twenty Canadians (4.51%) have been victims of investment fraud” (CSA, 2007:4). “When extrapolated to the Canadian adult population (approximately 22.5 million adult Canadians); an estimated 1,014,750 Canadians have fallen victim to investment fraud at some point in their lives” (p.4). In a more recent study commissioned by the British Columbia Securities Commission (BCSCn) of Canadians aged 50 and older, it was noted that “[n]early 1-in-5 (17%) of respondents believe they have been a victim of investment fraud at some point in their lives” (BCSCn, 2012a: 7). When the data is looked at regionally,

[o]ne-in-seven (14%) British Columbians say that they have been victims of fraud one time, while almost one-in-ten (8%) say they have been victims of fraud multiple times. On average, BC residents are more likely to have been victims of fraud once (14% vs. 10%) and are about as likely as Canadians in other provinces to have been victims of fraud multiple times (8% vs. 6%) (p. 7).

Investment fraud is not only pervasive, but the victims come from all walks of life. It does not matter if the victims are rich or poor, financially literate or not, young or old - they are all vulnerable to investment fraud (BCSCn, 2012a: 3). From the limited systematic research available, the risk factors that are associated with investment fraud victimization are not confined to a particular subset of investors. Blum (1972) studied 24 individuals who were deceived through investment fraud and found that the median age of the victims was between "60 to 69 ...disproportionately female, predominantly widowed, and deeply religious" (as Cited in Ganzini, McFarland and Bloom, 1990: 57). They were also "predominately lower middle class and somewhat less educated than the city average" (p. 57). Ganzini, McFarland and Bloom (1990), in

their study of 77 victims of a Ponzi fraud scheme in Oregon found that

83 percent earned more than \$20,000... Eighty-seven percent were married at the time of the interview. The average age was 53, and 88 percent were between 40 and 65 years of age. Forty-eight percent were female. Sixty percent had some college education, and 33 percent were somewhat or very religious (p. 57).

What is clear from the extant literature is that there is no clear and consistent pattern on what risk factors are associated with the vulnerable investor. The purpose of this study is to examine the demographic characteristics of Canadian investors who have been victims of fraud from 1984 to 2008. To do this, I will first describe the methodology used to collect and code the data. I will then expand and give a detailed analysis of the findings. In the conclusion, the demographic portrait of the typical Canadian investors will be discussed, along with policy implications for the future.

Methodology

Data Collection

Data for this study came from the Investment Dealers Association's (IDA)¹ tribunal cases that were decided between 1984 and June of 2008 ("IDA Study"). Cases decided by the IDA across Canada were identified by typing in the search term; "Investment Dealers Association" into the Securities Regulation Tribunal Decisions database in Quicklaw. The search term "Investment Dealers Association" was sorted by its relevance and retrieved 1,934 cases. I then carefully perused each case to identify the ones that were heard by an IDA hearing panel. Out of the 1,934 cases retrieved from the database, I found 708 that were heard by an IDA hearing panel between 1984 to June of 2008. Once these cases were identified, I then sorted them by the year they were decided (oldest first) and individually downloaded and converted each case to a

¹ In June of 2008, the IDA became the Investment Industry Regulatory Organization of Canada (IIROC).

Microsoft Word file. Each case was then given a number with the first case starting from 1984 being labeled “1”, and the last case ending in June of 2008 being labeled “708”. The other 1,226 cases were cases from regulatory agencies, namely - the Market Regulation Services, the Toronto Stock Exchange, and the ASC, the BCSCn, and the OSC, in which the respective hearing panel made references to the IDA or a case that was decided by the IDA in their decisions.

Data on the Victim

The 708 cases contain demographic information on 1,167 investors. Where available, data on the victim’s gender, age, occupation, relationship to the offender, and investment knowledge were collected in order to obtain a demographic portrait of the victims of securities violations. To understand the financial profile of the investors, data on their annual income, liquid net worth, and the amount of losses incurred, were collected. The victim’s investment objective(s), source(s) and purpose(s) of investment and the type of account(s) that they opened with the Member firm (margin, cash, Registered Retirement Savings Plan (RRSP) etc.) were also recorded.

Data Limitations

One concern relates to missing data for variables describing the demographic profile of the victims. As will soon be made transparent, for some of the variables (investors’ annual income, household net worth, and relationship to the offender), I was only able to obtain data that represents between 15% and 17% of the identified victims. For all of the other victims’ related variables, I was able to obtain data that ranged between 20% and 40%. With the exception of the three variables mentioned above, the data available for the other variables on victims were no different from the response rate of mail-out surveys that is typically around the

20% to 30% range (see Henderson, 1990; Denison and Mishra, 1995). However, some may be hastened to argue that with only 15% to 17% of the data available for investors' annual income, household net worth, and relationship to the offender, it will limit the generalizability of the results. As such, the key question to ask is whether an increase in the data for these three variables would have made any significant impact on the results? As you will soon see, no information power was lost, because the results from the data available provided sufficient information for a representative analysis on these variables. It is highly unlikely that there would have been any significant changes in the results with additional data on the three aforementioned variables.

Data comparisons

Where available, the victims' data from the IDA's cases were compared with the results of the 1999 Angus Reid Survey on the typical Canadian investor, and Boyd's (2005) study on the Eron mortgage fraud.² The 1999 Angus Reid survey was based on 1,500 Canadian investors (See Boyd, 2005: 12, footnote number six). Boyd's (2005: 11) study was based on a "random sample of 559 respondents taken from a population of 2,800 investors in the Eron Mortgage fraud."

² The values in the tables and figures for this section are shown in percentages.

Findings

Descriptive Results

Number of Investors per Case in the IDA Study

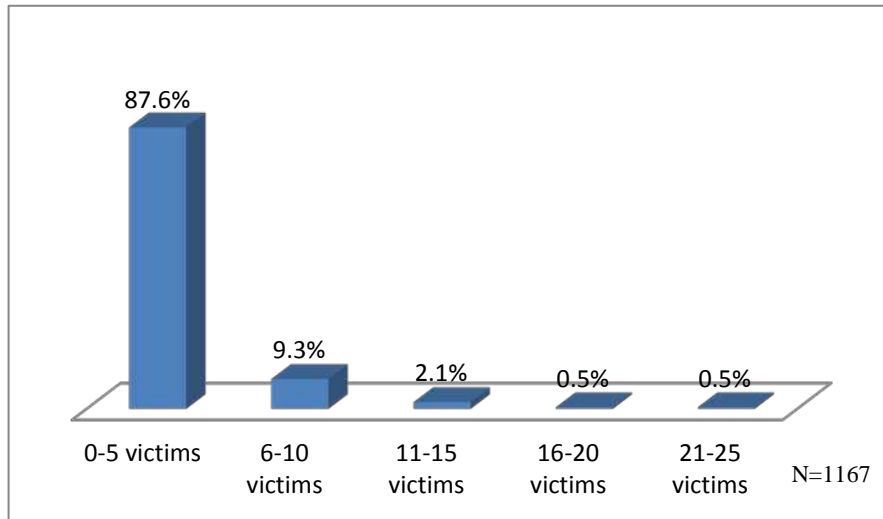


Figure 1-1 Victims per Case

Figure 1-1 shows the number of investors per case found through *Quicklaw* in the IDA study. Close to 88% of the cases contained anywhere between 0 to 5 victims. Of the remaining cases, 9.3% contained anywhere between 6-10 victims, while only 2.1% contained 11 to 15 victims. Less than 1% of cases contained between 16 to 20 and 21 to 25 victims. As can be seen below in Table 1-1, on average, there are 3 victims per case, with most cases dealing with only 1 victim. Given that the 1% of the cases with between 16 to 20 and 21 to 25 victims is pulling the average in the higher direction, the median number of 2 victims per case seems like a much more accurate summary.

Table 1-1 Investors per Case in the IDA Study

N	Valid Cases	429
	Missing Cases	0
Mean		3
Median		2
Mode		1
Minimum		1
Maximum		24
Number of identified victims		1167

Gender

Of the 1,167 investors, data on gender was available for 1,026 (87.92%) of them. The gender of the other 141(12.8%) investors could not be identified, because in some cases the IDA referred to the victims by their initials rather than their names. Out of the data in which the gender of the investors was identified, 581 (57%) were male, while 445 (43%) were female. The proportion of female victims in the IDA study is slighter higher than the proportion of females in the Eron study, where 39% were female (see Boyd, 2005: 12). The Eron study covered a period of four years, from 1993 (time of investment) to 1997 (time of collapse) (p. 12). Thus, the proportion of male and female victims reported in the Eron study was for the four year period in which they invested. For a more accurate comparison that will reflect the Eron study timeline, I split the IDA study into two time intervals: from 1986 to 1997, and from 1998 to June of 2008.³ When I split the data, I found that the proportion of women affected in the IDA study increased by 7 percentage points from the first to the second time interval. More specifically, there were 224 (61%) male and 142 (39%) female victims between 1986 and 1997, while there were 357 (54%) male and 303 (46%) female victims between 1998 and June of 2008. Notice also that the

³ I split the time-interval starting from 1986, because the first case dealing with victims was in 1986.

proportion of male and female victims affected from 1986 to 1997 in the IDA study is the same as the proportion of male and female victims affected in the Eron study.

A few reasons have been presented to explain this outcome. Women are increasingly taking an active part in managing family finances and have the “disproportionate responsibility” of having to plan “for child and elderly care” within the family (see TD Waterhouse: 2006: para 5; Heminway, 2009: 310). Most women also live longer than men and more often than not, are married to men who are older than them (Nice, 2010: para. 5-7). These factors, along with the fact that the female labour force participation has been on the increase in Canada since the 1980’s, combines to explain the increasing number of women setting up financial plans to secure their financial independence (see Canadian Labour Congress, 2008: 3-4; TD Waterhouse, 2006: para. 6).

Age

As can be seen in Table 1-2, the age of the investors at the time of their investment in the IDA study, was remarkably different from the age of the investors in the Eron and the Typical Canadian Investor’s studies. The majority (60%) of the investors in the IDA study were over the age of 55, while 39% and 30% of investors in the Eron and the Typical Canadian Investor’s studies were over the age of 55. More than one-third or 36% of the investors in the IDA study were over 65 years of age, compared to 14% of Eron and 15% of the Typical Canadian Investors in the same age category. The findings of the IDA study compared to the Eron and Typical Canadian Investor’s studies suggest that older individuals are much more likely to be the victims of securities infractions than their younger counterparts. Consequently, with only a few or no

working years remaining, the infractions would have a greater impact on the lives of the IDA investors.

Table 1-2 Age of Investors in the Three Studies

Age of Investors			
Age	IDA Study N=255	Eron’s Investor at the Time of investment	Typical Canadian Investor⁴
Under 45	22	25	52
45-54	18	25	17
55-64	24	25	15
65+	36	14	15
N/A	0	11	1
Total percent	100	100	100

Investors’ Occupation and Knowledge

Using Statistics Canada’s “National Occupational Classification for Statistics 2006 (NOC-S 2006),” investors’ job type will be classified into the following occupations: Management Occupations; Business, Finance and Administrative Occupations; Natural and Applied Sciences and Related Occupations; Health Occupations; Occupations in Social Science, Education, Government Service and Religion; Occupations in Art, Culture, Recreation and Sport; Sales and Service Occupations; Trades, Transport and Equipment Operators and Related Occupations; Occupations Unique to Primary Industry; and Occupations Unique to Processing, Manufacturing and Utilities (Statistic Canada, 2010).⁵

⁴ These figures “refer to the typical Canadian investor at the time of the Eron collapse” in 1997 (see Boyd, 2005: 12).

⁵ Statistics Canada does not include employees who are self-employed, unemployed or retired in their classification. Given that these attributes show up in the cases, I have included them in my analysis.

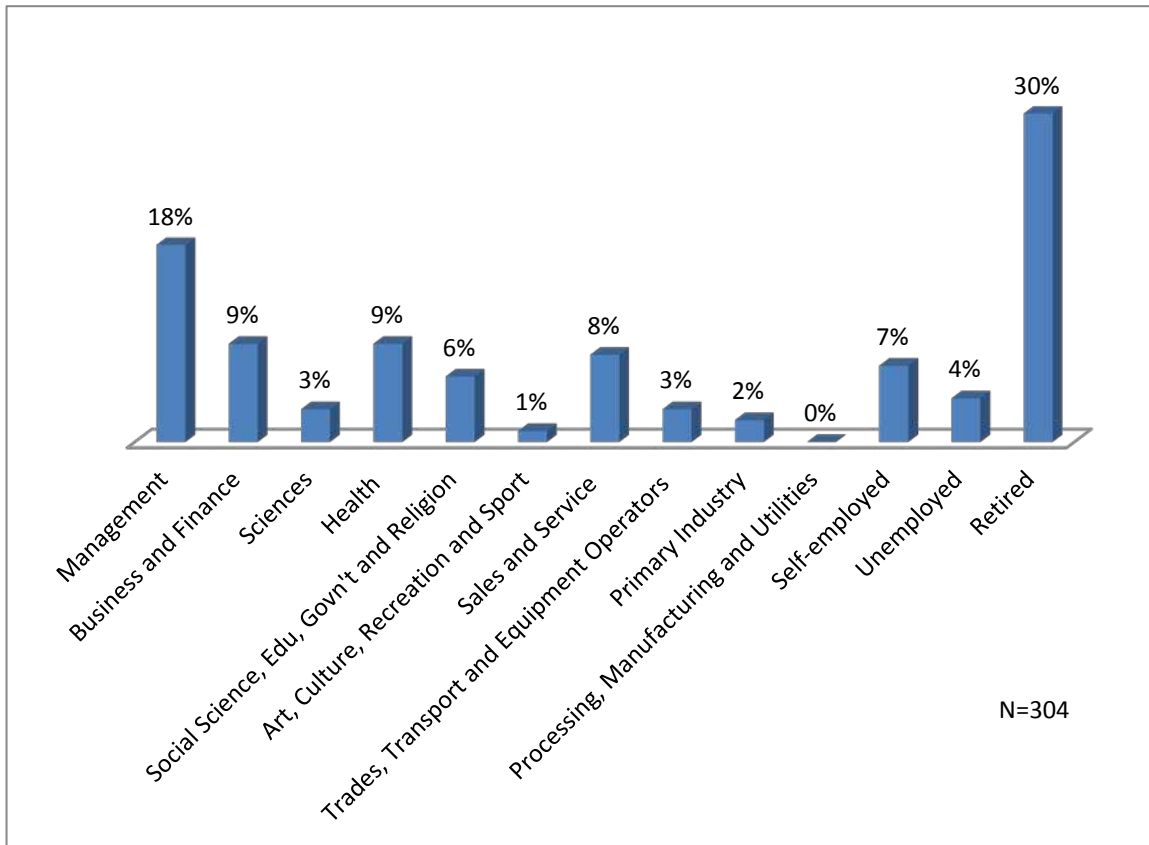


Figure 1-2 Investors' Occupational Classification

For the first time in Canada, data is available to show the occupational classification of investors who were victims of securities infractions.⁶ As Figure 1-2 shows, 30% of investors were retired at the time of investment, while 18% worked in Management. Investors who worked in Business, Finance and Administration and Health services comprised 9% respectively. Other noteworthy occupational classifications were Sales and Services (8%), and Social Services, Education, Government, and Religion (6%). Investors who were self-employed comprised 7% of the victims. Of the remaining occupation classifications, none of them surpasses 5%.

Not only were a significant proportion of the investors retired, but most of them were classified as unsophisticated. The IDA hearing panels referred to an unsophisticated investor as

⁶ The data is limited by missing data and the fact that many security infractions are probably never discovered and if they are discovered, many are not complained about or processed through the IDA's enforcement system.

someone with “limited investment knowledge” and “no previous investment experience” in the securities industry (e.g., see *IDA v. Schillaci*, 2004: para. 31; *IDA v. Tebbutt*, 1990: para. 9; also see *IDA v. Balanko*, 2007: para. 88). As shown in Figure 1-3, 62% of the IDA’s investors were classified as unsophisticated and had limited investment knowledge. Of the others, 22% had average investment knowledge, while only 16% described themselves in the New Account Application Form (NAAF) as sophisticated investors.⁷ When determining a sophisticated investor,

consideration is usually given to an investor’s education, occupation, business experience, income, previous investment exposure, investment knowledge, understanding of securities and the dynamics of the security industry, and experience in securities trading. The main test is whether the investor possesses the intelligence and experience to independently evaluate a broker's suggestions (Goldin, 2010: 298).

From the information provided so far, the investors who are more often taken advantage of therefore, are the elderly with “limited financial literacy” (e.g., see Heminway, 2009: 307).

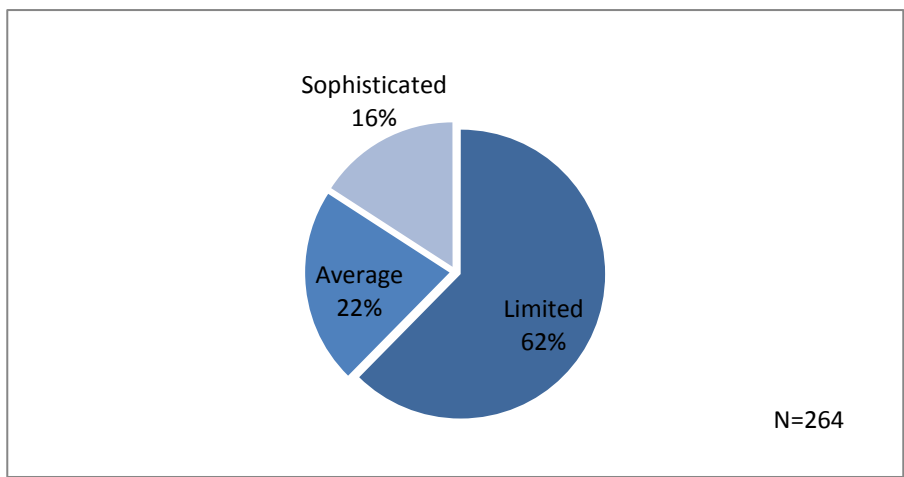


Figure 1-3 Investors’ Investment Knowledge

⁷ Similarly, 17 percent of Eron investors classified themselves as being “sophisticated” investors (see Boyd, 2005: 16).

Purpose of Investment

Table 1-3 compares the purpose of investment from the IDA’s study to that of Eron. Given that 30% of the investors in the IDA study were already retired, and that 4% were unemployed at the time of investment, it is not surprising that 31% invested because they wanted money for their basic needs, compared to the 12% of Eron’s investors who invested for the same purpose. What is noticeable, however, is that 58% of Eron’s investors invested to fund their future retirement in comparison to 15% of IDA’s investors. The fact that most of the Eron investors were working at the time of investment, explains their desire to set up financial plans to fund their retirement needs (Boyd, 2005: 12). Note also, that 20% of the investors in the IDA study wanted a higher rate of return on their investments compared to only 1% of the Eron investors. This finding points to the possibility that vulnerable investors were lured by promises of higher returns, only to be swindled of their investments by their financial advisors.

The “Other” category of 6% in the IDA’s study consisted of investors who opened accounts for various purposes. Some opened accounts to facilitate private placement of securities and to reduce their income taxes; others opened accounts to provide security and cover the operating expenses of companies they owned; while some invested to transfer-in funds from other accounts, and to deposit securities received from inheritances.

Table 1-3 Purpose of Investment in the IDA and Eron Studies

Purpose of Investment	IDA Study (N=228)	Eron Study
Fund future retirement	15	58
Enhance current lifestyle	-	19
Income for basic needs	31	12
For children/grandchildren	4	3
Extra income	2	3
Diversify investment portfolio	3	2

Higher rate of return than other investment	20	1
Trust Funds	10	-
Purchase Property	9	-
Other	6	1
DK/NA	*	1
Total Percent	100	100

*Not available

Sources of Investment

The IDA investors dipped into various sources to fund their investments. As Table 1-4 shows, an alarming 57% of the investors in the IDA study borrowed money to invest, in comparison to only 6 % of Eron’s investors who invested with borrowed money. Whereas 68% of Eron’s investors took out money from their savings and retirement savings to invest, only 11% of the IDA investors were able to withdraw funds from their saving accounts to fund their investments. These differences can be attributed to the perception and nature of the investments.

The Eron investors were led to believe that

there was security in real estate, [and that] Eron’s business appeared legitimate, based on, among other things, the fact that Eron had been in operation for three years with apparently stellar earnings for its clients. Many Eron investors did not see themselves as investors: 34 per cent thought that they were not investing, but lending money – providing a loan with a guaranteed rate of return (Boyd, 2005: 17).

Being given the assurance that there was less risk in investing with Eron, it does not come as a surprise that 68 percent of the investors would use their savings and retirement savings to fund their investments. After all, it makes good financial sense for investors to use their own money to fund their investments, rather than with loans that they would have to repay with interest. The fact that the majority of the IDA investors borrowed money to invest can be partly attributed to their financial advisors who encouraged their clients to invest with borrowed funds, with

promises of higher returns. Given that only 10% of the investors in the IDA study, and 4% in the Eron study, received money from a recent windfall or inheritance to fund their investments, it is clear that investors were willing to “jeopardize their financial security,” by either dipping into their savings or borrowing funds to invest “because of their apparent concerns for their financial futures” (Boyd, 2005: 13).

With the exception of investors who mortgaged their primary residence to obtain funds to invest, there was no significant difference in the other categories. The funds from the 7% of investors belonging to the “Other” category in the IDA study could not be easily categorized for coding purposes. The “Other” category in the IDA study included funds that came from excess cash or “play money,” liquidated belongings, total net worth, and total assets. Some investors deposited securities and transferred their “holdings” from other firms into their new accounts.

Table 1-4 Sources of Investment in the IDA and Eron Studies

Sources of Investment	IDA Study (N=435)	Eron Study
Savings	5	36
Retirement savings	6	32
Cash in other investment	9	8
Borrowed funds	57	6
Mortgage primary residence	1	5
Recent windfall or Inheritance	10	4
Sold Property	5	4
Mortgage other property	0	1
Other	7	2
DK/NK	*	1
Total Percent	100	100

*Not available

Type of Accounts

Margin and cash accounts were the most frequent type of accounts opened by investors. As shown in Figure 1-4, margin accounts made up 41% of all accounts opened by investors. This

is partly due to

the raging bull market of the past several years, [which led] many brokers [to]... seized the opportunity of loading up their clients with as many investments as possible. When clients don't have the money available to fund such investments, brokers aggressively promote the leveraging principle (i.e., borrow money and use that money to invest with) (Goldin, 2010: 46).

Moreover, margin accounts give the clients "extra buying power, which generates more commissions for their financial advisor" (p. 201). The "brokerage house [also] charges [the clients] interest on [the] margin loan, which generates more income for [the] brokerage house (p. 201). Trading in margin accounts is a very risky proposition.

Using a margin account means borrowing money from the Brokerage House to finance purchases, and use the securities in their account as collateral for the loan. Carrying a debit balance means using leverage and investing with *borrowed* money. A margin investor profits only if the investment increases in value more than the cost of borrowing. If the market moves in the opposite direction, the investor will be responsible for the full amount of the loss (*IDA. V. Babb*, 2000: para: 51 emphasis added).

Margin accounts were opened for investors even though many did not know what a margin account was and how it operated. In one instance, a client noted that she

did not fully understand what a margin account involved, at the time the margin account was opened. Furthermore, over time she became concerned about [the] account statements as [she] did not understand the meaning of the negative signs on the account statements (*IDA v. Latta*, 2004: para. 6).

Similarly, in another case, the client "signed a Margin Agreement, but did not know what [a] margin was[,] as the Respondent had not explained the meaning of margin nor any of its associated risks to her" (*IDA v. Xiao*, 2004: para. 21). When one considers that both the investment advisor and Member firm benefits from the opening of margin accounts, it does not come as a surprise that they would encourage investors to open and operate margins accounts to

fund their investments. The use of leverage also shows the level of risk that investors are willing to take in order to secure their financial futures.

Cash accounts comprised 30% of all of the accounts opened by investors to fund their investments. The implication of this finding is that while investors overwhelmingly borrowed money to invest, a significant proportion of them used cash to settle trades in their accounts. There is also the possibility that cash accounts were opened to be used as collateral for the funds borrowed from the Member firm, to settle trades in margin accounts.

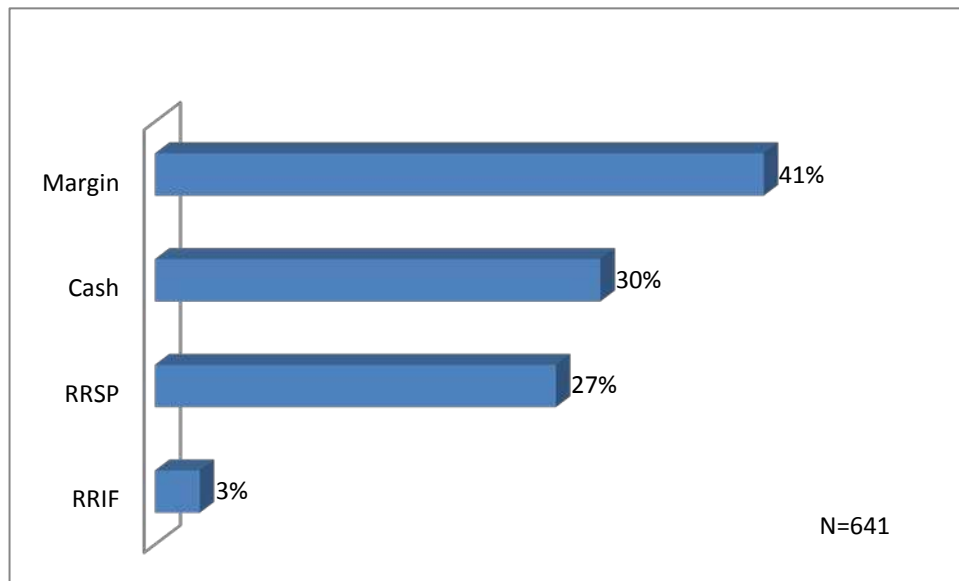


Figure 1-4 Type of Accounts

Investment Objectives

Income and long-term growth made up the majority of the investors' investment objectives. As shown in Figure 1-5, income represented 41% of investors' investment objectives, while long-term capital growth represented 30%. The implications of these findings are that investors prefer a return on their investment for immediate use, rather than waiting for long-term capital gains (see Brigham, Ehrhardt, Gessaroli, Nason, 2011: 478). However, this

should not detract from the fact that long-term capital gains still represent 30% of investors' investment objectives. Two possible explanations for a long-term investment strategy are that with capital gains, taxes are deferred until the investor sells the stocks (p. 479). Second, investors who can afford it may want to time the capital gains and wait until they retire and are in a lower income tax bracket before they cash in their stocks (see p. 479). Hence, in the long-term, these investors will effectively pay lower taxes on their capital gains.

Notice also that high risk speculative trading only represented 11% of investors' investment objectives. This is further evidence that the majority of investors were conservative in their investment approach. That said, as investors lean towards income as their investment objective, they must at the same time be willing to take some risk and reduce the emphasis on safety of their principal amount (see Investopedia, 2011: para. 5). This inverse relationship between income and safety of capital is one possible explanation as to why the latter represented only 6% of investors' investment objectives in the present study (see para. 5).

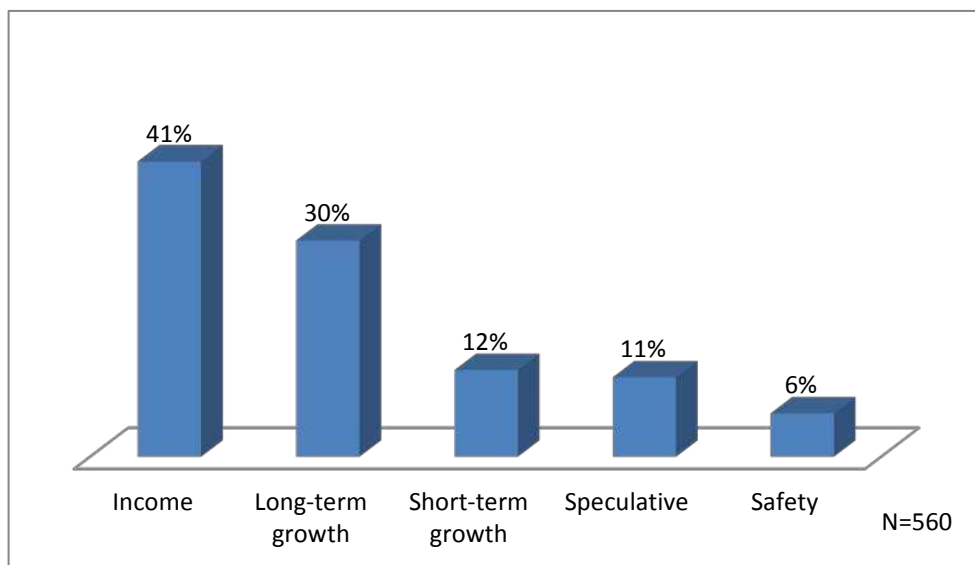


Figure 1-5 Investors' Investment Objectives

Household Income and Net Worth

Like the Eron and Typical Canadian Investors studies, the majority of the investors in the IDA study were not wealthy. As Table 1-5 shows, 66% of the investors in the IDA study made less than \$50,000 per year, compared to 37% and 40% of investors who were in the same income bracket in the Eron and Typical Canadian Investors studies. One possible reason as to why there are more investors in the IDA study that earned less than \$50,000 per year, is because the study also took into account the average salaries of Canadians in the 1980's and early 1990's, which was much lower than the average salaries in the past decade. Note also, that in the IDA study, only 2% of investors made over \$200,000 per year, a finding that is no different from the Eron and Typical Canadian studies.

Table 1-5 Annual Household Income of Investors in the Three Studies

Annual Income	IDA Study (N=172)	Eron Study	Typical Canadian Investors
Under \$25,000	31	10	10
\$25,000 to under \$50,000	35	27	30
\$50,000 to under \$75,000	19	27	25
\$75,000 to under \$100,000	4	16	13
\$100,000 to under \$150,000	6	8	9
\$150,000 to under \$200,000	3	2	2
\$200,000 and over	2	2	2
DK/NA	*	7	9
Total Percent	100	100	100

*Not available

As shown in Table 1-6, close to 60% of investors in the IDA study had a household net worth of under \$250,000. These findings in the IDA study are no different from the findings in the Eron study, which reported that approximately 60% of investors had a household net worth of under \$250,000 (Boyd, 2005:14). A closer look at Table 1-6, also shows that 45% of the

investors in the IDA study had a household net worth that was over \$250,000, compared to 32% and 10% of Eron and the Typical Canadian Investors in the same category. In interpreting these findings, it is important to keep in mind the proportion of investors in each age group in the three studies. As mentioned earlier, approximately 60% of the investors in the IDA study were over 55 years of age, compared to 39% and 30% of the investors who were in the same age group in the Eron and the Typical Canadian Investors' studies. As such, the investors in the IDA study had more working years to accumulate wealth, than investors in the Eron and Typical Canadian Investors' studies. It seems natural then that investors in the IDA study would have had more time to pay off their debts and have a higher household net worth than the investors in the Eron and Typical Canadian Investors' studies (see, Sauvé, 2002: 21-22; Boyd, 2005: 14).

Table 1-6 Household Net Worth (Excluding principal residence) of Investors of the Three Studies

Household Net worth	IDA Study (N=191)	Eron Study	Typical Canadian Investors
Under \$25,000	5	6	28
\$25,000 to under \$50,000	3	10	18
\$50,000 to under \$100,000	14	19	15
\$100,000 to under \$150,000	15	8	9
\$150,000 to under \$250,000	19	17	8
\$250,000 and over	45	32	10
DK/NA	*	8	12
Total Percent	100	100	100

*Not available

Financial Losses

Figure 1-6 presents the losses incurred by identified investors in the IDA study. For those investors where financial losses were identified, 41% lost under \$25,000. This finding points to the possibility that for the majority of investors, once they realized that they were losing money,

decided to cut their losses and get out at the earliest opportunity (e.g., see Goldin, 2010: 129). Another 19% of investors lost anywhere between \$25,000 to under \$50,000, 13% lost between \$50,000 to under \$75, 000, and 5% lost between \$75,000 to under \$100,000. Also notable, is that 22% of investors lost over \$100,000 from their investments. It is highly unlikely that investors will tolerate such huge losses in their accounts, without inquiring about the losses.

Financial advisors utilized a number of techniques from their toolkits to hide these losses. In some cases, the financial advisor took advantage of the investors' limited financial knowledge and swindled their investments. For example in *Silcoff*, the Panel noted that

[f]rom the time the E Account was opened on May 5, 2000 through February 28, 2001 Mr. S effected 75 discretionary transactions in the E Account. When NE and EE became aware of the discretionary transactions in [their] Account, NE called Mr. S to express concern over the trading in [their] account. Mr. S told NE not to be concerned because her bottom line account balance was not affected. When NE expressed concerns to Mr. S regarding the declining balance in [their] Account, he assured her that the ...Account was not losing money and that she was simply misreading the account statements. In fact, the discretionary transactions in the ...Account resulted in a loss of \$18,531.94 (*IDA v. Silcoff*, 2004: para. 21).

In other cases, investors were told by their financial advisors to keep their accounts active, and that their investment losses would recover over time. For example, in *Youden*, the Panel noted that the client

Mr. M...[gave] evidence that he first complained to Mr. B [his financial advisor] when his portfolio started to drop off in the spring of 2000. He stated that he made several phone calls to Mr. B enquiring about this and what Mr. B intended to do to either recover what he lost or prevent further losses. In response [the client] testified that Mr. B advised him that the market losses were temporary as it was just a dip in the market and things would recover and there was no need for concern...[Mr. M's] main investment account went from a high of \$351,000 in March of 2000 to a low of \$45,000 when all the accounts were transferred out of RBCDS in May of 2003 (*IDA v. Youden*, 2003: para. 30 and 94).

There were also cases where the financial advisors kept the account active in an attempt to recover the losses incurred. In *Migirdic* for example, the client

P.A. complained to [Mr. M, his financial advisor] about his losses. In reply, [Mr. M] gave his client a letter on May 14, 2000, in which he stated that he was taking responsibility for the decline of the portfolio and promised to restore the portfolio's value to its January 20, 2000 level, namely \$1,059,954, by the close of the third Friday in January 2001. [Mr. M] also wrote that, if he was unable to restore the value of the portfolio to its January 2000 level, he would reimburse the account holder the difference between the value as at January 2000 and the value as at January 2001...[Mr. M]...was hoping that the markets would recover and that he would not have to reimburse P.A (*IDA v. Mirgirdic*, 2004: para. 13 and 16).

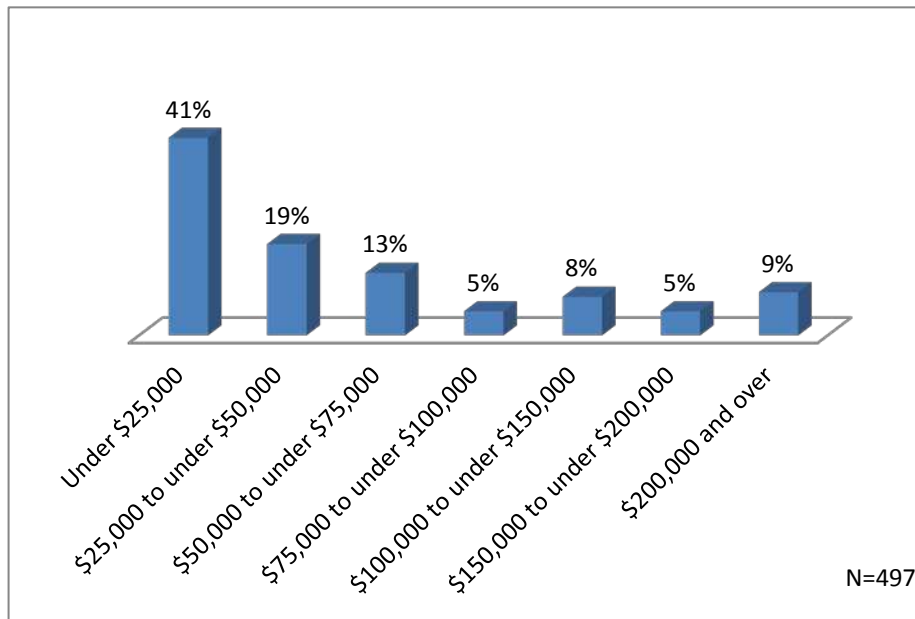


Figure 1-6 Investors' financial losses

Relationship to the Offender

As indicated in the literature, “a relationship of trust” is a major factor when it comes to handing over your money for investment (CSA, 2007:1; also see Boyd, 2005: 34-35). The first casualties of investment scams are investors who trusted their financial advisors the most (see CSA, 2007:2). As can be seen in Figure 7-7, 40% of the investors were a family member, 37%

were an acquaintance, and 23% were a friend of the offender. Like the mortgage brokers in the Eron fraud, investment advisors in the IDA study “operated on the basis of the exploitation of existing trust” (Boyd, 2005: 34). The available data, although limited, indicates that individual registrants were able to earn the trust of the people they were closest to and then betray that trust by swindling them of their retirement funds. It seems prudent to think that investors who are familiar with their financial advisors might have been secure with their investments. However, it may be that being familiar with and blindly trusting an investment advisor may “actually work...against” investors’ interests (see Boyd, 2005: 34). Far from giving investors peace of mind, trust without conducting due diligence on the background of the investment advisors, seems to be the cardinal sin investors are committing when selecting a financial expert to manage their money.

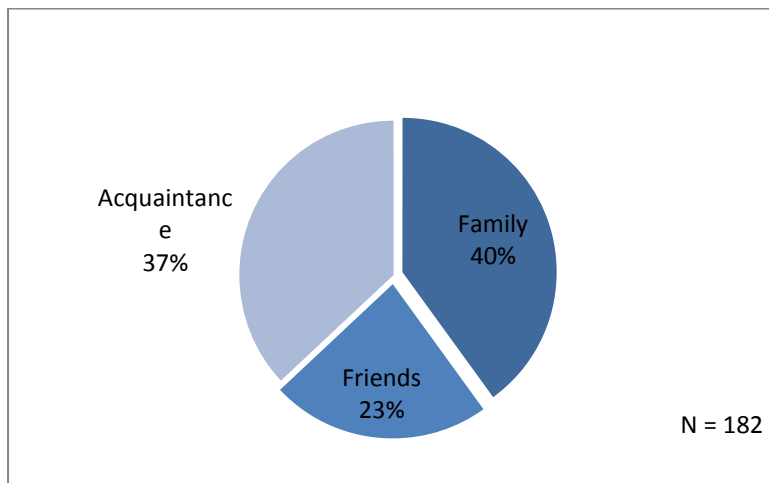


Figure 1-7 Investors' Relationship to the Offender

Conclusion and Discussion

Portrait of the Vulnerable Investor

Even though victims of investment scams can be from all walks of life, the IDA study shows that scam artists target some of the most vulnerable people in society (also see FAIR Canada, 2011: 21). The vulnerable investor in the IDA study can be described as someone who is interested in securing his or her financial future. Those most vulnerable are investors who are retired and have limited investment knowledge. Older Canadians (50+) are all too often the ones commonly victimized by securities breaches (also see BCSCn, 2012a). Their vulnerability is fueled by promises of high returns and low risks in investment schemes that lure them to invest in products they hardly know anything about. Brenda Leong, the Chair of the BCSCn noted that

[w]hen you combine the fact that many older Canadians do [not] have a good grasp of what a realistic level of return is in the market with their lack of understanding about the relationship between risk and return, you have the perfect storm for con artists. This group is more vulnerable to promises of unrealistic returns, especially when the offer comes with the additional promise of no risk (BCSCn, 2012b: para. 3).

A considerable number of individuals who invested were those who experienced recent windfalls, dipped into their life savings and borrowed money in order to invest (also see FAIR Canada, 2011: 21; Boyd, 2005: 36). The fear of not having enough money in their retirement years increases this vulnerability. The victims in the IDA study were not particularly wealthy, and approximately 66% of them earned less than \$50,000 per year at the time of the investment. Roughly 22% of the victims incurred losses of \$100,000 or more. Some of these victims include those who lost their entire life savings and in the process, ruined their retirement plans.

One commonality that a number of these investors shared is that they relied on the advice of people they trusted the most to secure their financial well being: family and friends. It does

not seem to matter whether the individual is “[y]oung or old, rich or poor, financially literate or not, the power of trust transcends all barriers when it comes to the likelihood of falling victim to investment fraud” (BCSCn, 2012a: 3). Far from giving investors peace of mind, trusting these individuals without conducting due diligence on their backgrounds as investment advisors, seems to be the cardinal sin investors were committing when selecting a financial expert to manage their money. It should also be noted that in some cases, conducting due diligence may not be sufficient to ferret out the deviant advisor who preys on vulnerable investors.

Policy Implications

While the findings from this study are from the victims data gathered from the enforcement of complaints by the IDA, they also have implications for its replacement, IIROC (see Kempa, 2009). One of the more significant findings of this study is that the majority (62%) of investors had limited investment knowledge. To address this problem, IIROC must focus on investors’ education as part of its gatekeeper’s mandate. Not just random seminars on fraud prevention, but, seminars that target vulnerable groups (also see Boyd, 2005: 35-37). A one size fits all approach will not “account for the significant difference between victim types” (Shadel, 2009: 4). For example, elderly men and women in their late 70s may need seminars on fraud awareness, while men and women in their 40s may need seminars that warn them about the lure of higher returns (also see Shadel, 2009: 4). As such, the focus should be on seminars that are specifically tailored for different subset of people. A special effort should be made to target retired seniors, individuals with funds to invest, and those with “limited financial literacy” (see Heminway, 2009: 307).

Investors' education should be in the form of a major public campaign designed to reach out to and educate these vulnerable groups (see FAIR Canada, 2011: 34; Tomasic, 2011: 12-17).

The goal of the campaign should be to equip vulnerable groups

with the necessary tools to detect and avoid financial fraud. The campaign should include advertisements or notices in publications targeting the elderly, ethnic groups (in various languages), religious groups, [and] reaching out to organizations representing [other] vulnerable groups (p. 34).

To gain access to these vulnerable groups, IIROC can join forces with various ethnic communities, religious organizations, seniors' groups (such as the Canadian Association of Retired Persons (CARP), clubs, local governments of small towns, where retirees may be sitting on large amount of cash, and other governing bodies that represent vulnerable individuals. Innovative strategies can be developed such as the "God's Fraud Squad" initiative taken by the BCSCn, who teamed up with "two Fraser Valley pastors, to prevent and disrupt cases of investor fraud in faith-based communities" (see FAIR Canada, 2011: 34). Similar approaches to gain access to other vulnerable groups can be developed with priests from other faiths, community leaders, and club presidents.

Another key component of IIROC's education mandate is to inform investors to keep an eye out for people they trust the most and who work in the investment industry. These trusted individuals can be a family member or a friend. As mentioned earlier, 40% of investors were swindled by a family member and 23% by a friend. Part of IIROC's mandate should aim to educate prospective investors to be wary of individuals who can exploit this existing trust and convince them to invest in one of their schemes. This is particularly important, because in some cultures, reporting a family member to regulatory authorities is frowned upon. It is not uncommon for victims from tight knit ethnic communities to accept their losses, because they are

afraid of the repercussions from family members if they report the perpetrator to the authorities. The same can also be said for individuals from religious organizations and clubs, who may feel ashamed to make public their loss.

The content of investors' education should focus on the specific issues that investors should ask their financial advisors and brokerage firms before investing. Special consideration should be given to the advisor's disciplinary record, qualifications, industry experience, personality and attitude towards prospective investors. As a starting point, see Goldin for the "Eleven Key Questions to Ask When Choosing A Broker" (2010: 27-34). IIROC should also "make reference to the dangers of promises of unrealistic returns and guaranteed consistent returns[,] and how they are often a red flag for fraud" (FAIR Canada, 2011: 34). Increased emphasis should be placed on "educat[ing] investors about market risks and losses and the appropriate bearing of responsibility when an investment has negative returns" (Condon and Puri, 2006: 25). More importantly,

[c]onsideration should ... be given [that requires] financial advisors to specifically disclose the risk[s] associated with entering into a particular transaction before the transaction is entered into, and its effect on the client's overall portfolio in terms of risk, return and diversification (p. 25).

At the very least, investors should be advised to be extra cautious of investment advisors who try to persuade them to invest in financial products that their business acquaintances are associated with (e.g., see Stromberg, 2002: para.18). The goal should be to educate the individual to become an informed and skeptical investor.

IIROC should start with the assumption that prospective investors have limited financial literacy. Similar to the manner in which English and Mathematics are taught in elementary

school, IIROC's public campaign should start by teaching basic investment and financial literacy skills to investors. Part of IIROC's investment education mandate should be to encourage investors to invest with financial advisors and Member firms that are registered with IIROC (FAIR Canada, 2011b: 34). Resources should be dedicated to teach investors how to find out the registration status of their financial advisors and Member firms, and more importantly, the process to follow in order to register a complaint (see FAIR Canada, 2011: 13-14). Anecdotal evidence indicates that there are investors who do not even know that IIROC exists, much less the process of registering a complaint. Some may have heard about the Association in name only, and are oblivious of its purpose. Finally, investors should be encouraged to invest with IIROC's regulated firms that are backed by a compensation fund (p. 34).

References

- Boyd, N. (2005), "Eron Mortgage Study", available from the British Columbia Securities Commission Web site at: http://www.bsc.bc.ca/uploadedFiles/Eron_Research_Study.pdf (accessed 10 June 2006).
- Brigham, E., M. Ehrhardt, J. Gessaroli, R. Nason. (2011), *Financial Management: Theory and Practice* (1st Canadian Edition), Nelson, Toronto.
- British Columbia Securities Commission. (2012a), "National Investment Fraud Vulnerability Report", available from the British Columbia Securities Commission Web site at: <http://www.bsc.bc.ca/2012NationalInvestmentFraudVulnerabilityReport.pdf> (accessed 07 March 2012).
- British Columbia Securities Commission. (2012b), " BC Securities Commission releases its National Investment Fraud Vulnerability Report (ENG. and FR.)", available from the British Columbia Securities Commission Web site at: <http://www.bsc.bc.ca/release.aspx?id=14376> (accessed 07 March 2012).
- Blum, R.H. (1972), *Deceivers and Deceived: Observations on Confidence men and their Victims*, Charles C Thomas, Springfield.
- Canadian Foundation for Advancement of Investor Rights. (2011), "A Report on a Decade of Financial Scandals", available from FAIR Canada's Web site at : http://faircanada.ca/wp-content/uploads/2011/01/Financial-scandals-paper-SW-711-pm_Final-0222.pdf (accessed 08 February 2012).
- Canadian Labour Congress. (2008), "Women in the Workforce: Still A Long Way from Equality", available from the Canadian Labour Congress Web site: <http://www.canadianlabour.ca/sites/default/files/pdfs/womensequalityreportEn.pdf> (accessed 15 December 2011).
- Canadian Securities Administrators (CSA). (2007), "Understanding the Social Impact of Investment Fraud", available from the Ontario Securities Commission's Web site: https://www.osc.gov.on.ca/documents/en/About/csa_20071002_csa-investor-study-es.pdf (accessed 21 November 2011).
- Condon, M., and P. Puri. (2006), "The Role of Compliance in Securities Regulatory Enforcement. Paper Commissioned by the Task Force to Modernize Securities Legislation (TFMSL) in Canada", available at: <http://www.tfmsl.ca/docs/v6%281%29%20condonpuri.pdf> (accessed 11 December 2011).
- Denison, D. and A. Mishra. (1995). "Toward a theory of organizational culture and effectiveness." *Organization Science*, Vol. 6 No 2, pp. 204-223.

- Kempa, M. (2010). "Combating white-collar crime in Canada: serving victim needs and market integrity." *Journal of Financial Crime*, Vol. 7, No 2, pp. 251-264.
- Ganzini, L., B. McFarland, and J. Bloom. (1990). "Victims of fraud: Comparing victims of white-collar and violent crime", *Bulletin of the American Academy of Psychiatry and the Law*, Vol. 18 No1, pp. 55-63.
- Goldin, R. (2010), "Investor Beware! - Protect Your Investment from Broker Misconduct", available at: <http://www.macgold.ca/investorbeware> (accessed 20 December 2011).
- Heminway, J. (2009), "Female Investors and Securities Fraud: Is the Reasonable Investor a Woman"? *William & Mary Journal of Women and the Law*, Vol. 15 No 2, pp. 291-336.
- Henderson, D. (1990). The Influence of Corporate Strategy, Structure and Technology on Location of Procurement and Sales. Unpublished doctoral dissertation, University of Michigan.
- Investopedia. (2011), "Basic Investment Objectives", available at: <http://www.investopedia.com/articles/basics/04/032604.asp#axzz1gwcwtz9J> (accessed 19 December 2011).
- Nice, D. (2010), "Why women need to save more than men for retirement", available from *The Globe and Mail* Web site at: <http://www.theglobeandmail.com/globe-investor/personal-finance/retirement-rrsps/women-and-retirement/why-women-need-to-save-more-than-men-for-retirement/article1797078/> (accessed 06 January 2012).
- Sauvé, R. (2002), "The Dreams and the Reality: Assets, Debts And Net Worth Of Canadian Households", available from *The Vanier Institute of the Family* Web site at: http://www.vifamily.ca/media/node/435/attachments/Dreams_and_the_reality.pdf (accessed 20 December 2011).
- Shadel, D. (2009), "Introduction to Research. Stanford Center on Longevity", paper presented at the *Stanford Financial Fraud Conference*, available at: <http://www.fraudresearchcenter.org/wp-content/uploads/2011/02/Introduction-to-Research.pdf> (accessed 16 February 2012).
- Statistics Canada. (2010), "National Occupational Classification - Statistics (NOC-S) 2006", available from Statistics Canada's Web Site at: <http://www.statcan.gc.ca/> (accessed 10 August 2010).
- Stromberg, G. (2002), "Listen up, Bay Street", available at: <http://www.investorvoice.ca/PI/190.html> (accessed 12 January 2012).
- TD Waterhouse. (2006), "Women investors: more active, more confident", *Investor Insights*, available at: <http://www.tdwaterhouse.ca/insights/jan07/article5.jsp> (accessed 15

December 2011).

Tomasic, R. (2011). "The financial crisis and the haphazard pursuit of financial crime." *Journal of Financial Crime*, Vol. 18 No 1, pp. 7-31.

Cases Cited

Investment Dealers Association of Canada v. Babb, [2000] I.D.A.C.D. No. 39

Investment Dealers Association of Canada v. Balanko, [2007] I.D.A.C.D. No. 10

Investment Dealers Association of Canada v. Latta, [2004] I.D.A.C.D. No. 31

Investment Dealers Association of Canada v. Migirdic, [2004] I.D.A.C.D. No. 34

Investment Dealers Association of Canada v. Schillaci, [2007] I.D.A.C.D. No. 6

Investment Dealers Association of Canada v. Silcoff, [2004] I.D.A.C.D. No. 24

Investment Dealers Association of Canada v. Tebbut, [1990] I.D.A.C.D. No. 9

Investment Dealers Association of Canada v. Xiao, [2004] I.D.A.C.D. No. 38

Investment Dealers Association of Canada v. Youden, [2005] I.D.A.C.D. No. 52