THE WALL STREET JOURNAL.

PRACTICE MANAGEMENT CANADA: Discerning Fraud In Investment Practice

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Wall Street Journal
Feb 28 2011

TORONTO (Dow Jones)--Headlines about big-money fraud cases have made investors more wary, and that's an attitude more advisers should adopt, too.

Many cases involve illegal activities by investment advisers or other types of registered representatives who take advantage of clients. But honest advisers need to be aware that they can get hurt as well.

"Advisers do have the tendency to accept stuff at face value," says Larry Boyce, senior vice president at compliance consultancy firm, Sutton Boyce Gilkes.

Boyce urges basic due diligence, such as cross-checking documents for inconsistencies in the information being provided. Also, checking on the bona fides of a client is important, especially if that client handles other people's money. These efforts can help an adviser to develop a "sixth sense for nonsense," he says.

Accusations made against the country's largest bank, Royal Bank of Canada (RY), by victims of investment fraudster Earl Jones highlight how investment advisers can get caught up in the schemes of a fraudster--who could even be one of their clients.

Jones is now serving an 11-year sentence for posing as a financial planner and bilking clients out of about C$50 million over a decade. Some of his clients are suing RBC, charging that it aided Jones in his Ponzi scheme by failing to detect forged client signatures.

Barbara Macleod of Montreal says in a suit filed against RBC in early February that Jones took money from her account by issuing a series of fraudulent directives. It says Jones helped Macleod prepare income tax reports on estate trusts, and was the sole estate liquidator of Macleod's husband when he died in September 2002.

A class action suit seeking C$40 million in damages was filed last year by Jone's former clients against RBC, alleging that the bank allowed him to use a trust account for personal use.

In response to both cases, RBC said that they too have been victimized by Jones' fraudulent schemes. To some industry experts, however, that suggests a need for heightened vigilance.

"The firms themselves really need to have better processes in place--checks and balances to make sure client signatures are real client signatures," said Ilana Singer, deputy director of non-profit Canadian Foundation for the Advancement of Investor Rights, or FAIR Canada.

For instance, calling the client first to verify certain instructions like account transfers delivered by someone else on the client's behalf could help avoid potential fraud by unscrupulous business persons. "There should be a culture of compliance and double-checking to make sure that clients aren't being fleeced," says Singer.

FAIR Canada recently issued a study on 15 major financial scandals over the past decade which reveals that 78% of the total losses in those 15 cases involved firms or individuals registered with regulators.