Brent Sheather's RESEARCH

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Brent Sheather is a Financial Advice Provider and a personal finance and investments writer.

The Strange Case Of The World's Luckiest Investor – Until Disaster Struck- Part 3

Three weeks ago, in part 2 of the story on the Tesla share collateralized "rags to riches to rags again" story we briefly looked at the forthcoming court action against RBC Securities. The Notice of Civil Claim by the plaintiff asserts that RBC didn't properly consider his risk profile (RP). We then looked at some of the less obvious but nevertheless fundamental problems within the whole RP area. I highlighted the inevitable tension between a wealth management firm's overriding objectives of maximizing profits and the client's objective of properly interpreting their risk profile by way of the appropriate mix of low risk and risky assets. High fees require high risk assets and as a general rule of thumb the higher the annual fees within a financial plan the greater the likelihood that the asset allocation will be high risk as well. Coincidentally while writing part three I was listening to a track by Witch Mountain - recently recommended by the music critic in the FT, entitled Your Corrupt Ways Sour the Hymn. The reality of high annual fees inevitably corrupts the risk profiling hymn, irrespective of how earnestly it is sung.

Anyway, back to that Tesla portfolio. Reading the claim filed with the Court, and acknowledging I am not a lawyer, the legal argument seems to be as follows: having accumulated about C$50 million from a high risk strategy of using leverage to buy Tesla shares, he went to see RBC Wealth Management for financial planning advice. This advice appears to have primarily related to making the existing high risk strategy more tax effective instead of encouraging the plaintiff to own a more balanced portfolio. Bloomberg's Matt Levine summarized the law suit as follows: *A Canadian carpenter who allegedly made hundreds of millions of dollars day-trading Tesla options and went to RBC to ask them what to do about it, and they were allegedly like "Have you considered putting 200% of your net worth into Tesla options?"*

Today we will review the legal case presented by the Plaintiff focusing on the specifics of that case. The legal basis for the Plaintiff's claim was that RBC, in its capacity as a financial planning advisor, had a duty to provide financial planning advice with the care, skill and diligence reasonably expected from a professional advisor. In particular, RBC:

- Failed to property identify the Plaintiff's needs, objectives and plans.
- Failed to properly assess the Plaintiff's knowledge and sophistication regarding investment.
- Failed to make reasonable enquiries into the Plaintiff's health challenges and factor that into its advice.
- Recommended a charitable gift giving plan and tax strategy that compelled the Plaintiff to maintain their concentrated holding in Tesla.
- It further failed to advise the Plaintiff

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that avoiding taxes should not be a primary objective and should not drive high-risk investment decision making.

- RBC placed its advisor in a conflict of interest by virtue of the fact that the same individual received commissions from the Plaintiff's trading activity while also being responsible for advising on an appropriately conservative financial plan.

So there looks to be lots of potential angles there for the prosecution however this is just the opening shot and no evidence has been presented thus far. I contacted the court and they advised that neither RBC nor Grant Thornton had formally responded to the Claim as at mid-April. As is typical in these sort of cases the outcome will depend in part on what was written down: was there a financial plan prepared recording the plaintiff's objectives and a recommendation prepared showing how those objectives might be achieved? This would obviously include an assessment of his risk profile however as outlined in the claim the "agreement for advice was partly written and partly oral " so there will be an element of " he said, you said " which may make predicting an outcome uncertain . Additionally, as mentioned in the Claim the defendant may have had some sort of trading/gambling addiction, not altogether surprising given his extraordinary run of luck so the courts will need to consider the extent to which this may have impacted his perception of any advice to adopt a lower risk approach. Then there's the question as to whether RBC had a responsibility to protect the plaintiff from himself like casinos are apparently required to do as regards compulsive gamblers.

Bloomberg columnist Matt Levine covered the Tesla story when it first broke and he alludes to the murky world of risk profiling in a brief excerpt from his cynical take on the matter, reprinted here: *"One thing that has always puzzled me about retail financial advice is that people like to ask you about your risk tolerance, like that's a thing that you could know. But I suppose if you walk into a financial adviser's office and are like "I have $300 million and it's all in Tesla options," she will pull up her new client intake form, and there will be a field for "what is the client's risk tolerance on a scale of 1 to 10," and she will write "eight thousand," and the advice will proceed on that basis. Man if I made $300 million trading Tesla options my risk tolerance would then be zero forever. I would put everything in Treasury bills and gold bars and New Zealand bunkers and $100 bills sewn into my mattress. Nobody stays that lucky for long!"*

Brent Sheather is a Financial Advice Provider. A disclosure statement is available upon request. Brent Sheather may have an interest in the companies discussed.

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