Investors get victory in 17-year court battle with mutual fund companies

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After a 17-year court battle, an Ontario judge has ruled in favour of retail investors who suffered losses as two Canadian companies had let big investors make profitable, improper trades in a number of their funds.

Ontario Superior Court Justice Markus Koehnen in February found that both CI Mutual Funds Inc. and AIC Limited, which is now known as AIC Global Holdings Inc., breached their duty of care to prevent market-timing trades in their funds. While the court found both companies did not breach their fiduciary duties, they did act negligently, and the court directed a separate trial to determine damages.

Also known as frequent trading or short-term trading, market timing is a practice where certain sophisticated investors are allowed to move in and out of their funds very quickly. The practice dilutes the returns available to long-term unit holders

The class action includes any investors who held money in AIC funds from Jan. 1, 1999, to Sept. 30, 2003, or CI Mutual funds from Sept. 1, 1998, to Sept. 30, 2003. Counsel for the plaintiffs estimate damages to investors could total as much as $674-million.

"There was ample evidence before me to demonstrate that the standard of care during the class period required the defendants to be aware of the dangers of frequent trading in and out of their funds and take reasonable steps to prevent it," Justice Koehnen said in the court decision. "The harm that frequent trading causes to long-term unitholders has been known for decades."

AIC Global Holdings did not respond to requests made by The Globe and Mail. CI Investments spokesperson Murray Oxby said in an e-mail that "this decision is lengthy and deals with many issues. CI is considering the reasons and its legal position."

The mutual-fund market-timing scandal first exploded into view in 2003 in the United States when then-New York attorney-general Eliot Spitzer announced a settlement with Canary Capital, a small fund company. The Securities and Exchange Commission, the primary regulator of the U.S. fund industry, and various state officials then jumped in.

Ultimately, industry participants – the fund companies and the traders who benefitted – executed settlements amounting to US$4.25-billion in penalties and returned profits, according to academic Jerry W. Markham in a 2006 article in the Hastings Business Law Journal.

At the same time, the Ontario Securities Commission launched its own investigation into similar practices in the province, resulting in five Canadian asset managers – including both defendants – entering into settlement agreements with the provincial regulator. The five companies, which also included IG Investment Management Ltd., Franklin Templeton Investments Corp. and AGF Funds Inc., paid over $200-million to their respective fundholders, according to recent court documents. Mr. Oxby confirmed that CI paid $49.3-million to investors as part of that settlement in 2004.

In 2006, investors launched a class-action lawsuit against all five companies that settled with the OSC, with retail clients alleging that this frequent trading diluted the returns of long-term investors in the funds.

Three of the companies have since settled with plaintiffs, leaving AIC Limited and CI Mutual Funds Inc., now known as CI Investments Inc., to go to trial.

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The case took over six years to certify as a class action, including an appeal with the Supreme Court of Canada. The trial was eventually held over the course of three months in 2022, with a decision ruled last month.

“For retail investors this is an important day for accountability, for behavior modification and to really send a signal to the wider investment industry that there will be consequences for conduct that does not meet the appropriate standard of care and where steps are not taken to appropriately protect unit holders,” said Joel Rochon, co- lead counsel for the plaintiff and managing partner at Rochon Genova LLP, in an interview.

Justice Koehnen said in his decision that mutual fund prospectuses – documents that are provided to investors upon purchasing a fund – warned that frequent trading caused harm to funds and could result in fees of up to 2 per cent being charged to participants.

Despite the contents of their prospectuses, the defendants not only failed to take steps to prevent frequent trading or charge the fees set out in their prospectuses when it occurred, they facilitated the practice by entering into “switch agreements” that allowed certain investors to switch in and out of funds for a much lesser fee of only 0.2 per cent.

The court found companies permitted sophisticated investors to execute large volume, short-term trades in their funds, amounting to hundreds of millions of dollars per month, and billions of dollars per year in funds “switched in” and out.

“The 2-per-cent fee would have stopped switching or frequent trading immediately,” Justice Koehnen said.

A hearing date for damages has not yet been determined.

With a report from David Milstead