

Massachusetts Suing RBC Capital Over Leveraged ETF Sale (3) 2011-07-20 18:13:03.932 GMT

(Updates with RBC's comment in fifth paragraph.)

By Christopher Condon

July 20 (Bloomberg) -- Massachusetts' top securities regulator is suing RBC Capital Markets LLC over the sale of leveraged and inverse exchange-traded funds, saying they sold them to clients who didn't understand the investments.

Secretary of the Commonwealth William F. Galvin said RBC Capital and Michael D. Zukowski, a former agent, used "dishonest practices" in selling the funds, according to a statement e-mailed today. The lawsuit seeks restitution to Massachusetts investors, a cease and desist order, and an administrative fine.

"The point of the complaint is not that the investors lost money," Galvin said in the statement. "The dishonesty here is that the investors, and indeed the agent soliciting their investment, did not understand the workings of these funds."

Galvin opened a probe into leveraged and inverse ETFs in July 2009, a month after the Financial Industry Regulatory Authority said that such products might not be a good fit for long-term investors. Leveraged ETFs use swaps or derivatives to amplify daily index returns, while the inverse funds are designed to move in the opposite direction of their benchmark.

Kevin Foster, a spokesman for New York-based RBC Capital Markets, said the firm was "disappointed" with Galvin's lawsuit.

"We have been cooperating fully on this matter which involves the practices of an ex-employee," Foster said in an e-mailed statement, adding the firm has "in place extensive policies and procedures and training requirements."

Client Losses

Galvin said Zukowski, who worked in the firm's Osterville office, sold clients such "non-traditional" ETFs without proper training or supervision.

The lawsuit alleges RBC didn't have practices in place to prevent unsuitable sales until Dec. 22, 2009, six months after FINRA's warning.

The complaint cited losses totaling \$793,000 by 35 of Zukowski's clients. Brian McCabe, a spokesman for Galvin, said the state's investigation is continuing and that other investors may have been affected.

The U.S. Securities and Exchange Commission halted the approval of new ETFs making significant use of derivatives in March 2010 because it wanted to review the products more closely. FINRA and the SEC have said the products could confuse individual investors.

Leveraged and inverse ETFs in the U.S. hold about \$33.9 billion in assets, according to Boston-based State Street Corp.

RBC Capital is a subsidiary of Toronto-based Royal Bank of Canada.

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