Mutual Fund Dealers Association of Canada
Association canadienne des courtiers de fonds mutuels

IN THE MATTER OF A DISCIPLINARY HEARING
PURSUANT TO SECTIONS 20 AND 24 OF BY-LAW NO. 1 OF
THE MUTUAL FUND DEALERS ASSOCIATION OF CANADA

Re: Jose Luis Bautista

Heard: July 12, 2012 in Toronto, Ontario
Reasons for Decision: July 24, 2012

REASONS FOR DECISION

Hearing Panel of the Central Regional Council:

The Hon. Patrick T. Galligan, Q.C.	Chair
Guenther Kleberg	Industry Representative
Robert C. White	Industry Representative

Appearances:

Maria L. Abate	)	Counsel, Mutual Fund Dealers Association of
	)	Canada ("MFDA")
Jose Luis Bautista	)	Respondent, did not appear either in person or by
	)	counsel

1. By Notice of Hearing issued January 23, 2012, MFDA made the following allegations of breaches of its by-laws, rules or policies against the Respondent:

> **Allegation #1**: Between October 30, 2006 and December 17, 2009, the Respondent had and continued in at least four gainful occupations that were not disclosed to or approved by the Member, contrary to MFDA Rules 1.2.1(d) and 2.1.1.
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> **Allegation #2**: Between October 30, 2006 and December 17, 2009, the Respondent engaged in securities related business that was not carried on for the account and through the facilities of the Member by selling or facilitating the sale of investments in the total amount of approximately $500,000 in a company outside the accounts and facilities of the Member, contrary to MFDA Rules 1.1.1(a) and 2.1.1.
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> **Allegation #3**: Between October 30, 2006 to December 17, 2009, the Respondent engaged in personal financial dealings with clients, thereby creating a conflict or potential conflict of interest between the Respondent's interests and the clients' interests which the Respondent did not ensure was addressed by the exercise of responsible business judgment influenced only by the best interests of the clients, contrary to MFDA Rules 2.1.4 and 2.1.1.

2. The Notice of Hearing was returnable on February 24, 2012. On that date the Respondent did not appear. The Hearing Panel then conducted an inquiry into the issue of service. At the conclusion of that inquiry the Hearing Panel was satisfied that the steps taken by Staff to serve the Notice of Hearing upon the Respondent constituted good and sufficient service, having regard to the circumstances and the requirement of MFDA Rule of Procedure 4.2(1)(d). It then made an order as follows:

> IT IS HEREBY ORDERED THAT:
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> 1) the Respondent has been served with the Notice of Hearing according to the provisions of MFDA Rule of Procedure 4.2(1)(d);
> 2) the Hearing on the Merits in this matter shall take place on July 12, 2012 at 10:00 a.m. (Eastern); and
> 3) if at any time a non-party to this proceeding requests production of, or access to, any materials filed in, or the record of, this proceeding, including all exhibits and transcripts, then the MFDA Corporate Secretary shall not

> provide copies of, or access to, the requested documents to the non-party without first redacting from them any and all intimate financial or personal information, pursuant to Rules 1.8(2) and (5) of the MFDA *Rules of Procedure.*

3. When, pursuant to paragraph 2 of that Order, the case came on for hearing on July 12, 2012 the Respondent did not appear. Ms. Abate advised us that the MFDA had heard nothing from the Respondent since the order was made and submitted that we should proceed with the hearing. We agreed.

4. She then submitted that because the Respondent had not filed a Reply, as required by Rule of Procedure 8.1, and had not attended the hearing, that we should act in pursuant in pursuance of the provisions of Rule 7.3(1) and Rule 8.4(1)(a) and (b). The provisions of those rules are, in substance, identical. In the event of the failure of a respondent to file a reply or to attend a hearing, a hearing panel may:

> (a) proceed with the hearing without further notice to and in the absence of the Respondent; and (b) accept the facts alleged and conclusions drawn by the Corporation in the Notice of Hearing as proven and impose any of the penalties and costs described in sections 24.1 and 24.2 respectively of MFDA By-law No. 1.

5. We decided that it was appropriate to exercise that power. In addition, pursuant to Rule 13.4, we allowed the affidavit of Daniela Capozzolo to be filed as Exhibit #4. Therefore the record upon which the hearing was based was the facts and conclusions contained in the Notice of Hearing and the evidence contained in Exhibit #4.

THE ALLEGATIONS

6. We intend to deal with each allegation separately. Before doing so, however, it is worth mentioning that the circumstances surrounding each of the allegations are set out in the Notice of Hearing which, as noted above, we accept in the exercise of the discretion conferred upon us by Rule 7.3(1) and Rule 8.4(1)(a) and (b). Details of those circumstances are provided in the affidavit of Daniela Capozzolo, Exhibit #4. Exhibit #4 is a substantial document which in itself contains 27 exhibits. Our references to the circumstances supporting each allegation will be as brief as possible and will be drawn from those two sources. For more detail, readers are directed to the Notice of Hearing and to Exhibit #4.

ALLEGATION #1

7. The essence of this allegation is that the Respondent had four occupations which were not disclosed to his employer Member. During the period October 2006 to December 2009, the Respondent was employed as a mutual fund salesperson, first with Dundee Private Investors Inc. ("Dundee") and then with MGI Financial Inc. ("MGI"). They were both Members of the MFDA.

8. Between October 2006 and December 2009, the Respondent had other gainful occupations other than his employment with his employer Members. Those gainful occupations were with Cygnet International Inc. ("Cygnet"), 7033451 Canada Inc. (operating as "Bell Street Property"), 2043969 Ontario Inc. (operating as "Leisure Days") and WorldCrest Management Inc. ("WorldCrest").

9. Cygnet sold and marketed vacation properties on a lake near Ottawa. In 2006 he entered into a compensation agreement with Cygnet where he would receive an ongoing management fee of 4% of Cygnet's gross sales per annum. During the material time the Respondent was involved in the ownership and operation of a multi-unit residential building in Ottawa. He was also involved in the ownership and operation of an RV dealership named "Leisure Days" located in Smith Falls, Ontario.

10. While on occasion the Respondent did declare some of his participation in outside business activities the Respondent never declared the true nature and extent of those outside activities to the Member. He failed to declare a complete list of dual occupations and outside business activities on many occasions and failed to obtain the consent of the Member to his activities.

11. Member Rule 1.2.1(d) regulates when an Approved Person, employed by a Member, may have another gainful occupation. (A recent rule amendment has changed the numbering of Rule 1.2.1(d) to Rule 1.2.1(c). There is no change of substance.). The rule provides:

> (d) **Dual Occupations.** An Approved Person may have, and continue in, another gainful occupation, provided that:

(iii) Member approval. The Member for which the Approved Person carries on business either as an employee or agent is aware and approves of the Approved Person engaging in such other gainful occupation

12. The Respondent, by engaging in other gainful occupations without the consent of his Member employers, was in clear breach of the provisions of the above Rule.

13. Ms. Abate submitted that the conduct of the Respondent which violated Rule 1.2.1(d) also constitutes a violation of Member Rule 2.1.1. That Rule reads as follows:

2.1.1 **Standard of Conduct**. Each Member and each Approved Person of a Member shall:

a) fairly, honestly and in good faith with its clients;

b) observe high standards of ethics and conduct in the transaction of business;

c) not engage in any business conduct or practice which is unbecoming or detrimental to the public interest; and

d) be of such character and business repute and have such experience and training as is consistent with the standards described in this Rule 2.1.1, or as may be prescribed in this Rule 2.1.1, or as may be prescribed by the Corporation.

14. There is jurisprudence which tends to support Ms. Abate's contention that the failure to abide by his obligation not to engage in another gainful employment, without his employer's consent, amounts to a failure on the part of the Respondent to "observe high standards of ethics and conduct" in business. See *Re Tonnies*, [2005] MFDA No. 200503 at p. 17 where the following appears:

> The British Columbia Securities Commission has held that registrants are obliged to follow their member firms' business procedures for dealing with clients. In *Re Cartaway Resources Corp.*, [2000] B.C.S.C.D. No. 92, the Commission found that the member firms' business procedures, as reflected in its Guidelines for Business Conduct, established that the member 'had a legal duty to act with the 'highest standard of ethical business conduct' towards clients, shareholders and the public' (para. 228). The Commission went on to state:
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> > The Guidelines stated that every employee was to avoid any activity, interest or association which might interfere or even appear to interfere with the independent exercise of judgment in

> the best interest of [the member firm] its shareholders, clients and the public. All outside business connections were required to be reported so that they could be scrutinized and continuously monitored for potential conflicts. To the extent that employees were engaged in outside activities, they were required to ensure their activities were not in conflict or competition with their duties and responsibilities. (para. 228)

15. While, in *Re Tonnies*, an employer's Policies and Procedures Manual was in issue, we think that the failure to comply with an important provision of the Member Rules can also be viewed as failure to observe "high standards of ethics and conduct". We therefore conclude that the Respondent has also been in breach of the provisions of Rule 2.1.1(b).

16. We hold, therefore, that Allegation #1 has been established upon both bases upon which the allegation was advanced.

ALLEGATION #2

17. The essence of this allegation is that the Respondent dealt in securities other than for the account of and through the facilities of the Member by whom he was employed. In our discussion of Allegation #1 we set out the Members and the time periods which were involved. They are the same for the circumstances giving rise to this allegation.

18. During the relevant time period the Respondent solicited clients of his Member employers to invest in WorldCrest. He obtained at least 11 of their clients to invest a total of approximately $500,000. He provided those clients with an invitation to purchase the promissory notes of WorldCrest offered at $1,000 per note with a minimum investment of 50 notes. The promissory notes of WorldCrest were not an investment product known to or approved for sale by either Dundee or MGI.

19. Member Rule 1.1.1(a) regulates how an Approved Person may conduct securities business. It provides:

> 1.1.1 **Members.** No Member or Approved Person (as defined in By-law 1.1) in respect of a Member shall, directly or indirectly, engage in any securities related business (as defined in By-law 1.1) except in accordance with the following:

a) all such securities related business is carried on for the account of the Member, through the facilities of the Member …

(Inapplicable exceptions omitted)

20. The Respondent, by his transactions respecting the notes in WorldCrest other than for the account of and through the facilities of his Member employers was in clear breach of Rule 1.1.1(a). For the same reasons which we gave in regard to Allegation #1, the Respondent's dealing in securities in breach of Rule 1.1.1(a) should be viewed as a failure to observe "high standards of ethics and conduct". Accordingly that conduct amounts to a breach of the provisions of Rule 2.1.1(b).

21. We hold, therefore, that Allegation #2 has been established on both of the bases upon which it was advanced.

ALLEGATION #3

22. The essence of this allegation is that the Respondent was in conflict of interest with clients of his Member employers. The Member employers and the time periods are the same as they are in respect to Allegation #1.

23. It will be remembered that the Respondent was directly involved with Cygnet. During the relevant time period he engaged in financial dealings with clients of his employer by facilitating loans of approximately $50,000 from them to two of his fellow shareholders in Cygnet. In our view this conduct constituted a direct conflict of interest. The loans were repayable at the somewhat surprising rate of 15% per annum compounded annually and payable monthly. The notes also provided for a setup fee payable to the Respondent of $3,000 per loan.

24. It will be remembered that the Respondent was involved in the Bell Street Property, Leisure Days RV Centre and WorldCrest. In addition to convincing clients to lend money to shareholders in Cygnet the Respondent also convinced clients to invest with him in the Bell Street Property, Leisure Days RV Centre and WorldCrest.

25. Member Rule 2.1.4 establishes the procedure for dealing with conflicts of interest and the possibilities of conflicts of interest which might arise. That Rule provides as follows:

> 2.1.4 **Conflicts of Interest**
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> a) Each Member and Approved Person shall be aware of the possibility of conflicts of interest arising between the interests of the Member or Approved Person and the interests of the client. Where an Approved Person becomes aware of any conflict or potential conflict of interest, the Approved Person shall immediately disclose such conflict or potential conflict of interest to the Member.
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> b) In the event that such a conflict or potential conflict of interest arises, the Member and the Approved Person shall ensure that it is addressed by the exercise of responsible business judgment influenced only by the best interests of the client and in compliance with Rules 2.1.4(c) and (d).
>
> c) Any conflict or potential conflict of interest that arises as referred to in Rule 2.1.4(a) shall be immediately disclosed in writing to the client by the Member, or by the Approved Person as the Member directs, prior to the Member or Approved Person proceeding with the proposed transaction giving rise to the conflict or potential conflict of interest.
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> d) (Inapplicable - omitted)

26. The Respondent's conduct in dealing with clients of his Member employers created serious and obvious conflicts of interest. He took none of the steps mandated by Rule 2.1.4 when even a possibility of a conflict of interest exists. In our view he was in clear breach of that Rule.

27. For the same reasons which we gave in regard to Allegation #1, the Respondent's actions in relation to conflicts of interest in breach of Rule 2.1.4 should be viewed as a failure on his part to observe "high standards of ethics and conduct". Accordingly that conduct amounts to a breach of the provisions of Rule 2.1.1(b).

28. We hold, therefore, that Allegation #3 has been established upon both of the bases upon which it was advanced.

Conclusion Respecting Allegations

29. We find that the MFDA has established, to the requisite degree of proof, that the Respondent has committed violations of the Members Rules set out in all three allegations which it has made against him in the Notice of Hearing. We must therefore consider the appropriate penalty.

PENALTY

30. It is not necessary for us to cite authority to say that the primary purpose of the Member Rules is the protection of the investing public. It is also intended to earn public confidence in the market system and to assist in the maintenance of market efficiency. The circumstances in this case are grave. The flagrant violation of some of the most important rules of professional conduct must be treated very seriously. Conduct such as that of the Respondent in this case strikes at the very heart of a regulatory system intended to protect members of the investing public.

31. When determining an appropriate penalty a tribunal must always consider any mitigating circumstances. In this case we can see none, but we can see circumstances of aggravation. While in some circumstances the absence of a disciplinary history can be seen as a mitigating factor, we consider it to be neutral in the circumstances of this case. What is seriously aggravating is the fact that the Respondent is a sophisticated person with long experience in the financial industry. Indeed at one time he was a bank manager. He should have known better. He must have known better. He was cavalier of his most fundamental obligations to his Member employers and to some of his clients who suffered financially as a result of his misconduct. His misconduct was obviously deliberate, calculated and extended for a little over three years. In those circumstances we think an extract from *Re Tonnies (supra)*, at p. 22 is apposite:

> The Ontario Securities Commission has set out succinctly its role, not dissimilar to the role of this Panel, in determining penalty in *Re Mithras Management Ltd. et al.* (1990), 13 O.S.C.B. 1600. The Commission stated at 1610:
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> > … [T]he role of the Commission is to protect the public interest by removing from the capital markets - wholly or partially, permanently or temporarily as the circumstances may warrant - those whose conduct in the past leads us to conclude that their conduct in the future may well be detrimental to the integrity of those capital markets. We are not here to punish past conduct, that is the role of the courts, particularly under section 118 of the Act. We are here to restrain, as best we can future conduct that is likely

to be prejudicial to the public interest in having capital markets that are both fair and efficient.

32. In order to do what we can to restrain future prejudicial conduct by the Respondent we think that a permanent prohibition of his authority to conduct securities related business in any capacity over which the MFDA has jurisdiction is called for.

33. In some cases, where the maximum prohibition is imposed, a fine may not be imposed, or if one is imposed, it is a moderate one. This case, however, is so egregious that it seems to us that the requirement of general deterrence calls for the imposition of a substantial fine. We fix the amount of the fine at $150,000.

34. The MFDA is entitled to its costs. We fix them in the amount of $7,500.

35. In our opinion the penalties which we are imposing, which are consistent with the recommendations of MFDA Staff, are in keeping with the purpose of the MFDA to enhance investor protection and strengthen public confidence in the Canadian Mutual Fund Industry by ensuring that high standards of conduct are maintained by Members and by Approved Persons. Furthermore it is our intention that the sanctions which we are imposing will prevent future misconduct by the Respondent and equally importantly deter others from engaging in similar misconduct. The penalties should improve overall compliance by Mutual Fund Industry participants and foster public confidence in the Mutual Fund Industry

36. Pursuant to By-law 24.1.1 we impose the following penalty upon the Respondent:

(a) A permanent prohibition of the authority of the Respondent to conduct securities-related business in any capacity over which the MFDA has jurisdiction.
(b) A fine of $150,000.
(c) Costs of $7,500.

DATED this 24th day of July, 2012.

"Patrick T. Galligan"
The Hon. Patrick T. Galligan, Q.C.,
Chair

"Guenther Kleberg"

Guenther Kleberg,
Industry Representative

"Robert C. White"

Robert C. White,
Industry Representative

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