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: Derek Chapman

Heard: March 31, 2021 by electronic hearing in Toronto, Ontario
Decision (Penalty) and Reasons: June 22, 2021

DECISION (PENALTY) AND REASONS

Hearing Panel of the Central Regional Council:

Martin L. Friedland, C.C., Q.C.	Chair
Brigitte J. Geisler	Industry Representative
Melody Potter	Industry Representative

Appearances:

Alan Melamud	)	Enforcement Counsel for the Mutual Fund Dealers Association of Canada
Derek Chapman	)	Respondent, not in attendance or represented by Counsel

Background

1. This is a Penalty Hearing under Sections 20 and 24 of By-law No. 1 of the Mutual Fund Dealers Association of Canada (the "MFDA"). The Hearing was held as an electronic hearing on March 31, 2021. Derek Chapman (the "Respondent") was not in attendance or represented by counsel at the Hearing.

2. The Respondent was registered as a mutual fund salesperson (now known as a dealing representative) in Ontario from August 2, 2002 to November 1, 2016 and in Alberta from July 25, 2007 to November 1, 2016 with Quadrus Investment Services Ltd. ("Quadrus" or the "Member"), a Member of the MFDA. The Respondent also acted as a life insurance agent.

3. On November 1, 2016, the Member terminated the Respondent's registration as a result of the events that are the subject of this proceeding. At al1 material times the Respondent carried on business in the St. Catharines, Ontario area. The Respondent is not currently registered in the securities industry in any capacity.

4. An electronic Misconduct Hearing had been held on October 28, 2020, where the Panel found that the Respondent violated the By-laws, Rules or Policies of the MFDA. The respondent did not appear at that Hearing in person or by counsel.

5. There were two allegations made against the Respondent in the Notice of Hearing dated April 25, 2019. They were:

> **Allegation #1**: Between December 2014 and October 5, 2016, the Respondent engaged in personal financial dealing with a client by borrowing $600,000 from the client, thereby giving rise to an actual or potential conflict of interest, which the Respondent failed to address by the exercise of responsible business judgment influenced only by the best interests of the client, contrary to the Member's policies and procedures and MFDA Rules 2.1.4, 2.1.1, 2.5.1, and 1.1.2.
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> **Allegation #2**: Beginning on or around February 13, 2018, the Respondent failed to cooperate with an investigation into his conduct by MFDA Staff, contrary to section 22.1 of MFDA By-law No. 1 and MFDA Rule 2.1.1.

6. The Panel found that both allegations were clearly proven. The Panel's reasons, dated December 2, 2020, can be found on the MFDA website and will not be set out in any detail in this decision on the appropriate penalty for the misconduct.

7. The Respondent admitted that he had borrowed $600,000 from a client, LM, as alleged in Allegation 1 and the Panel also found that he contravened allegation 2. As is often the practice, the determination of the proper penalty was left to a later hearing. This was, in part, to permit the Respondent to have the opportunity to attend the Penalty Hearing. He did not, however, appear at the present Hearing.

Seriousness of the Conduct

8. As discussed in the Misconduct Decision, both the allegations are very serious.

9. Borrowing money from a client has consistently been held by other Panels to be a conflict of interest under Rules 2.1.1 and 2.1.4. An MFDA Member regulation Notice 0047, dated October 3, 2005, takes a hard line on borrowing from clients, stating under the heading "Borrowing from Clients": "Borrowing from a client by either the Member or Approved Person raises a significant and direct conflict that in almost all cases will be impossible to resolve in favour of the client." The Member also had a policy against borrowing money from clients. The Respondent admitted that he knew that borrowing from a client was wrong. He told his branch manager during a compliance interview in June 2016 that he had not borrowed money from a client and knew it was improper to do so. He never disclosed to the firm that he borrowed money from LM.

10. An Approved Person's failure to cooperate with an MFDA investigation undermines the MFDA's regulatory obligations. As stated by the Panel in *Re Vitch* 2011 LNCMFDA 63 at para. 55, to cite only one case:

> "There can be no exceptions to that obligation. The fulfillment of that obligation is particularly important to the MFDA because it has no statutory power to search and seize or to compel the production of documents. Without the cooperation of Members and Approved Persons, the MFDA's ability to investigate and discipline its Members and Approved Persons is gravely fettered."

The Appropriate Penalty

11. The Panel had no difficulty in concluding, as recommended by counsel for the MFDA, that the "Respondent be permanently prohibited from conducting securities related business in any capacity while in the employ of, or in association with, any MFDA Member pursuant to section 24.1.1(e) of MFDA By-law No. 1."

12. The combination of improper borrowing from a client and failure to cooperate show that the Respondent should not be in the securities industry. As counsel for the MFDA argued, the

Respondent is "ungovernable". The Respondent tried to limit the MFDA's investigation of his conduct, would not answer questions that the MFDA rightly asked him, and would change his story from time to time. Further, he requested many unnecessary delays in the hearings and failed to take part in the Misconduct Hearing or this Penalty Hearing.

13. The Panel also has no difficulty in requiring the Respondent to pay a significant portion of the costs of the investigation, which were a little over $25,000, not including the actual cost of the hearings. We concluded that $15,000 would be an appropriate sum for the Respondent to pay for costs pursuant to section 24.2 of MFDA By-law No. 1.

14. The determination of an appropriate monetary penalty caused us more difficulty. Counsel for the MFDA cited a large number of cases where penalties were imposed for borrowing from clients. In a number of cases, the monetary penalty imposed was approximately the same as the amount borrowed. When the amount borrowed was a relatively small sum, the penalty was often much higher than the sum that was borrowed.

15. Further, should the Panel impose a separate penalty for each of the two allegations, as some Panels have done, or one overall penalty, as proposed by the MFDA in this case?

16. It is clear from the cases that a very significant factor in what the penalty should be is whether the sum borrowed was repaid. If it was repaid, the harm to clients is obviously not as great as when it is not repaid and so the fine is often a significantly lower percentage of the amount borrowed.

17. In the present case, the amount borrowed was repaid, but only after the client had to go to court to get payment. Moreover, he had to cash in his whole-life insurance policy when he was not initially repaid the interest (12%) and capital. A further factor is that the loan was not secured by a mortgage or in any other manner and was simply a promissory note and so the client's risk of loss was obviously higher than it would have been if it had been a secured loan.

18. The key issue for the Panel is whether we should take into account the circumstances relating to the repayment of the loan. As discussed in the Misconduct Reasons, the Respondent repaid the loan by mortgaging the family home, which had fairly recently been put in his wife's name. The Respondent refused to tell the MFDA whether the mortgagee, EI, who put up the funds for the mortgage of $900,000 was an insurance client of his. He would only say that EI was not an MFDA client. The Respondent's position was that he borrowed money from the first lender, LM,

and paid it back and the involvement of other persons in how the money was obtained to pay back LM is irrelevant.

19. The MFDA discovered the source of the funds by searching the title of the Respondent's home and also through an anonymous tip from a whistleblower, but were unable to determine the relationship between the mortgagee and the Respondent. The mortgagee and the Respondent's wife would not assist the MFDA.

20. Should the fact that the lender may have been the Respondent's insurance client be relevant in our decision on the appropriate penalty? The MFDA argued that borrowing from an insurance client was inappropriate conduct and we should almost completely disregard the fact that the first borrower was, in fact, repaid. In counsel's written submissions to the Panel he stated that "because the Respondent repaid client LM by borrowing from an insurance client, little to no weight should be given to the repayment of client LM as a mitigating factor." At the Hearing, however, he was less dogmatic, stating that the Respondent's conduct should be "taken into account in assessing the penalty."

21. The MFDA suggested in its written submissions that the fine that should be imposed in the present case should be "at least $600,000, pursuant to section 24.1.1(b) of MFDA By-law No. 1." That was the amount that was borrowed by the Respondent from LM. Counsel for the MFDA argued that although repayment is usually a mitigating factor in cases of borrowing, "that mitigating factor ought to be discounted because the Respondent ameliorated the misuse of his position of trust with [LM, the first lender] by misusing his position of trust with [EI, the second lender]." Counsel points out that section 24.1.1(j) provides that a Panel may sanction an Approved Person where the Approved Person "has engaged in any business conduct or practice which such Regional Council in its discretion considers unbecoming or not in the public interest."

22. There are cases cited to the Panel on whether harming non-members of the MFDA should be taken into account in determining the penalty. (See *Re Hothi* (2020) MFDA File No. 202012 at paras. 43-49; *Re Aksomitis* 2016 LNCMFDA 72 at paras. 29-34; and *Re Groulx* 2007 LNCMFDA 9) We accept those cases, but have concluded that it should be a factor in our decision, but not to the extent that the MFDA has requested. In *Aksomitis*, for example, conduct involving harm to only three MFDA members drew a fine of $57,000 while similar conduct by the same Respondent involving 24 non-MFDA members drew a fine of only $10,000.

23. We are also concerned that although the second lender may well have been one of the Respondent's insurance clients, we have no clear proof of his status and will leave that issue to other regulatory agencies. In the end, we have given very little weight to the second lender's relationship with the Respondent.

24. We should also note that in a short email to counsel for the MFDA on the morning of the hearing the Respondent stated: "Unfortunately we will not be attending the video hearing this morning as we have previously stated our position on this; Please let the panel know that I am extremely sorry that my actions resulted in a conflict of interest."

25. We also note that the Respondent had been a member of the MFDA since 2002 and has not previously been the subject of a disciplinary proceeding.

26. In weighing all these issues, we have determined that the appropriate monetary penalty for both allegations together should be $300,000.

27. This is a substantial penalty and when coupled with the permanent prohibition easily satisfies the need for general deterrence. Moreover, it is not out-of-line with the many cases cited to us by counsel. It is also consistent with the MFDA Sanction Guidelines.

28. We therefore order that the Respondent be permanently prohibited from conducting securities related business in any capacity while in the employ of, or in association with, any MFDA Member; that he pay a fine of $300,000; and that he pay costs of $15,000.

DATED this 22nd day of June, 2021.

"Martin L. Friedland"
Martin L. Friedland, C.C., Q.C.
Chair

"Brigitte J. Geisler"
Brigitte J. Geisler
Industry Representative

"Melody Potter"
Melody Potter
Industry Representative

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