



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

**IN THE MATTER OF A SETTLEMENT HEARING
PURSUANT TO SECTION 24.4 OF BY-LAW NO. 1 OF
THE MUTUAL FUND DEALERS ASSOCIATION OF CANADA**

**Re: Colin Michael Corner, Heather Darlene Halladay, John Joseph
Hanson, Richard Gerald Moore and James Edward Rainbird**

Heard: July 6, 2010 in Toronto, Ontario
Reasons for Decision: July 20, 2010

REASONS FOR DECISION

Hearing Panel of the Central Regional Council:

The Hon. Edward Saunders, Q.C.
Jeanne E. Beverly
Linda J. Anderson

Chair
Industry Representative
Industry Representative

Appearances:

Michelle Pong)	For the Mutual Fund Dealers Association of
Charles Toth)	Canada
Neil Gross)	For the Respondents, Corner, Halladay,
)	Moore and Rainbird
John Joseph Hanson)	Via Teleconference

1. This is a settlement hearing pursuant to Section 24.4 of By-law No. 1 of the Mutual Fund Dealers Association of Canada (the “MFDA”). There are two settlement agreements to be considered. The first is between the MFDA and the Respondents Corner, Halladay, Moore and Rainbird, represented by Mr. Gross, and the second is between the MFDA and the Respondent Hanson. The parties agreed that the agreements be considered together.

2. By Notice of Hearing dated October 21, 2008 the MFDA alleged the following violation of the By-laws, Rules and Policies of the MFDA.

Allegation #1: Between June 25, 2003 and April 1, 2007, the Respondents, in their capacity as Approved Persons of Farm Mutual Financial Services Inc. (“Farm Mutual”), sold an exempt product to approximately 300 Farm Mutual clients without ensuring that:

- a) the investments were suitable for the clients and in keeping with the clients’ investment objectives, contrary to MFDA Rules 2.2.1(a), (b), (c) and (d), and 2.1.1(c); and
- b) the clients qualified as accredited investors in accordance with Ontario Securities Commission Rule 45-501 and subsequently National Instrument 45-106, contrary to MFDA Rule 2.1.1(c), thereby engaging the jurisdiction of the Hearing Panel to impose a penalty on the Respondents pursuant to s. 24.1.1(h) of MFDA By-law No. 1.

Allegation #2: Between June 25, 2003 and April 1, 2007, the Respondents, in their supervisory capacity with Farm Mutual, failed to ensure that all business conducted on behalf of Farm Mutual by Approved Persons under their supervision at their respective branch office, including the sale of exempt products to Farm Mutual clients, was in compliance with MFDA Rules and Policies and applicable securities legislation, contrary to MFDA Rules 2.5.3(b) and 2.1.1(c) and MFDA Policy No. 2.

3. All the Respondents had at least 14 years experience in the industry and at the

relevant times were the Managers or Co-Managers of a branch of Farm Mutual. None of the Respondents had any disciplinary history throughout their years in the industry.

4. The allegations against the Respondents have their source in the sale of debentures issued by FactorCorp Financial Inc. (“FactorCorp”). There is agreement on the following facts:

- (1) FactorCorp held itself out as being in the business of extending credit to companies which purchased accounts receivable from other companies at a discount and then attempted to collect the accounts in full.
- (2) On June 25, 2003, and again on December 18, 2003, Farm Mutual entered into a distribution agreement with FactorCorp pursuant to which Farm Mutual agreed to promote and distribute debentures issued by FactorCorp (the “Debentures”) to Farm Mutual clients through its Approved Person.
- (3) The Debentures offered investors a fixed rate of interest of 6%, 7% or 8% based on one-, two- or three-year terms, respectively.
- (4) The Debentures were offered to investors in Ontario in reliance on the “accredited investor” exemption set out in section 2.3 of Ontario Securities Commission Rule 45-501 and subsequently National Instrument 45-106.
- (5) In June 2003, Farm Mutual permitted Approved Person at the Respondent Rainbird’s branch offices to sell the Debentures. In October 2003, Farm Mutual approved the Debentures for sale by Approved Person at all of its branch offices.
- (6) In September 2003, Farm Mutual’s Manager of Compliance & Audit had distributed materials to Farm Mutual’s branch managers describing the Debentures as “highly-secured” and stating that the Debenture funds were “at significantly less risk than typical investments in the equity markets”. In October and November 2003, Farm Mutual’s President sent emails to the branch managers updating them on Farm Mutual’s due diligence review of FactorCorp, stating that Farm Mutual’s legal counsel had assessed the Debentures, and describing them as “an outstanding investment opportunity”.

- (7) On November 5, 2003, Farm Mutual's Manager of Compliance & Auditing began approving advertisements describing the Debentures as “fully secured”, with “guaranteed rates” and “no market correlation or volatility”. Subsequently, from November 2003 through July 2005, Farm Mutual's Manager of Compliance & Auditing approved at least 8 additional similar advertisements, including advertisements describing the Debentures as “secured”, as combining attractive growth “with reduced risk versus equity investments”, and as “a better alternative to GICs.”
- (8) It is agreed that based on the aforementioned materials, emails and approved advertisements, the Respondents concluded that Farm Mutual had rated the Debentures as either a low or medium-low risk product
- (9) On November 11, 2003, Farm Mutual’s Manager of Compliance & Auditing sent an email message to all Farm Mutual branches, the purpose of which was, among other things, to clarify the definition of “accredited investor” in OSC Rule 45-501. This email was not sent directly to all branch managers, however, and one of the Respondents (Moore) never received it.
- (10) In the same email message, the Manager of Compliance & Auditing stated the following:

“Please make sure that any training that is provided to your sales associates stress the proper definition of an accredited investor under OSC Rule 45-501. Any misinterpretation of this rule/definition could result in a non-compliant sales of an exempt product to our clients and leave the agent, the branch and FMFS the dealer exposed to large financial losses and also put our licensing under review. All exempt products fall in a high risk category as they require more than the basic knowledge for selling mutual funds. There must be a clear understanding by the sales associate of what they are selling and extra due diligence in supervision by the branch manager in reviewing and approving, first of all the account set up for the investor based on the KYC information and secondly the sale of the product supported by the information obtained by the associate from the investor.”

The Respondents state that they read this email as a caution, first, that the sale of any exempt product, including the Debentures, carried significant risk for

Farm Mutual if proper procedures for exempt product sales were not followed; and second, that extra due diligence was required by branch managers in the supervision of the sale of such products. The said Respondents state that they did not read it as a statement that the Debentures were high risk securities suitable only for investors with a high risk tolerance, since such an interpretation of the email was inconsistent with statements contained in the aforementioned emails, materials and advertising approvals distributed by Farm Mutual

- (11) Between June 25, 2003 and April 1, 2007, 35 Approved Persons of Farm Mutual sold approximately \$52 million of the Debentures to approximately 680 Farm Mutual clients.
- (12) The Respondents either sold, or were responsible for the supervision of Approved Persons who sold, approximately \$50.3 million of the Debentures to 656 Farm Mutual clients.
- (13) At the time the Debentures were sold, Farm Mutual clients were asked to complete a Farm Mutual new account application form, a FactorCorp Subscription Agreement, and a FactorCorp Accredited Investor Status Certificate (collectively, the "Sales Documentation"). In accordance with specific instructions from Farm Mutual, clients were directed to make all cheques payable to FactorCorp.
- (14) For each sale, the Approved Person provided the Sales Documentation, along with the client's cheque in payment for the Debentures, to the Approved Person's branch manager whose responsibility it was to ensure that the Sales Documentation was complete. In accordance with specific instructions from Farm Mutual, the branch manager then forwarded the Sales Documentation, along with the client's cheque, directly to FactorCorp.
- (15) In their capacity as branch managers, the Respondents conducted first-tier reviews of these purchases upon receiving the Sale Documentation. In Corner's branch, some of the first-tier reviews were conducted by him and some were conducted by his co-branch manager. All of the Respondents'

first-tier reviews included reviews for suitability, however those reviews were based on:

- (a) the Respondents' aforementioned belief that Farm Mutual had rated the Debentures as low or medium-low risk; and
- (b) the Respondents' specific training, by Farm Mutual, that the portfolios of clients with low risk tolerance or medium risk tolerance could suitably hold some higher risk investments provided the clients' other assets were predominantly low risk. (However, Staff's investigation did not reveal any evidence that the Respondents had used any calculations or methodology to apply a "portfolio" approach to suitability or any documentary evidence in the client files to this effect.)

Further, Farm Mutual's President had instructed the branch managers in November 2003 that the onus lay on investors who purchased the Debentures to determine whether or not they qualified as accredited investors, and accordingly the Respondents did not conduct detailed reviews to determine this. Instead, the Respondents considered the clients' assets as part of their first-tier review, however that review was based on advice from Farm Mutual that assets such as shares in private farm corporations and farm product quotas could be included as securities for purposes of the accredited investor qualification criteria, and Farm Mutual did not clarify that this advice was incorrect until September 2006

- (16) In accordance with specific instructions from Farm Mutual, the Respondents sent the Sales Documentation, including the Know-Your-Client forms (the "KYCs"), to FactorCorp and the Respondents did not forward copies of the Sales Documentation or KYCs to Farm Mutual's head office, but instead, in accordance with Farm Mutual's specific instructions, the Respondents retained copies of the Sales Documentation and KYCs at the branch offices. At no time did Farm Mutual conduct second-tier suitability reviews of any of the Debentures transactions.
- (17) On October 31, 2005, the MFDA issued Member Regulation Notice MR-0048 "Know-Your-Product" the purpose of which was to set out Staff's

interpretation and to assist Members and Approved Persons with respect to the approval and sale of investment products. The Notice states, among other things, that “Approved Persons are required to ensure that each order accepted or recommendation made for any account of a client is suitable for the client and in keeping with the client’s investment objectives. Know-your-client requirements are a fundamental part of meeting basic suitability obligations. However, these obligations can only be properly discharged if Approved Persons...also fully understand the products that are being recommended to clients.”

- (18) FactorCorp suspended redemptions in May 2007. On July 6, 2007, the Ontario Securities Commission issued a temporary cease trade order. Eventually FactorCorp became bankrupt, as did Farm Mutual.
- (19) Of the approximately \$52 million invested by Farm Mutual’s clients in the FactorCorp Debentures, approximately \$49 million remained outstanding and unredeemed at the time of the cease trade order.

5. Farm Mutual has been disciplined for deficiencies in its due diligence assessment of FactorCorp debentures, deficiencies in its approval of FactorCorp debentures for sale to clients, and deficiencies in its supervision of such sales, including its failure to conduct second-tier supervisory reviews. The Respondents’ admitted contraventions referred to below, occurred in the context of those deficiencies and, in large part, as a result of those deficiencies.

6. The Respondents admit that between June 25, 2003 and April 1, 2007, the Respondents, in their capacity as Approved Persons of Farm Mutual, conducted sales of exempt securities – specifically FactorCorp debentures – using training and information provided by the Respondents’ Member, Farm Mutual, and as a result of deficiencies in that training and deficiencies in that information the Respondents sold FactorCorp debentures to clients who did not qualify as accredited investors in accordance with Ontario Securities Commission Rule 45-501 and subsequently National Instrument 45-106 and to clients whose risk tolerance was less than high, thereby contravening MFDA Rule 2.1.1 (c) and thereby engaging the jurisdiction of the Hearing Panel to impose a

penalty on the Respondents pursuant to s. 24.1.1(h) of MFDA By-law No. 1. In effect, the Respondents admit Allegation #1.

7. In making these admissions, the Respondents acknowledge that their regulatory obligations as mutual fund salespersons and branch managers were not limited to the training and information they received from Farm Mutual with respect to the risks associated with the FactorCorp debentures but extended to include a knowledge of the essential framework associated with the sale of exempt securities.

8. Turning to Allegation #2, the Respondents admit that between June 25, 2003 and April 1, 2007, the Respondents, in their supervisory capacity as branch managers of Farm Mutual, complied with a directive from Farm Mutual to send all FactorCorp debenture sales Documentation, including KYCs, directly to FactorCorp and not to Farm Mutual's head office, and in so complying the Respondents failed to discern that Farm Mutual's Compliance department and its senior management were rendering themselves incapable of conducting second-tier reviews necessary for Farm Mutual to properly supervise client accounts, thereby contravening MFDA Rule 2.5.3(b)(i) and thereby engaging the jurisdiction of the Hearing Panel to impose a penalty on the Respondents pursuant to s. 24.1.1(h) of MFDA By-law No. 1.

9. MFDA Rule 2.5.3(b)(i) provides as follows:

It is the responsibility of a branch manager to:

(i) ensure that the business conducted on behalf of the Member by an Approved Person and other employees and agents at the branch is in compliance with applicable securities legislation and the By-laws and Rules;

10. The Farm Mutual head office directed branch managers to send FactorCorp documents directly to FactorCorp and not the Farm Mutual head office. It would be a bold manager that would not comply with such a direction. In complying with the direction, the Respondents admit that they failed to discern that Farm Mutual's compliance department and the senior management were rendering themselves incapable of conducting second-tier reviews necessary for Farm Mutual to properly

supervise client accounts. The second-tier review was a head office responsibility not a branch responsibility. In our view, Rule 2.5.3(b)(i) is confined to the business conducted by Approved Persons and other employees and agents at the branch and does not extend branch manager responsibility to the supervision of head office responsibilities.

11. The Respondents have agreed to the terms of the settlement as set out in the respective Settlement Agreements. After consideration, we find the settlement terms fall well within a reasonable range even if the admissions with respect to Allegation #2 are ignored. The Settlement Agreements are therefore accepted.

DATED this 20th day of July, 2010.

“Edward Saunders”

The Hon. Edward Saunders, Q.C.,
Chair

“Jeanne Beverly”

Jeanne E. Beverly,
Industry Representative

“Linda Anderson”

Linda J. Anderson,
Industry Representative