



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: Enzo DeVuono

Heard: April 11, 2013 in Vancouver, British Columbia
Decision and Reasons (Penalty): May 27, 2013

**DECISION AND REASONS
(Penalty)**

Hearing Panel of the Pacific Regional Council:

The Hon. Thomas R. Braidwood, Q.C.
Susan Monk
Holly Millar

Chair
Industry Representative
Industry Representative

Appearances:

Shelly Feld)
Francis Roy)
)

For the Mutual Fund Dealers Association
of Canada

Enzo DeVuono)
)

On his own behalf (via teleconference)

1. In our Decision and Reasons dated the 22nd day of November, 2012, we found that the allegations alleged against the Respondent were well founded. Those allegations are:

“Allegation #1: Between March 2006 and March 5, 2009, the Respondent recommended and sold mutual funds to clients BW and LW by way of a leveraged investment strategy without performing the necessary due diligence to learn the essential facts relative to the clients and without ensuring that the investments and the leveraged investment strategy were suitable and appropriate for clients BW and LW and in keeping with their investment objectives, contrary to MFDA Rules 2.2.1 and 2.1.1.

“Allegation #2: Between March 2006 and March 5, 2009, the Respondent failed to fully and adequately explain the features and inherent risks of a leveraged investment strategy and its underlying investments to clients BW and LW, including:

- (a) the risk that the underlying investments might decline in value and the clients would be unable to pay back their investment loans or cover investment losses;
- (b) the risk that the underlying investments might reduce or suspend the distributions paid to investors and required by clients BW and LW to sustain the leveraged investment strategy;
- (c) the risks associated with maintaining the required debt to asset ratio of the margin loans recommended and facilitated by the Respondent on behalf of clients BW and LW to implement the leveraged investment strategy;

thereby failing to ensure that the investments and the leveraged investment strategy were suitable and appropriate for clients BW and LW and in keeping with their investment objectives, contrary to MFDA Rules 2.2.1 and 2.1.1.”

2. The two principles, namely the suitability of the investment and the duty upon the registrant to know his client, are the cornerstone of the relationship between a salesman and his client. These concepts are necessary to define firstly “fairness” in a democratic free enterprise society and, of course, are substantially part of the bargain that exists between the parties and is indeed what the client has contracted for when he/she agrees to pay a commission.

3. The following comment was noted by the Hearing Panel:

Re: *Daubney* at para. 39, namely:

“39. As a registrant experienced in the capital markets, Daubney was expected to understand the know-your-client and suitability rules, which “are an essential component of the consumer protection scheme of the Act

and a basic obligation of a registrant.” (*Re Daubney*, para. 213, referring to *Re E.A. Manning, at 5339*)

4. The proposed sanctions suggested are:

Proposed Sanctions

- a) a fine in the range of \$100,000.00 to \$150,000.00, pursuant to s. 24.1.1(b) of the MFDA By-law No. 1;
- b) a suspension in the range of two (2) to three (3) years on his authority to conduct securities related business in any capacity over which the MFDA has jurisdiction, pursuant to s. 24.1.1(c) of the MFDA By-law No. 1 (the “Suspension”);
- c) the successful completion of the Canadian Securities Course offered by the Canadian Securities Institute, or other appropriate course, prior to being re-registered in the mutual fund industry, pursuant to s. 24.1.1(f) of the MFDA By-law No. 1;
- d) after the conclusion of the Suspension and upon becoming re-registered in the mutual fund industry:
 - i. the requirement that he be subject to close supervision by a Member for a term of at least eighteen (18) months; and
 - ii. the prohibition to recommend or carry out leveraged investments for any individuals for a term of at least twelve (12) months;pursuant to s. 24.1.1(f) of the MFDA By-law No. 1; and
- e) costs of at least \$20,000.00.

5. The circumstances are fully set out and in our prior Decision and Reasons mentioned above, but here it is appropriate to make a brief statement by way of summary.

6. There are two victims, husband and wife. BW was 77 years of age and her husband, LW, was 57 years of age at the time of the investment. BW had no formal education beyond Grade 7, and had no previous investment experience and essentially was financially illiterate. She had never borrowed money, with the exception of small amounts of credit card debt, or held any investments prior to dealing with the Respondent, and had been retired for more than 10 years. Her occupation had been the driver of a bus. Her gross income for the 2005 calendar year was approximately \$19,000.00 earned from Canada Pension Plan and Old Age Security payments. She had also in the past engaged in housekeeping services for a lodge and was an employee there for a brief period of time. At the time of the case, she and her husband lived on a small parcel of land on Bowen Island, where she raised chickens.

7. BW's husband, LW, was mentally deficient from the time of his birth as there was a restriction of the blood flow to his brain which caused him to have a serious mental handicap. Since September 4, 1998, his wife BW held a power of attorney appointing her as lawful attorney for him so she could manage what money they had. His employment was limited to the completion of menial jobs for minimum pay. In 2005, his income was between \$400.00 and \$1,900.00. He, of course, had no investment experience or education. Both he and BW were struggling financially to maintain their home.

8. The only significant asset these two victims had was their home on Bowen Island, which was appraised at the approximate value of \$500,000.00.

9. The Respondent had never actually met his two clients, but rather dealt with them through their son, Mr. Scott, who had very limited experience in matters to do with finance, through emails and faxes. Mr. Scott did however have a leverage arrangement with the Respondent in order to assist him in financing an automobile.

10. Mr. Scott was anxious concerning the lack of funds in the hands of his mother and desired to make some arrangement to have her receive \$1,000.00 a month. So the purpose of the arrangement with the Respondent was for his mother and her husband to receive \$1,000.00 a month.

11. Accordingly, they were referred to a mortgage broker and they arranged the loan of

\$300,000.00 on their farm, \$50,000.00 of which was used to pay some back taxes and to upgrade the area and \$250,000.00 was placed in the hands of the Respondent.

12. The investment is described in our Decision and Reasons as follows:

Investment

“25. Between March 2006 and March 2009, the Respondent advised BW and LW to implement a leveraging strategy. The circumstances are:

- (a) obtaining a mortgage as above-described on their previously unencumbered home that was valued at approximately \$500,000.00 in the amount of \$300,000.00;
- (b) using \$250,000.00 of the mortgage proceeds as collateral for additional investment loans in order to triple the amount of money available for investment specifically by:
 - i. dividing the \$250,000.00 in mortgage proceeds into two sums of \$125,000.00 each;
 - ii. posting the two sums of \$125,000.00 as collateral to obtain two additional “2 for 1” margin loans amounting to:
 - A. \$250,000.00 from AGF Trust Company (“AGF”); and
 - B. another \$250,000.00 from B2B Trust Company (“B2B”);
- (c) applying the total amount of \$750,000.00 in proceeds from loans obtained by his new clients, BW and LW, into mutual funds.”

13. The various forms necessary to be completed were mailed by the Respondent, for he lived in Ontario, to his two clients in British Columbia. Essentially, they merely signed the forms and left all the important matters blank.

14. When the Respondent received the forms, he deliberately set out matters that were totally untrue. Under the various headings, he wrote:

Investment Objectives	Income, Tax Savings and Estate Planning.
Estimated Income	\$26,000 – 50,000
Estimated Net Worth	\$200,000+

Investment Knowledge	Good
Time Horizon	10+ years
Risk Tolerance	Medium

15. It is obvious that the investment knowledge was certainly not “good” and that the estimated income to his knowledge was incorrect.

16. There are also instances in some of the documents that the Respondent indicated on the documents that he was guaranteeing their signatures, which of course he could not.

17. It should also be noted that when the Respondent prepared and submitted the loan applications on behalf of these clients for a 2 for 1 investment loan from each of B2B and AGF, the Respondent purposely made two separate loan applications on behalf of BW and LW in order to circumvent credit checks that otherwise had been carried out by their loan companies in order to make sure that his plan was successful.

18. Also the Respondent listed these funds, namely the original \$250,000.00, as capital when of course they were loaned monies. The amount of money borrowed, namely \$750,000.00, was an outrageous sum.

19. In our original Decision and Reasons at paragraph 35, we wrote as follows:

“35. We have reached the conclusion on the above evidence that these blatant incorrect statements in the forms was a deliberate attempt to mislead anyone who read the documents, including any supervisory body or the Respondent’s “partner” and must have been done to allow him to proceed improperly with a leveraged strategy.”

20. After the information was assembled, the Respondent had received \$250,000.00 from the mortgage proceeds from which he invested \$125,000.00 in the Canadian Dividend Fund and \$125,000.00 in the Tactical Income Fund. Then using these funds as a base, leveraged each of them twice for a total of \$375,000.00 in each fund for an overall grand total of \$750,000.00 of borrowed funds.

21. On one of the loan applications, the Gross Annual Income was indicated as “combined

family income of between \$30,000.00 and \$49,999.00. This was on the B2B application.

22. As a result of these activities, the Respondent earned \$38,300.00 by way of commission and subsequently earned trailer fees of:

- a) 0.5% per year on the total assets that remained invested in the Deferred Sales Charge version of the funds; and
- b) 1% per year on the total assets that were re-invested in Front End Load versions of the fund. This fund had been referred to as a “slush fund” which was an overage of the monies that he sent to them in the sum of the \$1,000.00 per month.

23. Another feature that ought to be emphasized that in presenting the arrangement to Mr. Scott, who was there on behalf of his parents, at no time was the risk of such a massive leverage investment ever identified. Further, the Respondent did not understand the difference between what he called the dividend that should result from the investment when in fact for the previous number of years the return on the invest was a return of capital and in no sense could be characterized as a dividend.

24. As we noted before, a simple loan of \$300,000.00 (even though the first \$50,000.00 was spent on external matters) if drawn down at \$1,000.00 a month plus interest would have lasted far beyond the age of 100 for the mother. Obviously such a simple arrangement was never identified.

25. In our original Decision and Reasons we also identified the extreme harm this caused these two unsophisticated clients:

“82. As a result of the strategy that the Respondent recommended to BW and LW, these elderly unsophisticated clients who lacked any significant sources of income obtained margin loans in amounts that substantially exceeded their net worth and invested the proceeds in “return of capital” equity mutual funds, the operation and features of which, the clients could not possibly understand.

83. The Respondent’s recommendations had devastating consequences to the clients as the investment portfolio that the Respondent recommended declined in value and the amounts of distributions payable

by the “return of capital” mutual funds were significantly reduced, resulting in margin calls that eliminated the clients’ entire investment portfolio and left them substantially indebted to lenders without any means of repaying their outstanding loans.”

26. Indeed, as a result of the leverage investment strategy collapse, BW and LW were left no investment portfolio and outstanding loans in excess of \$285,000.00.

27. The Respondent, when he testified before the Hearing Panel, admitted that he recognized these investments were unsuitable, but he did not advise his clients of this opinion at any time.

28. This Hearing Panel agrees with the submission of counsel for MFDA which was stated as follows:

“6. Staff further submits that these penalties will foster and improve overall compliance by mutual fund industry participants, especially as it relates to leveraged investing practices, and will additionally emphasize the importance of providing skilled and careful advice when dealing with vulnerable clients. Briefly stated, the penalties sought by Staff will not only discourage future misconduct by the Respondent, but more generally discourage other industry participants from failing to comply with their fundamental duty to know their clients and encourage them to perform proper suitability assessments when recommending and implementing particular investments for them.

Tonnies, supra, at p. 22, Book of Authorities at Tab 5.

See *Phillips (Re)*, 2011 IIROC 60. Staff’s Book of Authorities at Tab 15.

See also *Daubney, supra* at para. 28. Staff’s Book of Authorities at Tab 3. At para. 28 of the decision, the Ontario Securities Commission adopts the following passage from *In The Matter of Mithras Management Ltd. et al* (1990), 13. O.S.C.B. 1600:

... the 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 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 (at 1610-1611).

See also *Committee for the Equal Treatment of Asbestos Minority Shareholders v. Ontario (Securities Commission)*, [2001] S.C.R. 132, per Iacobucci, J. at para. 42. Staff's Book of Authorities at Tab 6."

29. In considering an appropriate penalty, the Hearing Panel has considered, amongst other things, the following:

- a) the protection of the investing public;
- b) the integrity of the securities market;
- c) specific and general deterrence;
- d) the protection of the MFDA's membership; and
- e) the protection of the integrity of the MFDA's enforcement processes.

30. The Hearing Panel has also been guided by the consideration of various applicable precedents. Without going into them in detail, they are as follows:

- a) *In the Matter of Thomas G. Arseneau*, [2012] MFDA File No. 201115;
- b) *Lamoureux (Re)*, [2002] A.S.C.D. No. 125 (A.S.C.);
- c) *Phillips (Re)*, 2011 IIROC No. 34 (IIROC);
- d) *Mytting (Re)*, 2012 IIROC No. 45 (IIROC); and
- e) *Jones (Re)*, 2012 IIROC No. 48 (IIROC).

31. Depending on the circumstances, these cases impose anywhere from a \$100,000.00 fine to a \$500,000.00 fine, 5-year probation, absolute suspension, various education costs, and so forth.

Conclusion

32. Generally speaking, the Hearing Panel agrees with the submission of counsel of MFDA with reference to the penalty, except this conduct is so outrageous that with reference to paragraph (d)(i), we are of the opinion that the Respondent should never be allowed to deal in

leveraged investments. Accordingly, we order as follows:

- a) a fine in the amount of \$150,000.00, pursuant to s. 24.1.1(b) of MFDA By-law No. 1;
- b) a suspension for three (3) years on his authority to conduct securities related business in any capacity over which the MFDA has jurisdiction, pursuant to s. 24.1.1(c) of MFDA By-law No. 1 (the “Suspension”);
- c) the successful completion of the Canadian Securities Course offered by the Canadian Securities Institute, or other appropriate course, prior to being re-registered in the mutual fund industry, pursuant to s. 24.1.1(f) of MFDA By-law No. 1;
- d) upon conclusion of the Suspension and upon becoming re-registered in the mutual fund industry:
 - i. the requirement that he be subject to close supervision by a Member for a term of eighteen (18) months; and
 - ii. the prohibition to ever carry out leveraged investments for any individual;pursuant to s. 24.1.1(f) of MFDA By-law No. 1; and
- e) costs in the sum of \$20,000.00.

DATED this 27th day of May, 2013.

“Thomas R. Braidwood”

The Hon. Thomas R. Braidwood, Q.C.,
Chair

“Susan Monk”

Susan Monk,
Industry Representative

“Holly Millar”

Holly Millar,
Industry Representative

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