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: Michael Franco

Heard: January 25, 2011 in Calgary, Alberta
Reasons for Decision: May 6, 2011

REASONS FOR DECISION

Hearing Panel of the Prairie Regional Council:

Alan V. M. Beattie, Q.C.	Chair
Elaine Bradley	Industry Representative
Kathleen Jost	Industry Representative

Appearances:

Francis Roy	)	For the Mutual Fund Dealers Association of Canada
	)	
Michael Franco	)	On his own behalf
	)	

AGREED STATEMENT OF FACTS

(Including Allegations and Proposed Penalties)

I. INTRODUCTION

1. By Notice of Hearing dated July 28, 2010, the Mutual Fund Dealers Association of Canada (the "MFDA") commenced a disciplinary proceeding against Michael Franco (the "Respondent") pursuant to ss. 20 and 24 of MFDA By-law No. 1.

2. The Notice of Hearing sets out the following allegations (*Panel's note: amended, by agreement, as to Allegation #3*):

> **Allegation #1:** Between October 9, 2003 and December 27, 2007, the Respondent had and continued in another gainful occupation that was not disclosed to and approved by the Member by facilitating participation in the total amount of $428,279 by twenty-six (26) clients in four charitable donation programs, contrary to MFDA Rules 1.2.1(d) [*now 1.2.1(c) as a result of Rules of Amendment, December 10, 2010*] and 2.1.1.
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> **Allegation #2:** Between October 9, 2003 and December 27, 2007, the Respondent facilitated the participation of twenty-six (26) clients in four charitable donation programs which were not disclosed to and approved by the Member, thereby failing to comply with the Member's policies and procedures and interfering with the ability of the Member to supervise the Respondent and comply with its obligations under MFDA Rule 2.1.4, contrary to MFDA Rules 1.2.1 and 2.5.1, and MFDA Rule 2.1.1.
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> **Allegation #3:** Between October 9, 2003 and December 27, 2007, the Respondent recommended and facilitated the participation of twenty-six (26) clients in four charitable donation programs without disclosing to the clients that he would receive, in total, $80,176 in commissions for doing so, thereby giving rise to an actual or potential conflict of interest between the Respondent and the clients which the Respondent failed to address by the exercise of responsible business judgment, contrary to MFDA Rules 2.1.4 and 2.1.1.

II. IN PUBLIC / IN CAMERA

3. The Respondent and Staff of the MFDA ("Staff") agree that this matter should be heard in public pursuant to Rule 1.8 of the MFDA Rules of Procedure.

III. ADMISSIONS AND ISSUES TO BE DETERMINED

4. The Respondent has reviewed this Agreed Statement of Facts and admits the facts set out in Part IV herein. The Respondent admits that the facts in Part IV constitute misconduct for which the Respondent may be penalized on the exercise of the discretion of a Hearing Panel pursuant to s. 24.1 of MFDA By-law No. 1.

5. Subject to the determination of the Hearing Panel, Staff submits, and the Respondent does not oppose, that the appropriate penalty to impose on the Respondent is:

a) a suspension of five (5) years on the authority of the Respondent to conduct securities related business in any capacity over which the MFDA has jurisdiction, pursuant to s. 24.1.1(e) of MFDA By-law No. 1;
b) a fine in the amount of $40,000 pursuant to s. 24.1.1(b) of MFDA By-law No. 1; and
c) costs in the amount of $5,000 pursuant to s. 24.2 of MFDA By-law No. 1.

IV. AGREED FACTS

6. Staff and the Respondent agree that submissions made with respect to the appropriate penalty are based only on the agreed facts in Part IV and no other facts or documents. In the event the Hearing Panel advises one or both of Staff and the Respondent of any additional facts it considers necessary to determine the issues before it, Staff and the Respondent agree that such additional facts shall be provided to the Hearing Panel only with the consent of both Staff and the Respondent. If the Respondent is not present at the hearing, Staff may disclose additional relevant facts, at the request of the Hearing Panel.

7. Nothing in this Part IV is intended to restrict the Respondent from making full answer and defence to any civil or other proceedings against him.

Registration History

8. The Respondent was registered in Alberta as a mutual fund salesperson with Aegon Dealer Services Canada Inc. ("Aegon") from March 14, 2003 to June 26, 2008, when he was terminated.

9. Until September 25, 2008, when it amalgamated with Investia Financial Services Inc. ("Investia"), Aegon was a Member of the MFDA and was registered as a mutual fund dealer in all Canadian provinces except Newfoundland and Labrador. Aegon was also registered as a limited market dealer in Ontario.

10. Investia is a Member of the MFDA and, with the exception of Nunavut, is registered in all provinces and territories as a mutual fund dealer. It is also registered as a limited market dealer in Ontario and Newfoundland and Labrador.

Allegations #1 and #2

11. During the summer of 2002, in anticipation of becoming registered as a mutual fund salesperson with Aegon, the Respondent signed:

a) an Aegon Representative Agreement, on July 9, 2002, which included, among other provisions, an acknowledgement that the Respondent would "not market or sell or attempt to market or sell any financial service or product other than the [Aegon] approved Financial Service Products, except with the prior written consent of and subject to any conditions established by [Aegon]…" [1];

b) an "Aegon Compliance Certificate", on August 30, 2002 and September 3, 2002, acknowledging that he would observe and comply with MFDA Rules and relevant provincial securities laws, that his sales conduct and trading activity would be compliant with Aegon's Conduct and Practices Guide, and that all outside business

[1] Section 1.3(i) of the Aegon Representative Agreement dated July 9, 2002.

names, trade names or style names under which he operated would be disclosed to Aegon's registrations and licensing department. [2]

12. At all material times, Aegon's Conduct and Practices Guide, consistent with MFDA Rule 2.4.2, prohibited an Approved Person (as opposed to Aegon) from entering into referral arrangements.

13. At all material times, the Aegon Representative Agreement did not allow an Approved Person to accept payments from persons or organizations other than Aegon without Aegon's approval.

14. On November 6, 2002, prior to becoming registered with Aegon, the Respondent incorporated Franco Financial Inc. ("Franco Financial"), a business through which he intended to sell life insurance and provide financial planning and tax preparation services to clients and other individuals.

15. The existence of Franco Financial and the type of services that the Respondent contemplated providing through Franco Financial was disclosed by the Respondent to, and approved by, Aegon when the Respondent became registered with Aegon. However, other than approving the sale of life and disability insurance by Franco Financial, Aegon did not give permission to the Respondent to sell or attempt to market or sell any other financial products or services, nor did Aegon give permission to the Respondent to accept payment of any compensation or remuneration from any other persons or organization.

16. Between October 9, 2003 and December 27, 2007, the Respondent, through Franco Financial, sold or facilitated the sale of a total of $428,279 of the following four (4) charitable donation programs (the "Charitable Donations Programs") to twenty-six (26) clients:

1) Global Learning Program;
2) Canadian Humanitarian Trust;

[2] After he became registered with Aegon on March 14, 2003, the Respondent again signed similar compliance certificates on October 13, 2005, November 16, 2006 and June 6, 2007.

3) Universal Health Care Trust; and
4) Synergy Group 2000 Inc.

17. The Charitable Donation Programs held themselves out as tax minimization programs designed to work as follows:

a) A participant purchased products for donation to registered charities at prices secured by the Charitable Donations Programs' promoters that were significantly below fair market value;
b) Once a participant purchased such products, the participants received charitable donation tax receipts from the registered charities to which the participant, by way of the Charitable Donations Programs, donated the products. The value of the charitable tax receipts was equal, not to the price paid by the participant for the products, but rather to the products' supposed fair market value; and
c) The participant could then use the charitable tax receipts provided by the registered charity in the preparation of the income tax filings to reduce the total amount of taxes the participant was required to pay.

18. Franco Financial signed agent agreements with each of the four Charitable Donation Programs. These agreements specified, among other things, that Franco Financial would be paid the following commissions or fees on the initial purchase amount of each participant in the programs:

Charitable Donation Program	**Commission Rate**
Global Learning Program	22%
Canadian Humanitarian Trust	20%
Universal Health Care Trust	25%
Synergy Group 2000 Inc.	10%

19. For its efforts in selling the Charitable Donations Programs to clients, Franco Financial was paid commissions or fees from the four Charitable Donation Programs totaling $80,176.80, the details of which are as follows:

Charitable Donation Program	# of Clients	Purchase Dates	Purchase Amount	Earned by the Respondent
Global Learning Program	19	October 9, 2003 to November 10, 2005	$113,800	$25,036
Canadian Humanitarian Trust	2	October 15 & 24, 2004	$10,579	$2,115
Universal Health Care Trust	23	December 16, 2005 to December 27, 2007	$150,900	$37,725
Synergy Group 2009 Inc.	11	October 31, 2007 to December 15, 2007	$153,000	$15,300
Total	**26** [3]	**October 9, 2003 to December 27, 2007**	**$428,279**	**$80,176**

20. The Charitable Donations Programs were not Approved Financial Service Products of Aegon and the Respondent never sought or obtained approval from Aegon to market or sell the Charitable Donations Programs.

21. The Respondent did not disclose to Aegon that he was recommending and facilitating the participation of clients in the Charitable Donations Programs and that he, through Franco Financial, was being paid commissions or fees by the Charitable Donations Programs for doing so.

22. The Respondent states that, because he had obtained Aegon's approval to provide financial planning and tax preparation services for clients via Franco Financial, he mistakenly assumed that Aegon had approved his selling of the Charitable Donation Programs. The Respondent believed this notwithstanding the fact that the Aegon Representative Agreement did

[3] Although a total of 26 Aegon clients invested in the Charitable Donations Programs, some of the clients contributed to more than one program and/or made more than one investment in the same charity.

not allow an Approved Person to accept payments from persons or organizations other than Aegon without Aegon's approval.

23. In June 2006, the Canada Revenue Agency (the "CRA") informed the clients who purchased the Charitable Donation Programs that their tax returns were subject to re-assessments given that the donations they had made pursuant to the Charitable Donation Programs were disallowed by the CRA based on their interpretation of the Income Tax Act (the "CRA Tax Re-assessment Notices"). The Respondent also received a similar Notice given that he had also participated in the Programs. Therefore, all clients, as well as the Respondent, were faced with the potential for significant losses for their 2003 to 2006 tax years. The Respondent states that he has assisted clients in filing Notices of Objection with CRA and states that those objections are currently being dealt with by the Tax Court of Canada.

24. As such, all clients, as well as the Respondent, were faced with increased tax bills for the 2003 to 2006 taxation years resulting in significant losses to them.

25. Notwithstanding the CRA Tax Re-assessment Notices,[4] the Respondent continued to facilitate client purchases of alternative Charitable Donation Programs until December 2007.

Allegation #3

26. The Respondent provided clients with marketing materials, promotional literature and point of sale documents prepared by each of the Charitable Donation Programs. None of these documents specified or disclosed, among other facts, that commissions, fees or other forms of compensation would be paid to the Respondent or Franco Financial by the Charitable Donation Programs in the event that the clients participated in the Charitable Donations Programs. In addition, at no time did the Respondent himself disclose to the clients, either orally or in writing, that he would be paid commissions, fees or other forms of compensation by the Charitable Donations Programs in respect of the clients' participation in the Charitable Donation Programs.

[4] n.b. The CRA Tax Re-assessment Notices sent out in 2006 concerned client purchases of the 2003 Global Learning Program tax shelter.

27. The undisclosed compensation received by the Respondent for facilitating the participation of clients in the Charitable Donations Programs was material and, except in the case of the Synergy Group 2000 Inc. charitable donation program (10% commission rate), significantly exceeded the sales commissions he might have otherwise earned by selling mutual funds or other Aegon approved products to the clients.

Mitigating Factor

28. The Respondent has not previously been the subject of MFDA disciplinary proceedings.

Misconduct Admitted

29. By engaging in the conduct described above, the Respondent admits the [misconduct described in Allegations #1, # 2 and #3, above at p. 2].

V. ACKNOWLEDGEMENT

30. In admitting the facts and misconduct described herein, the Respondent acknowledges that he was advised of his right to be represented by, and obtain the advice of, legal counsel or an agent.

SUBMISSIONS OF STAFF OF THE MFDA ON THE ALLEGATIONS OF MISCONDUCT

31. Mr. Roy, Enforcement Counsel for the MFDA, provided written Submissions and a Book of Authorities. He referred to the facts as set out in the Agreed Statement of Facts (above) and to the admissions by the Respondent to the allegations of misconduct as also set out in the Agreed Statement of Facts. (For continuity of paragraph numbering, the numbers of the paragraphs in the MFDA Submissions have been changed to numbers which continue from the preceding numbers in these Reasons for Decision.)

32. The sections of the MFDA By-laws, Rules, Member Regulation Notices and Bulletins that are most applicable to this matter are listed below:

MFDA Rule 2.1.1	Standard of Conduct
MFDA Rule 2.1.4	Conflicts of Interest
MFDA Rule 1.2.1	Qualifications of Salespersons
MFDA Rule 2.5.1	Member Responsibilities (Minimum Standards of Supervision)
MFDA Member Regulation Notice MR-0040	Outside Business Activities
MFDA Member Regulation Notice MR-0049	Charitable Donation Programs
MFDA Member Regulation Notice MR-0054	Conflicts of Interest

Allegation #1 - The Respondent's Outside Business Activities

33. MFDA Rule 1.2.1(d) [*now Rule 1.2.1(c), see note above on p. 2*] sets out the conditions that must be satisfied and complied with if an Approved Person wishes to engage in outside business activities. In particular, the Rule requires Approved Persons to ensure that outside business activities are disclosed to and approved by the Member and permitted by applicable provincial securities legislation.

34. MFDA Rule 1.2.1(d) [*now Rule 1.2.1(c), as above*] is fundamental to the regulatory mandate of the MFDA to enhance investor protection and strengthen public confidence in the Canadian mutual fund industry. The Rule creates a regime whereby the role of the Approved Person in the outside business will not be inconsistent with the general standards of conduct imposed by MFDA Rule 2.1.1 and will not bring the MFDA, MFDA Members or the mutual fund industry into disrepute. Consequently, the Rule ensures that, among other things:

a) the Member has had an opportunity to conduct due diligence on the outside business, including any services or product it intends to offer, to determine whether such business should be allowed to operate or whether or not the outside business's products should in fact be sold or referred to investors and that any limitations or conditions on its authorization of dealings with the product are observed;
b) the Member has had an opportunity to ensure that the Approved Person's involvement with the outside business does not impair the ability of the Approved Person and the Member to provide continuous and effective service to clients;
c) the Member is aware of and has approved the sale of the products being sold through the outside business and clients can rest assured that the Member stands behind and takes responsibility for the business conducted by its Approved Persons;

d) the Member has the ability to supervise the sale or referral process to ensure that transaction recommendations are suitable and all regulatory requirements are complied with;
e) the Member's compliance staff has an opportunity to apply any guidance received from regulators concerning the product even after the sale or referral of the product has been approved;
f) any actual or potential conflicts of interest are closely scrutinized and addressed by the exercise of responsible business judgment influenced only by the best interests of the client (including, if appropriate by means of the provision of appropriate disclosure);
g) potential exposure to complaints, litigation or other material risks to the Member have been taken into account and appropriately managed; and
h) appropriate procedures are implemented to enable the Member to satisfy any supervisory requirements arising as a result of the Approved Person's involvement with the outside business.

Member Regulation Notice MR-0040

35. Although the Respondent's Branch Manager BB was aware of some of the Respondent's involvement in outside business activities, it is submitted that this was not sufficient to comply with MFDA Rule 1.2.1(d) [*now 1.2.1(c), as above*] or the Member's policies and procedures requiring disclosure and approval by the Member of all outside business activities.

36. The Respondent had appropriately disclosed and obtained approval from the Member to operate his insurance, financial planning and tax preparation business called Franco Financial Inc. (**"**Franco Financial**"**). However, he did not disclose to the Member or seek approval of his involvement in selling the charitable donation programs known as Global Learning Program, Canadian Humanitarian Trust, Universal Health Care Trust and Synergy Group 2000 Inc. (together, the "Charitable Donation Programs"). The Respondent's failure to disclose and seek approval of his outside business activities deprived the Member of a proper opportunity to supervise his activities and to prevent the Respondent from contravening regulatory requirements.

37. The failure of an Approved Person to inform and obtain approval from the Member's head office compliance department before engaging in outside business activities and the absence of any record of the outside business activities in the Approved Person's registration records constituted a contravention of Rule 1.2.1(d) [*now 1.2.1(c), as above*]

> *In The Matter of Gerard H. Brake and Mavis E. Brake*, [2008] Hearing Panel of the Prairie Regional Council, MFDA File No. 200804, Reasons For Decision on Misconduct dated December 3, 2008
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> *In the Matter of Meiz Mohammed Majdoub*, [2010] Hearing Panel of the Central Regional Council, MFDA File No. 201010, Reasons For Decision dated November 12, 2010

Allegation #2 - Failure To Comply With The Policies And Procedures Of The Member

38. The obligation of the Approved Persons to comply with the policies and procedures of the Members that they are registered with is a cornerstone of the self-regulatory system. MFDA Members are expected to be aware of their regulatory obligations and to implement policies and procedures to ensure compliance. When Approved Persons disregard those obligations, the Member's ability to supervise the conduct of such Approved Persons and protect the interests of clients and the public is undermined.

39. By engaging in the conduct admitted in Allegation #1, the Respondent admittedly failed to comply with the Members Policies and Procedures in respect to the sale the Charitable Donation Programs (Agreed Statement of Facts paragraphs 20 to 22).

40. MFDA Rule 2.5.1 requires each MFDA Member to establish, implement and maintain policies and procedures to ensure that the handling of its business is in accordance with MFDA By-laws, Rules and Policies and applicable securities legislation.

41. An Approved Person is required to comply with the supervisory policies and procedures established, implemented and maintained by a Member under Rule 2.5.1. The Respondent's failure to do so in this case was a breach of his obligation under MFDA Rule 1.2.1(d)(iii) and (vi) [now 1.2.1(c)] which provide as follows:

1.2.1(d) [*now 1.2.1(c), as above*] **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;

….

(vi) *Disclosure.* Clear disclosure is provided to clients that any activities related to such other gainful occupation are not business of the Member and are not the responsibility of the Member;

42. In this case, the Member had explicit policies throughout the material time that:

a) required Approved Persons to disclose all outside business activities to the Member's compliance and registration department;
b) prohibited Approved Persons from engaging in outside business activities without prior written approval from the Member; and
c) restricted trading by Approved Persons to mutual fund transactions placed through the books and records of the Member. (See Agreed Statement of Facts at paragraphs 11 to 15 and 20 to 22).

43. In previous MFDA cases such as *Tonnies* and *Laverdiere*, Hearing Panels determined that a Respondent's failure to comply with the Policies and Procedures of the Member constitutes a breach of an Approved Person's standard of conduct and MFDA Rules (in particular, MFDA Rule 2.1.1).

In The Matter of Arnold Tonnies, Hearing Panel of the Prairie Regional Council, MFDA File No. 200503, Panel Decision dated June 27, 2005 at pp. 16-19

In the Matter of Luc Marc Andre Laverdiere, [2010] Hearing Panel of the Pacific Regional Council, MFDA File No. 200936, Reasons for Decision dated May 12, 2010 at para. 13

44. It is thus submitted that, in the present case, the Respondent's failure to comply with the Member's policies and procedures contravened MFDA Rules 2.5.1, 1.2.1 and 2.1.1(b).

Allegation #3 - The Respondent's Conduct Gave Rise to Conflicts of Interests

45. MFDA Rule 2.1.4 requires that an Approved Person be aware of the possibility of conflicts of interest arising in connection with business conducted by them for a client. In the event that such a conflict or potential conflict of interest arises, an Approved Person must ensure that it is addressed by the exercise of responsible business judgment influenced only by the best interests of the client.

46. Although the expression "responsible business judgment" is not defined in Rule 2.1.4 (or elsewhere), the Hearing Panel in *Tonnies* determined that such expression means "the exercise of the care and diligence reasonably required in the circumstances to address the conflict or potential conflict of interest, having regard to only the best interests of the client". The Panel in that case went on to state that:

> The exercise of responsible business judgment will therefore vary depending on the nature of the conflict of interest. In cases involving a significant, actual conflict of interest, the exercise of responsible business judgment may require a blanket prohibition on, or refusal to proceed with, the proposed type of transaction giving rise to the conflict. In contrast, in cases involving a potential conflict of interest of a very speculative and relatively minor nature, the exercise of responsible business judgment may require only that the client is directed to obtain independent advice before proceeding with the proposed transaction.
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> *Tonnies, supra* at. Pp.13-14

Member Regulation Notice MR-0054

47. Where a conflict of interest arises or can reasonably be expected to arise, it must immediately be disclosed in writing to clients prior (to) business being conducted for those clients.

MFDA Rule 2.1.4

48. In the present case, there is no evidence that the Respondent disclosed to clients, either orally or in writing, that he would be paid commissions, fees or other forms of compensation by the Charitable Donation Programs in respect of the clients' participation in these Programs.

Further, and as is admitted to by the Respondent (at para. 26 of the Agreed Statement of Facts), the undisclosed compensation received by the Respondent for facilitating the participation of clients in the Charitable Donation Programs significantly exceeded the sales commissions he might have otherwise earned by selling mutual funds or other Aegon approved products to the clients in question.

49. There does not appear to be any previous MFDA decision in which a hearing panel has specifically stated that the conduct in which the Respondent engaged, that is his failure to inform clients of his pecuniary interests in selling the Charitable Donation Programs, amounted to a conflict of interest. However, previous MFDA Hearing Panels have determined that other analogous situations amounted to a contravention of MFDA Rules 2.1.4 and 2.1.1.

Brake, supra at para. 30

50. For example, in the *Brake* case, the Respondents sold securities of a corporation they owned to clients without informing the clients of their interest in the corporation. The Panel determined that that situation amounted to a conflict of interest and also constituted conduct unbecoming Approved Persons.

51. Several prior MFDA cases dealt with similar facts where Approved Persons conducted outside business activities in which they sold products or securities not approved by their Members and for which they earned undisclosed commissions or fees. Nevertheless, in each of those cases, though Hearing Panels found that the Respondents had contravened MFDA Rules, Policies and Procedures, specific conflict of interest allegations were not pleaded by Staff. It is submitted that in the factual circumstances of those cases, such allegations could have been made as they have been in this particular instance.

In the Matter of Peter Bruno Lamarche, [2008] Hearing Panel of the Prairie Regional Council, MFDA File No. 200821, Reasons for Decision dated February 23, 2009

Majdoub, supra

In the Matter of Jawad Rathore, [2005] Hearing Panel of the Ontario Regional Council, MFDA File No. 200504, Reasons for Decision dated May 31, 2005

52. It is therefore submitted that the Respondent's failure to inform clients of his pecuniary interests in selling the Charitable Donation Programs constituted a failure by him to exercise reasonable business judgment in addressing conflicts of interest between his interests (the earning of significant commissions or fees from the Charitable Donation Programs) and those of the clients.

SUBMISSIONS OF STAFF OF THE MFDA ON PENALTY

53. The sections of the MFDA By-law and Rules of Procedure concerning applicable penalties and the settlement hearing process are as follows:

Section 24.1.1 of MFDA By-law No. 1	Disciplinary Powers
Section 24.2 of MFDA By-law No. 1	Costs
Rule 13 of the MFDA Rules of Procedure	Conduct of Disciplinary Hearings

Penalties Sought by Staff

54. Pursuant to section 24.1.1 of MFDA By-law No. 1, if in the opinion of a Hearing Panel an Approved Person has failed to comply with the provisions of any By-law, Rule or Policy of the MFDA, a Hearing Panel can impose any of the penalties set out in section 24.1.1(a)-(f). A Hearing Panel can also require that respondents pay costs of a proceeding pursuant to section 24.2 of MFDA By-law No. 1.

55. For the reasons set out below, Staff submits that the penalties (in the Agreed Statement of Facts, above) are appropriate.

General Considerations On Penalty

56. The primary goal of securities regulation is the protection of the investor.

> *Pezim v. British Columbia (Superintendent of Brokers),* [1994] 2 S.C.R. 557 per Iacobucci J. at paras. 59, 68

57. Sanctions are intended to be preventive, protective and prospective in nature. One of the objectives of securities regulation is to prevent harm to investors and capital markets. It is therefore appropriate for a Hearing Panel to impose sanctions on the basis of past conduct that will protect the public interest and prevent future conduct detrimental to the integrity of the capital markets 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".

> *Tonnies, supra* at pp. 21-22

58. The effect of general deterrence should thereby advance the goal of protecting investors. As the Supreme Court of Canada stated in *Re: Cartaway Resources Corp.:*

> A penalty that is meant to deter generally is a penalty that is designed to keep an occurrence from happening; it discourages similar wrongdoing in others. In a word, a general deterrent is preventative. It is therefore reasonable to consider general deterrence as a factor, albeit not the only one, in imposing a sanction…The respective importance of general deterrence as a factor will vary according to the breach of the Act and the circumstances of the person charged…
>
> *Re Cartaway Resources Corp.* [2004] 1 S.C.R. 672 at para. 61

59. In previous cases, Hearing Panels have pursued the objective of establishing deterrence in particular by imposing fines that will result in the disgorgement of any possible benefit to the Respondent of engaging in the misconduct. It is submitted that this is always an important consideration to take into account.

> *In The Matter of Gerard H. Brake and Mavis E. Brake*, [2008] Hearing Panel of the Prairie Regional Council, MFDA File No. 200804, Panel Decision on Penalty dated February 19, 2009 at p. 4, para. 7

MFDA Penalty Guidelines

60. When determining the appropriate penalties to be imposed in disciplinary proceedings, a Hearing Panel should also take the MFDA Penalty Guidelines into consideration. Although the MFDA Penalty Guidelines are only intended to be instructive to Hearing Panels and are not

intended to be binding, they help to identify factors to be taken into account and delineate the reasonable range of appropriateness for various types of misconduct.

61. In cases involving the misconduct alleged in the present case, the MFDA Penalty Guidelines recommend consideration of the following penalties for Approved Persons:

a) Securities Related Business/Outside Business Activity/Referral Arrangements: minimum fine of $10,000; write or rewrite an appropriate industry course; period of increased supervision; suspension; and permanent prohibition;
b) Conflicts of Interest: minimum fine of $5,000; write or rewrite an appropriate industry course; suspension or, in the case of egregious cases, a permanent prohibition from engaging in securities related conduct; and
c) Standard of Conduct/Policies and Procedures of the Member: minimum fine of $5,000; write or rewrite an appropriate industry course; suspension; and permanent prohibition.

62. The Guidelines recommend that a Hearing Panel take into account the following factors in cases concerning unapproved outside business activities and referral arrangements when determining the appropriate penalties to impose:

a) Magnitude (in size and value) of outside business activity.
b) Number of clients affected.
c) Magnitude of client losses.
d) Suitability of outside business activity if involving securities.
e) Compensation received by the Respondent.
f) Any personal interest of the Respondent in the outside business activity.
g) An honest but mistaken belief that proper approval was obtained.
h) Legality of outside activity.
i) Whether the marketing and sale of the product or service could have created the impression that the Member had approved the product or service.
j) Whether the Respondent misled the Member about the existence of the outside activity or otherwise concealed that activity from the Member.

63. The MFDA Penalty Guidelines recommend that a Hearing Panel take into account the following factors in a conflict of interest case when determining the appropriate penalties to impose:

a) Whether the activity was an isolated incident or part of a larger pattern of conduct involving multiple clients;
b) Whether the conflict of interest was adequately explained to the client;
c) The level of client sophistication;
d) Whether the conflict of interest was brought to the attention of the Member;
e) Whether the Respondent was aware of the prohibited nature of the activity;
f) Whether the Respondent concealed or attempted to conceal the activity from the client and/or the Member; and
g) Whether the client was harmed by the activity and if so, to what extent.

Other Factors To Consider

64. Other factors that Hearing Panels frequently consider when determining the appropriate penalty include the following:

a) the seriousness of the misconduct;
b) the Respondent's past conduct, including prior sanctions;
c) the Respondent's experience in the capital markets;
d) whether the Respondent recognizes the seriousness of the improper activity;
e) the harm suffered by investors as a result of the Respondent's activities;
f) the benefits received by the Respondent as a result of the improper activity;
g) the risk to investors and the capital markets in the jurisdiction where the Respondent to continue to operate in capital markets in the jurisdiction;
h) the need to deter not only those involved in the case being considered, but also any others who participate in the capital markets, from engaging in similar improper activity; and
i) previous decisions made in similar circumstances.

Tonnies, supra at. p. 23

65. (The actions of the Respondent) exposed clients to potential harm and financial losses, a fact that became reality when the Canada Revenue Agency re-assessed the tax returns and filings of all Charitable Donation Program participants.

66. The admissions of misconduct described in the Agreed Statement of Facts indicate that the Respondent recognizes the seriousness of the misconduct. By entering into the Agreed Statement of Facts and by not opposing the penalties sought by Staff, the Respondent has accepted responsibility for the misconduct, has demonstrated remorse, and has avoided the necessity of the MFDA conducting a lengthy hearing at considerable additional expense to the MFDA, and ultimately to the membership of the MFDA.

67. This said, the Respondent's conduct contravened MFDA Rules and the policies and procedures of the Member, and the Respondent engaged in the conduct without the knowledge or approval of the Member. This compromised the Member's ability to conduct and satisfy its supervisory obligations, including its ability to protect clients.

68. It is submitted that this is a serious deficiency given that mutual fund dealers and Approved Persons carry on a business which is based upon the trust of clients. Indeed, clients rely upon Approved Persons to act in compliance with MFDA rules and regulations, including the requirement to conform to Members' policies and procedures. Therefore, the penalties imposed for failing to do so should reflect the gravity of the breaches and the importance of the maintenance of the trust of clients and the public generally in Approved Persons of the MFDA.

> *Hill & Crawford Investment Management Group Ltd. and Albert Rodney Hill (Re),* [2009] MFDA Central Regional Council, MFDA File No. 200834, Hearing Panel Decision dated June 23, 2009, at p. 4

69. It is submitted that (the proposed) penalties will send a message to other Approved Persons that undisclosed conflicts of interest create unacceptable risks that are difficult to properly deal with. This is especially so in circumstances where a Member is not made aware of an Approved Persons' conduct.

70. It is further submitted that these penalties will let the investing public, and clients in particular, know and expect that Approved Persons whose conduct give rise to conflicts of

interest with clients and who fail to comply with Members' policies and procedures will be held accountable.

CONCLUSION

71. In summary, having regard to all of the foregoing factors, Staff submits that the penalties proposed in this case are commensurate with the nature of the misconduct admitted to by the Respondent and that they are in the public interest. Staff is also satisfied that the proposed penalties would be sufficient to deter the Respondent and other MFDA registrants from engaging in similar conduct in the future. They are reasonable and proportionate and are in keeping with the purpose of the MFDA to enhance investor protection and ensure high standards of conduct in the industry.

SUBMISSIONS OF THE RESPONDENT

72. The Respondent spoke briefly. He reiterated his mistaken assumption that he was approved to sell the programs as being "part of Franco Financial", his company (Agreed Statement of Facts, para. 22, above). He said he did not have to disclose commissions on the sale of insurance policies and apparently considers the commissions in this case to be analogous. However, as agreed to in the Agreed Statement of Facts, he accepts that his actions contravened the stated MFDA Rules.

REASONS FOR DECISION

ON ALLEGATIONS

73. We agree with and adopt the submissions of Enforcement Counsel for the MFDA (above). As we stated at the conclusion of the Hearing, we find that the MFDA has proven the allegations against the Respondent, being Allegations #1, #2 and #3 (p. 2 above).

74. We will address the conflict of interest allegation and the apparent lack of any previous MFDA decisions on whether undisclosed commissions can constitute a conflict of interest. We are of the view that the Respondent's failure to disclose to clients that commissions he was

receiving on the sales of the Charitable Donation Programs, particularly given the extraordinary magnitude of the commissions (up to 25%) does constitute a conflict of interest. The clients should have been advised of the commissions so they could make an informed decision on whether to invest in the programs. We expect that many of the clients, had they been advised of the extent of commissions, would have reconsidered the investment. Furthermore, had the Respondent been properly informed about the risks (including CRA compound interest penalties) associated with the purported tax benefit, and conveyed those risks to the clients, it is probable that many would not have participated in the programs. It was his responsibility to "fully understand the product being recommended to clients" [Member Regulation Notice MR-0049 ("Charitable Donation Programs")]. The clients are to be made aware of the risks, including the position being taken by the CRA; that responsibility is on the Member firm but in this case it could not carry out its responsibility because it had not been informed of the Respondent's involvement in the sale of the programs. The misconduct of the Respondent was aggravated by his continuing to sell the programs even after the CRA notifications.

ON PENALTY

75. The misconduct of the Respondent resulting in the Allegations was serious and requires a serious response for all the reasons advanced by the MFDA including "other factors to consider" (para. 64, above). The Respondent having had no previous disciplinary record and having cooperated with the MFDA in its investigation and the Hearing, provides some mitigating effect but does not operate to diminish the need of a serious disciplinary response. We take into consideration the protection of the investing public, the integrity of the securities markets, specific and general deterrence, the protection of the MFDA's membership and the protection of the integrity of the MFDA's enforcement processes.

76. Although we had some concern about the proposed fine being less than the commissions received by the Respondent, we view the five year suspension as being a very significant penalty in itself. Accordingly we consider the proposed penalties and costs to be within a reasonable range and in line with the penalties established in other MFDA decisions, including those referenced by counsel for the MFDA (above).

77. We confirm our decision declared at the conclusion of the Hearing that the penalties

proposed by the MFDA are to be imposed on the Respondent, as follows:

a) a suspension of five (5) years on the authority of the Respondent to conduct securities related business in any capacity over which the MFDA has jurisdiction, pursuant to s. 24.1.1(e) of MFDA By-law No. 1;
b) a fine in the amount of $40,000 pursuant to s. 24.1.1(b) of MFDA By-law No. 1; and
c) costs in the amount of $5,000 pursuant to s. 24.2 of MFDA By-law No. 1.

78. We signed an Order confirming the foregoing.

DATED this 6th day of May, 2011.

"Alan Beattie"
Alan V. M. Beattie, Q.C.,
Chair

"Elaine Bradley"
Elaine Bradley,
Industry Representative

"Kathleen Jost"
Kathleen Jost,
Industry Representative

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