

**Reasons for Decision (Misconduct)**

**File No. 201415**



**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 Andrew Harrigan**

Heard in Halifax, Nova Scotia: September 21, 22, 25, 28, 29, 30, October 1, 2, 8, 2015  
January 11, 12, 13, 14, 15, April 18, 19, June 15, December 20, 21, 22, 2016  
Reasons for Decision (Misconduct): November 28, 2018

**REASONS FOR DECISION (MISCONDUCT)**

Hearing Panel of the Atlantic Regional Council:

Edward W. Keyes, QC  
Ann C. Etter  
Robert Malcolm

Chair  
Industry Representative  
Industry Representative

Appearances:

|                         |   |                                         |
|-------------------------|---|-----------------------------------------|
| Lyla Simon              | ) | Enforcement Counsel for the Mutual Fund |
|                         | ) | Dealers Association of Canada           |
|                         | ) |                                         |
|                         | ) |                                         |
| Michael Andrew Harrigan | ) | Respondent, in person                   |
|                         | ) |                                         |
|                         | ) |                                         |

1. By Notice of Hearing dated May 12, 2014 the Mutual Fund Dealers Association of Canada (“MFDA”) alleges that Michael Andrew Harrigan (the “Respondent”) committed the following violations of the Bylaws, Rules, or Policies of the MFDA:

**Allegation #1:** Between 2005 and 2008, the Respondent misrepresented the know-your-client (“KYC”) information on the account opening and loan application documents of seven clients, thereby engaging in conduct unbecoming an Approved Person and failing to observe high standards of ethics and practice in the conduct of business, contrary to MFDA Rules 2.2.1 and 2.1.1.

**Allegation #2:** Between 2005 and 2008, the Respondent misrepresented, failed to fully and adequately explain, or omitted to explain, the risks, benefits, material assumptions, costs and features of a leveraged investment strategy that he recommended and implemented in the accounts of seven clients, including the risks that:

- a) The underlying investments might decline in value such that the clients might incur investment losses and would be unable to rely on the sale proceeds of the investments to pay back their investment loans; and
- b) The underlying investments might reduce, suspend or cancel altogether the distributions paid to investors upon which the clients were relying to make the payments on their investment loans,

Thereby failing to ensure that the leveraged investment strategy was suitable and appropriate for the clients and in keeping with their investment objectives, contrary to MFDA Rules 2.2.1 and 2.1.1.

**Allegation #3:** Between 2005 and 2008, the Respondent recommended and facilitated the implementation of a leveraged investment strategy in the accounts of seven clients without performing the necessary due diligence to learn the essential facts relative to the clients and in keeping with their investment objectives, contrary to MFDA Rules 2.2.1 and 2.1.1.

2. On July 5, 2018 the Hearing Panel issued its decision in this matter, with written reasons to follow, finding that:

i) Between 2005 and 2008, the Respondent misrepresented the know-your-client ("KYC") information on the account opening and loan application documents of **six** clients thereby engaging in conduct unbecoming an Approved Person and failing to observe high standards of ethics and practice in the conduct of business, contrary to MFDA Rules 2.2.1 and 2.1.1;

ii) Between 2005 and 2008, the Respondent misrepresented, failed to fully and adequately explain, or omitted to explain, the risks, benefits, material assumptions, costs and features of a leveraged investment strategy that he recommended and implemented in the accounts of six clients including the risks that:

- a) The underlying investments might decline in value such that the clients might incur investment losses and would be unable to rely on the sale proceeds of the investments to pay back their investment loans; and
- b) The underlying investments might reduce, suspend or cancel altogether the distributions paid to investors upon which the clients were relying to make the payments on their investment loans,

Thereby failing to ensure that the leveraged investment strategy was suitable and appropriate for the clients and in keeping with their investment objectives, contrary to MFDA Rules 2.2.1 and 2.1.1.

iii) Between 2005 and 2008, the Respondent recommended and facilitated the implementation of a leveraged investment strategy in the accounts of six clients without performing the necessary due diligence to learn the essential facts relative to the clients and without ensuring that the leveraged investment strategy was suitable for the clients and in keeping with their investment objectives, contrary to MFDA Rules 2.2.1 and 2.1.1. (emphasis added)

3. These are our written reasons.

## INTRODUCTION

4. The Respondent was registered as a mutual fund salesperson with Manulife Securities Investment Services Inc. (“Manulife”), a Member of the MFDA, from December 2002 to April 2006.

5. From April 2006 to March 2007, the Respondent was registered as a mutual fund salesperson in Alberta, New Brunswick, and Nova Scotia with Global Maxfin Investments Inc. (“Global Maxfin”), also a Member of the MFDA.

6. From March 20, 2007 to November 14, 2011, when he was terminated as a result of the activities described herein, the Respondent was registered as a mutual fund salesperson in Alberta, New Brunswick, and Nova Scotia with Keybase Financial Group Inc. (“Keybase”), a Member of the MFDA.

7. At the material times giving rise to the events described herein, the Respondent carried on business from Dartmouth, Nova Scotia.

8. The hearing of this matter was held over 17 days in September and October of 2015; January, April and June of 2016; with the parties filing written submissions and making oral submissions in December of 2016. In June of 2017 the Panel received the transcripts of the hearing which total in excess of 2200 pages.

9. At the commencement of the hearing, Staff entered as exhibits 4 large binders containing in excess of 1100 pages of documentary evidence. The Respondent also entered numerous exhibits containing in excess of 360 pages of documentary evidence.

10. In addition to the MFDA Investigator who investigated the complaints against the Respondent, Staff called 5 former clients of the Respondent to testify in this matter and are referred to in this decision by their initials: FH, VC, LE, GC and CH.

## **Overview of the MFDA case**

11. The MFDA alleges that the Respondent recommended and implemented a leveraged investment strategy in the account of 7 clients, 5 of whom testified and whose evidence the Panel has considered in coming to its decision in this matter. The evidence relied on for the 2 clients who did not testify was put forward by their spouses or ex-spouses. Staff alleges that the investment strategy used by the Respondent was unsuitable for all of these clients having regard to their personal and financial circumstances, including their lower investment risk tolerance, their limited investment knowledge, and their inability to make the payments on the investment loans without using their own monies in the event the leveraged investment strategy did not perform as the Respondent represented it would.

12. In recommending the so called “Smith Manoeuvre” investment strategy to his clients Staff alleges the Respondent represented that the investments purchased using investment loans would generate sufficient returns to pay the client’s borrowing costs, as well as provide them with the ability to pay down their mortgages quickly and/or generate excess discretionary income, such that the clients would not have to incur any out-of-pocket expenses to sustain the strategy. Staff argued that the Respondent did not adequately explain to the clients/complainants the risks inherent in using borrowed monies to invest generally, or the risks specific to the leveraged investment strategy that he recommended.

13. Relying on the Respondent’s recommendation, Staff alleges that the clients in question borrowed far in excess of the amounts they could reasonably afford to finance and invested the borrowed monies in return of capital mutual funds (“ROC funds”).

14. Staff further argues that the Respondent misrepresented aspects of the clients’ know-your-client information on their account opening documents and loan applications in order to increase the likelihood that lenders would approve the clients’ investment loans and that the Members for whom the Respondent worked would approve the implementation of the leveraged investment strategy in the clients’ accounts.

15. By late 2008 to early 2009, Staff alleges that the unit values of the ROC mutual funds purchased by the clients had declined to such an extent that they received reduced distributions from the ROC mutual funds and suffered significant investment losses in their portfolios.

### **Overview of the Respondents position**

16. The Respondent denies the MFDA's allegations. He did not testify in this matter but argues that his former clients, the complainants, were aware of and at all times accepted the investment strategy he recommended and that the losses they incurred resulted from the 2008 downturn in the markets over which he had no control.

17. He denies that he misrepresented any client information on the witnesses' respective KYC information in order to facilitate lenders approving the investment loans. Through cross-examination, he attempted to demonstrate that at least one of the witnesses called by Staff, GC, had undertaken a campaign to publically disparage him which had the effect of tainting all of Staffs evidence against him and accordingly calls into doubt the MFDA case against him.

18. The Respondent also argued that neither his employer, Keybase, nor the MFDA had rules in place during the time in question that prevented him from recommending or implementing a leveraged investment strategy such as the Smith Manoeuvre for his clients and that the investment strategy he used was carried out to the satisfaction of many of his clients.

### **EVIDENCE BEFORE THE PANEL**

19. All 5 of the Respondent's former clients called as witnesses by Staff in this matter testified that the Respondent recommended a leveraged investment strategy to them that he called the Smith Manoeuvre. These witnesses had either been referred to the Respondent by a work colleague, relative, neighbour or had met the Respondent in social settings.

20. Each of the witnesses called by Staff gave detailed evidence as to his or her relationship with the Respondent; their background; financial experience; and reasons for investing with the

Respondent. They testified to most if not all of the exhibits entered in support of their testimony. All of the witnesses called by Staff were cross-examined by the Respondent some far more thoroughly than others.

21. The Respondent did not testify in this matter but called 3 former clients to testify on his behalf.

22. The following is a summary of the relevant evidence of each of the investor witnesses who testified including their personal situation, reasons for investing, investment knowledge and relationship with the Respondent regarding their investment activities.

23. For the reasons set out below the Panel takes issue with the evidence of only one of the witnesses who testified in this matter. In our opinion the testimony of GC, a former client of the Respondent called by Staff, did not support the MFDA allegations against the Respondent.

## **MFDA Witnesses**

### FH

24. FH, a Dentist, testified as to her dealings with the Respondent. She stated that in December of 2006 when she first met the Respondent she had no experience with borrowing to invest. She explained her personal and business affairs to him in order to assist him in developing an investment strategy for her. FH testified that she thought the Respondent had set up a portfolio that would allow her to receive monthly dividends from her investments and she would not be required to service the loans she obtained through him from her own funds.

25. FH testified that:

- i) The Respondent recommended she invest using the Smith Manoeuvre; she did not fully understand it when he originally explained it, nor did she understand it even when she was testifying at the hearing. She went along with the Respondent's advice because she trusted him because he was the "expert" in her words.

- ii) She set up a mortgage, as part of the leveraged investment strategy, which she did via a mortgage broker that the Respondent referred her to. She stated that the Respondent failed to have her implement the mortgage aspect of the Smith Manoeuvre.
- iii) The Respondent provided no explanation to her about the potential risks associated with borrowing to invest generally, or the difference between investing one's own money versus investing borrowed money. The Respondent also provided no explanation to her about the potential tax risks associated with implementing the investment strategy he recommended.
- iv) On a number of occasions, the Respondent had her sign documents where only her name on the top part of the document was completed with the rest left blank. She later, albeit after a civil action was apparently commenced against the Respondent, testified that she discovered inconsistencies and mistakes in the documents he had prepared or completed on her behalf.
- v) Some of the exhibits she was referred to and which the Respondent had used as originals on her accounts appeared to be photocopies, wherein her signature and all the other populated information was identical on each form, with the only difference being the date on the forms. The Respondent did not discuss with her that he would use photocopied forms for her accounts that were being moved to Keybase.
- vi) On December 6, 2006, on the Respondent's recommendation, she borrowed \$175,000. She did not recall any discussion with the Respondent as to how much she should borrow. The Respondent had recommended that she purchase 2 Clarington funds with the borrowed funds but he did not discuss with her what the funds were; any other choices available to her; the allocation of the borrowed monies into the funds; or what fees were associated with the funds.
- vii) On December 14, 2006, she borrowed a further \$100,000. Again she did not recall there being any discussion with the Respondent regarding how much she should borrow; the Respondent's recommendation to purchase 2 Clarington funds; any other choices available to her; the allocation of the borrowed monies into the funds; or what fees were associated with the funds.

- viii) She understood from her discussions with the Respondent that she would receive monthly “dividends” from her investments.
- ix) The Respondent did not discuss with her the fact that the funds being purchased for her account were ROC funds. She did not understand until later that some of the monies being paid to her were a return of her own capital and not just interest earned on her investments.
- x) The Respondent did not discuss with her as to how the principal of the loans would be repaid given that he had established them so that she was only paying interest on the loans. The Respondent also did not discuss what would happen if her distributions decreased in the future.
- xi) At the time of the Hearing, she was paying interest on the loans in the approximate amount of \$1,017 per month.
- xii) In January 2008, on the Respondent's recommendation, she invested the proceeds of the sale of her dental practice, \$300,000, into Clarington funds. She does not recall the Respondent explaining anything about what investments to buy with the sale proceeds, she testified she relied on him to do what was in her best interests as again, she had considered him to be the “expert”.
- xiii) By early 2009, her investments had declined in value and she set up a meeting with him which took place at his office in March of 2009. She testified that she did not understand what the Respondent was proposing to do with her investments at the meeting in order to deal with the declining value of same and asked him to email her something in writing that she could take her time and go through. In March 2009, the Respondent emailed her a 2-page explanation, Exhibit A-18. She testified the explanation he provided did not “make sense” to her as it seemed complex. She stated that she did not understand what the Respondent was proposing then or even at the time she was testifying.
- xiv) In April 2009, she transferred two of her investments from Keybase to another dealer. The third investment (the one associated with the \$100,000 investment loan) was not transferred because the loan would have become due had it been transferred.

- xv) At the time of the hearing, her \$175,000 investment was worth \$91,472.81 while her \$300,000 investment was worth \$218,011.52.
- xvi) At the time of the hearing, her \$100,000 investment, which was still at Keybase, was worth between \$50,000 and \$55,000. She testified she went out of pocket approximately \$100-\$200 per month to cover the shortfall in the interest payments on the \$100,000 loan.
- xvii) She estimated that the value of the \$175,000 investment at the time of the hearing was approximately \$87,500. She has only ever made interest payments on the associated investment loans, and the principal is still owing in full.

26. FH testified that the Respondent incorrectly completed the KYC information on her account opening and loan application documents by overstating her income, investment knowledge, and risk tolerance. She testified that the Respondent also had her sign account opening and loan application documents prior to the KYC information being populated on the forms.

27. She stated that in December 2006 the Respondent recorded the annual income on her KYC form, Exhibit A-2, as being \$140,000; however, this was not correct as her income (which included rental property income) had fluctuated over the previous years, being \$70,000 in 2003, \$130,000 in 2004, and \$90,000 in 2005 and at no time had it been \$140,000.

28. As well on a 2006 Investment Loan Application form, Exhibit A-4, the Respondent recorded her income as \$140,500 and her "other income" as \$18,000, for a total of \$158,500 which was not correct either.

29. In April 2008, the Respondent again wrongly recorded her annual income on an updated KYC form being Exhibit A-14. It was recorded by the Respondent as being "over \$200,000" but FH testified that at this time her income consisted solely of her rental property income being \$18,000 as she testified she was out of work on medical leave at that time for reasons which the Respondent was fully aware of. She told the Panel that she was living on savings at the time as she had put in claims for disability under two disability policies in March 2008, but they did not start generating any payments to her until December of 2008 and December of 2009.

30. FH testified that the Respondent had overstated her investment knowledge on her KYC forms that she reviewed. She stated that in December 2006, on Exhibit A-2, her investment knowledge was recorded by the Respondent as “good”; however, she stated that this was not accurate in 2006. She told the Panel that she did not spend much time thinking about investment matters and she did not attempt to learn about different investment vehicles as she trusted her advisor to look after this.

31. FH testified that the Respondent also overstated her risk tolerance on her account opening forms. In December 2006, her risk tolerance was recorded by the Respondent as "medium-high" on Exhibit A-2 when this was not accurate as she would have been only “medium” then.

32. She also stated, on Exhibit A-10, completed in November 2007, her risk tolerance was recorded by the Respondent as "medium high” when again she would have been “low” risk due to the fact that she had sold her dental practice and that due to her health issues she had told him she might not be able to continue working to the same level and accordingly she did want to take any risks with her money.

33. On reviewing Exhibit A-16 completed in January 2009 by the Respondent, her risk tolerance was recorded as "medium high". Again she testified that this risk level was not accurate, as in 2009 she would have also been "low" risk again due to the fact that she had sold her dental practice, and was living on disability payments.

34. Notwithstanding a thorough cross-examination by the Respondent, FH was unwavering and firm in her testimony. She maintained that the Respondent was aware of her personal health issues as she testified she had discussed them with him.

35. She stated she was not someone who accepted a high risk investment strategy and that while the Respondent did have discussions or review some documents on the Smith Manoeuvre she did not understand this strategy when he raised it with her initially or even at the hearing. She testified that she did not believe he was using the Smith Manoeuvre with her investments and at

the time of testifying understood that he did not follow through on all of the steps that she was told were required to be taken under the manoeuvre and that she believed the Respondent was aware that she did not want her investments exposed to high risk.

36. FH was forthright and convincing in her testimony before the Panel. The Respondent offered no evidence to contradict her on any of the evidence she presented as described above in support of Staff's allegations against him.

### VC

37. VC, a nurse, testified that she first met the Respondent in 2007 with her husband MC who at the time was in the Canadian Navy. MC, who had since retired from the navy, now worked as a commissionaire.

38. VC testified that when she and her husband first met the Respondent they had a young family; had no financial education or training; almost no experience with investing; had no experience with borrowing to invest; and were risk adverse.

39. VC testified that:

- i) She and MC owned a home with a mortgage, had two young children and had very limited investing experience. At the time they met the Respondent they had a total of \$14,000 in RESPs and RRSPs. She was unable to identify what these were invested in and did not know what the term "non-registered" meant when her account-opening form, Exhibit B-2, was shown to her at the hearing.
- ii) The Respondent recommended the Cs invest using the "Smith Manoeuvre", and gave them a book on the Smith Manoeuvre to read. In her words, he told them the Smith Manoeuvre "was how middle class people become rich". As part of the strategy the Respondent required the Cs to set up a line of credit attached to their home but VC testified the Respondent did not implement the mortgage aspect of the Smith Manoeuvre for them.

- iii) The Respondent advised VC and her husband that in borrowing money to invest, the money made off the investment would be used to pay the interest payment; there would be no other associated payments; and no money would be coming out of their pocket. The Respondent also assured them that their home could never be taken from them. VC testified that the Respondent told them that the only way they would be responsible to pay the loan was if “the investment went to zero” and made reference to the stock market crash of 1930.
- iv) That in employing this investment strategy, the Cs were told by the Respondent they would receive more money back on their tax return which they were then to provide to the Respondent to invest on their behalf. The more they invested, they were told, the more money they would make. The Respondent provided no explanation to VC and her husband about the potential tax risks or interest rate risk associated with implementing the investment strategy he recommended.
- v) On various occasions, the Respondent had the Cs sign documents (Exhibit B-5) in blank. They understood that the Respondent was going to fill in the information on the documents later. The Respondent did not explain to them what a “no margin loan” meant as he had recorded on the loan application form he prepared for them. (Exhibit B-5).
- vi) On the Respondent's recommendation, they borrowed \$100,000 on July 19, 2007. There was no discussion regarding how much they should borrow; rather the Respondent advised them that they had qualified for a \$100,000 loan.
- vii) With these borrowed funds the Respondent recommended that they purchase Clarington funds. The Respondent did not discuss with them what the funds were; the features of the funds; the 80%-20% allocation of the borrowed monies into the two funds; or what fees were that were associated with the funds.
- viii) They were told they would receive monthly payments directly into their bank account which would come from "money made off the investment". VC testified that the Respondent did not discuss with her and her husband the risk that the amount of the monthly distributions could fluctuate or be canceled altogether.
- ix) In March of 2008 VC took their \$2,000 income tax return to the Respondent's office. With these funds the Respondent made a purchase in their account. VC

testified that while the signatures on the relevant purchase documents appeared to be theirs, she and her husband never met with the Respondent to sign the documents nor did they have any discussion as to where the funds were to be invested.

- x) At the time of the Hearing, VC testified she had never heard of the term "ROC funds" nor did the Respondent ever mention the term to them or discuss the fact that the funds being purchased for the Cs' account were ROC funds.
- xi) The Cs noticed their investments starting to decline in value and thereafter received notice of a meeting at the Respondents residence.
- xii) They attended a meeting along with a number of other people where the Respondent discussed the fact that the markets historically go up and down, and they were told that their investments would eventually increase in value. VC left the meeting with the understanding that it would take some time but their investments would eventually return to their previous value. Despite his comments she indicated that as of the date of the hearing, some 7 years later, their investments still had not recovered.
- xiii) At the time of the hearing, the Cs' \$100,000 investment was worth approximately \$54,000. They have only made interest payments on the associated investment loan and the principal is still owing in full.
- xiv) The Cs were assigned various new Keybase financial advisors after the Respondent. VC testified that one of the advisors told her that based on their 2007 KYC status, they "should have never qualified for the loan" due to the value of their home and the money owing against it. They subsequently transferred their investment from Keybase to another dealer.

40. VC also testified that when the Respondent completed account opening and loan application documents for them, he misrepresented various information on the documentation including the value of their residence, their investment knowledge and risk tolerance.

41. In July 2007, the value of their residence was incorrectly recorded by the Respondent on their investment loan application as \$280,000. VC testified that they bought their house for \$107,000 in 1996 or 1997, and that in 2007 it would have been worth only \$130,000-\$140,000.

Her testimony was that they did not ask the Respondent to inflate the value of their residence, nor did they know that he had done so.

42. Regarding their investment knowledge VC stated that their investment knowledge was recorded by the Respondent on their New Account Application Form (“NAAF”) completed in July of 2007 as “good”; however, VC testified that this was not accurate, and should have been recorded as "novice", as she and her husband did not have very much knowledge about how investments worked back in 2007. In March of 2008 he again recorded their investment knowledge on their NAAF as “good” when it was only “novice” as again she and her husband had not become any more knowledgeable about investments.

43. In addressing the risk tolerance as recorded by the Respondent she stated that in July of 2007, their risk tolerance was recorded on their NAAF as “medium-high” when their risk tolerance would have been only “low” at that time as they did not have very much knowledge about how investments worked. In March of 2008, the Cs’ risk tolerance was again recorded by the Respondent on their NAAF as “medium-high”; when they still would have been “low” in her opinion. At the time of the Hearing she stated they still did not have very much investment knowledge.

44. VC’s cross-examination by the Respondent did not illicit any contradictions in her evidence nor did it seriously challenge the basis or substance of the allegations brought by the MFDA regarding the Cs’ accounts. Understandably due to the passage of time VC’s memory was vague on some of the details of the Cs’ discussions with the Respondent but overall the Panel finds her evidence to be forthright, convincing and clearly supportive of the allegations brought by the MFDA regarding the Respondent’s handling of VC and MC’s accounts.

#### LE

45. LE testified that she had worked in the dental lab at Dalhousie University for 23 years, first as a dental technician, and then as an assistant manager. She has a Bachelor of Arts from Dalhousie University, and had been on disability since 2011.

46. LE testified that:

- i) She started dealing with the Respondent in 2006; had no financial education or training; almost no experience with investing; no experience with borrowing to invest, and was risk averse. She stated she had been introduced to the Respondent by GC, one of the other complainants in this matter.
- ii) The investment strategy recommended to her by the Respondent was the "Smith Manoeuvre". She stated that he did not explain the strategy to her such that she ever understood it nor did she understand it when she was testifying at the hearing. As part of this strategy the Respondent had arranged for her to borrow funds from multiple lenders and was told that as a result of using the Smith Manoeuvre, she would receive sizeable tax returns which figured into her decision-making.
- iii) From what she was told by the Respondent, she believed she would be investing in long term, stable, conservative investments; would receive monthly dividends; would only have to pay interest on the investment loans; did not need to ever repay the principal; would not be required to pay any loans out of her pocket and the loans could be cashed in when she retired or could be kept for life.
- iv) The Respondent provided no explanation to her about the potential risks associated with borrowing to invest; did not explain what "DSC" meant nor did he advise her of any fees associated with the investments he recommended.
- v) On various occasions, the Respondent had her sign documents without her first reading them and on some of her account documents, Exhibit C-5 for example, she states her signature and initials were put on the document that she had not signed nor initialed.
- vi) In August 2006, on the Respondent's recommendation, she borrowed \$80,000. She stated she had no input as to how much to borrow but was advised that \$80,000 was the maximum amount he would be able to get for her.
- vii) With these funds LE purchased Clarington funds, however, the Respondent did not discuss any other choices with her; did not discuss what the funds were; nor the 75%-25% allocation of her borrowed monies into the two funds; and had no

discussion that the funds being purchased were ROC funds. In fact she stated that she did not even know what ROC funds were.

- viii) In September 2006 she again met with the Respondent and borrowed a further \$100,000, this time from a different lender. The Respondent again had no discussion with her as to how much to borrow; did not discuss any other investment choices; did not discuss the four funds being purchased nor the allocation of the borrowed monies into the four different funds.
- ix) In January of 2007 she borrowed another \$50,000 on the Respondent's advice, again from a different lender than with the previous two loans. This loan was a 2:1 loan. She borrowed her portion of the loan, \$25,000, from a line of credit that she had on a rental property she owned with a third party. When she questioned the Respondent as to whether she was getting over-leveraged, he testified, "No, I wouldn't do that."
- x) With the \$50,000 loan the Respondent purchased two different ROC funds, however, he did not discuss any other investment choices with her; did not discuss what the funds were nor the allocation of the monies into the two funds.
- xi) In June 2007, again on the Respondent's recommendation, she borrowed a further \$105,000 again under a 2:1 leveraged investment strategy. With these funds, the Respondent had her purchase 2 ROC funds but again she testified he did not discuss any other investment choices with her. He did not discuss what the funds were, or the allocation of the monies into the 2 different funds. By June of 2007, she told the panel she had borrowed a total of \$355,000.

47. LE also testified that the Respondent misrepresented KYC information on her account opening and loan application documents regarding her income, value of her residence, her investment knowledge and risk tolerance,

48. In August 2006, her annual income was wrongly recorded by the Respondent on her investment loan application, Exhibits C-1 and C-2, as "\$50,000-\$74,999" when her income (which including her rental property income) from the dental lab was only between \$40,000-\$47,000 including overtime payments she occasionally received.

49. As well she stated that on Exhibit C-2 her rental income was recorded by the Respondent as being \$1,120 per month but this was not correct either as her share of the rental income was only 50% of that amount, being \$560. She testified that the mortgage and other expenses were also required to be deducted from the rent received.

50. LE testified that on her September 2006 loan application, Exhibit C-4, her income was overstated by 50% as it was recorded by the Respondent as being a total of \$61,103 (i.e. income plus rental income).

51. On her June 2007 loan application, Exhibit C-13, LE testified that her rental income was incorrectly recorded by the Respondent as being \$31,560, when in fact her share of the rental income was approximately \$17,000 per year, and that other expenses required to be deducted from the rents received were not taken into account by the Respondent.

52. LE testified that the Respondent incorrectly recorded the value of her residence on her B2B Accelerator Application, Exhibit C-2 completed in August of 2006. Her evidence was that he recorded it as \$226,600 which was overstated by approximately \$81,000 as at the time the value was only approximately \$145,000. She had bought a piece of land in 1991, and built the house herself. She told the hearing she sold the house in 2009 or 2010 for only \$154,000. On cross-examination she agreed that an insurance policy she had in place in 2006, a copy of which she had provided to the Respondent, Exhibit R-9, indicated replacement coverage of \$226,600 was in place for the house.

53. In the Panel's opinion an insurance policy is clearly not adequate documentation in and of itself to support the value of an investor's residence when it is, as was done here, simply part of the information required to support LE's loan approval under the leveraged borrowing strategy that was being implemented by the Respondent for her accounts.

54. In August 2006, LE testified that her investment knowledge was incorrectly recorded by the Respondent on her Global KYC form as "good" when it should have been between "novice"

and "fair". She stated that while she had an understanding of mortgages at that time, she had very limited knowledge when it came to investment matters.

55. Her investment knowledge was again incorrectly recorded by the Respondent in March of 2007 on her NAAFs, Exhibits C-9, C-10, C-11, C-12 again as "good". She testified that at this time her investment knowledge was actually between "novice" and "fair", as she stated, in her words, she only knew "real basic stuff."

56. In August 2006, LE testified that her volatility was recorded by the Respondent on her Global KYC form, Exhibit C-1, as "moderate". Her evidence was that this was not correct and should have been recorded as "low" as she was a conservative investor in August of 2006.

57. On the same exhibit her risk tolerance was also wrongly recorded by the Respondent as being "medium-high". She stated it should have been recorded as "medium" but that she went along with this entry (and the entry regarding volatility), because the Respondent had assured her the investments were "safe".

58. Again in March 2007, LE's risk tolerance was recorded by the Respondent on her various NAAFs as "medium-high". She told the hearing panel that this was not correct, and should have been "low" or "medium low" at that time. She testified that she went along with this however because she understood from what the Respondent told her that this is what had to be recorded in order for her to be in the borrowing strategy.

59. After the market decline in 2008, LE testified that the Respondent recommended all of her investments be moved to cash, as he said this would be stable and the only loss she would incur would be the monthly payments. She eventually disposed of all her investment loans and sold all her corresponding investments. She testified she completed paying off the investment loans in 2012 or 2013 realizing a shortfall of \$109,000 which required her to sell her home in order to cover her loss.

60. LE's evidence was convincing and at times emotional as she related to the Panel the hardships that she had experienced as a result of following the Respondent's investment strategy using the Smith Manoeuvre. She explained at the hearing the impact of her losses on not only herself but on her family who were of very modest means and who she had tried to support over the years. The Respondent's cross-examination of LE did not shake her testimony nor in any way refute the MFDA allegations regarding the Respondent's handling of LE's accounts. The Respondent did not present any evidence in our opinion that contradicted or refuted LE's allegations regarding his handling of her accounts.

#### GC

61. GC, another former client of the Respondent, testified at the hearing. In our opinion, his testimony did not support the MFDA allegations against the Respondent. Staff argues that much of GC's evidence was uncontroverted. We disagree. His evidence on some of the key points both on direct and on cross-examination was both vague and at times confusing.

62. GC testified that he was the owner of a dental lab in Halifax, holds a business degree from Dalhousie University and a diploma in dental technology and first met the Respondent in 2005 when they were both members of a running club in Halifax. When he started dealing with the Respondent, he stated he had no financial education or training although he had previously invested in mutual funds. He stated he had no experience with borrowing to invest.

63. GC testified the Respondent recommended the "Smith Manoeuvre" to him as an investment strategy but he claimed that the Respondent did not explain the strategy such that he understood it. He said he was attracted to the strategy because he was told that it would generate monies from which he could service his spousal support obligations. He also was attracted to the tax benefits he was told he would receive.

64. GC also did not recall any downside of the strategy being discussed by the Respondent nor, he claims, did he explain the possibility of interest rate fluctuations and how this would impact the proposed investment strategy. GC also alleges that the Respondent did not discuss the possibility

of ever having to go into his own pocket if there were shortfalls in the strategy. He testified that the Respondent did not explain or discuss the ROC funds with him.

65. On September 27, 2005, as part of the strategy, he borrowed \$50,000 from Manulife. He alleges this was done with no explanation from the Respondent regarding how much he should borrow; which mutual funds should be purchased nor the allocations to each fund.

66. On September 29, 2005 he borrowed another \$50,000 from Manulife. On this occasion, he testified, he had assumed these were mutual funds being purchased for his account but later came to understand the Respondent had purchased segregated funds.

67. GC testified in his direct evidence in support of his allegations against the Respondent, that he was “shocked” after he signed for the 2 Manulife loans. On cross-examination however he admitted that he did not communicate to the Respondent that he was “shocked or felt discomfort with what we were doing” with respect to the 2 Manulife loans.

68. On November 1, 2005, he borrowed \$100,000 from another lender, B2B Trust. He testified that the Respondent again had no discussion with him on this occasion regarding what funds to purchase; why the borrowed monies were being used to purchase a single fund; or the features of the funds.

69. In December 2005, he testified he then gave the Respondent \$91,546, being his Dalhousie pension monies to invest on his behalf. He claims the Respondent invested them in a fund without any discussion with him as to what fund to select. He testified that by this time the Respondent was managing \$290,000 of investments on his behalf.

70. In January 2007, he borrowed a further \$125,000, this time from TD Canada Trust. He alleges that the Respondent did not explain to him that the loan was a 100% demand loan, nor what this term meant. Although he had applied for \$125,000, TD Canada Trust approved only \$85,000 but he did not know why the amount was lower than what had been applied for.

71. By early 2007, he testified he had at least three monthly payments from the investments totaling approximately \$1,953 coming into his bank account, and four monthly payments leaving his bank account that were servicing the interest costs on the investment loans.

72. In February of 2008, he testified his investments with another financial advisor were transferred to the Respondent even though he stated he thought the transfer had taken place in June of 2006.

73. He testified that in January and March of 2008, TD Canada Trust placed a margin call on the \$85,000 loan. His evidence was that he either did not open the margin letters at the time they were received from TD Canada Trust, or if he did, he did not deal with them. He also claims that in 2008 he did not understand what a margin call was, or that this loan was in fact subject to a margin call. Although the Respondent was specifically copied on the letters, he also alleges the Respondent did not contact him to discuss the letters or the margin call with him.

74. He testified that in July of 2008, TD Canada Trust issued another letter regarding the margin call on his \$85,000 loan. As with the previous letters he stated that he did not open the letter at the time he received it nor did the Respondent discuss the margin calls with him, even though he had met with the Respondent to complete a KYC update form in April of 2008.

75. In September 2008 he borrowed another \$100,000 from AGF Trust. He stated he did not choose the lender; the amount to be borrowed; nor did he and the Respondent discuss what funds were being selected for his account or the allocation.

76. GC also alleges that he didn't know how many investment loans he had at any given time.

77. He testified that in September 2008 he was called by the Respondent and asked to bring him a check in the amount of \$7,000 in order to satisfy the margin call. He claims he was "more than upset" but couldn't remember the specifics of what happened that day; what discussions he and the Respondent had; and couldn't recall what if any documents were presented to him regarding the \$7000 figure.

78. In November 2008 and March 2009, GC testified he received emails from the Respondent inviting him to attend an "information session" at the Respondent's home which was held in March 2009 where he testified the Respondent discussed historical trends and assured GC and the other attendees that their portfolios would recover.

79. GC testified that it was not until August of 2009 that he became aware of and concerned with the decline in the value of some of his accounts even though from the evidence it was apparent in January of 2009 that his monthly payments from the investments had started to decline.

80. He testified he sent an email to the Respondent in August of 2009 and again in October of 2009 about the decline in the value of his accounts which were not answered.

81. Staff submits that GC's delay in discovering the drop in value of his accounts until August of 2009 was simply due to his lack of diligence and general confusion. We are not convinced that GC was confused or was simply not paying attention to his accounts. In fact it is clear he would have been aware that his accounts were dropping in value from the simple fact that a year earlier he knew that one of his loans had been subject to a margin call for which he had to give the Respondent \$7000 to bring current.

82. In October of 2010, GC testified he went online and reviewed his accounts. Until then he claimed he had "no idea" that his portfolio was valued at \$328,161. He stated that he advised the Respondent he planned to get a second opinion on his portfolio and asked the Respondent about DSC and other fees if he were to transfer out.

83. In late 2010 after seeking a second opinion he testified he then raised concerns about the validity of his signature on various documents which he testified he did not discover but was discovered by a friend who he stated was in the financial field. In response to Staff's questions on direct examination as to whether he had ever noticed, prior to December 2010-January 2011 time frame, that his signature did not appear to be his he answered "No, not on my own".

84. GC was cross-examined by the Respondent on his allegations that the Respondent had him initial documents in blank. On showing him Exhibit R-21, GC agreed that his initials were on the bottom of the exhibit despite having previously claimed that he had never seen the document before. GC's attempt to clarify his evidence on this point after the fact by stating that he simply signed what the Respondent gave him is not convincing. In the Panel's opinion the allegations by GC that he signed and initialed documents in blank has not been established on a balance of probabilities as it was vague, unreliable and clearly self-serving.

85. In September of 2011 GC sent complaint letters to various Members, Lenders and other individuals about the Respondent.

86. According to Keybase's January 13, 2012 response to GC's September 2011 letter, neither the TD Canada Trust investment loan, nor the AGF Trust loan were suitable for GC however Keybase's January 13, 2012 letter does state that the 2005 Manulife Securities and B2B loans issued in 2005 were suitable for GC. The AGF loan would have been approved in 2008, it stated.

87. In the Panel's opinion the Member's responses to GC's complaints are not determinative of whether or not the loans were suitable for GC. In his testimony GC confirmed that the Respondent would have submitted the applications for the various loans based on the information given to him by GC. As mentioned above despite testifying on direct that he was "shocked" after he signed for the 2 Manulife loans, on cross-examination he admitted that at no time did he tell the Respondent that he was "shocked or felt discomfort with what we were doing" with respect to the 2 Manulife loans.

88. In 2013, GC transferred his investment accounts and ceased being a client of Keybase. GC testified he still had the investments but was not able to tell the Panel what the current value of the investments were that were originally purchased with the investment loans.

89. GC claims that the Respondent misrepresented KYC information on his account opening and loan application documents, including overstating his income and assets, and understating his liabilities. GC also believes his signature was placed on documents without his knowledge.

90. GC alleges his investment knowledge and risk tolerance was incorrectly recorded on the documentation filled out by the Respondent. GC admitted on cross-examination however that based on his own level of “confusion and inaccuracy” that it was entirely possible that GC could have “communicated inaccurate information” to the Respondent. So while there may be some evidence to establish that some of the information on GC’s KYC form was inaccurately recorded by the Respondent GC’s admission of his own confusion and inaccuracy is a plausible explanation and a defence to the MFDA allegations in this regard.

91. On assessing GC’s evidence the Panel finds that overall it did not support the MFDA allegations regarding his accounts. GC’s attempt to portray himself as an investor who was taken advantage of by the Respondent was not convincing in our view. By his own admission he was an individual whose goal was to make money in order to assist with his support payments. Whether he blindly followed the advice of the Respondent, who at one time he considered his close friend, as he alleges is clearly questionable in our opinion. To the contrary we believe the risks of using the Smith Manoeuvre investment strategy were adequately explained by the Respondent and accepted by GC. Between September 2005 and September 2008 he met with the Respondent on at least 7 separate occasions, 5 of which were for the purpose of signing loan documentation in support of the investment loans he took out, another to give the Respondent his pension monies and one to give him the cheque to cover the margin loan.

92. GC’s claims that the Respondent did not have discussions with him as to how much he should borrow or where the funds should be invested simply are not believable. Neither are his assertions that he was not aware of what a margin or demand loan was in our opinion. GC is a businessman who obtained investment loans of \$285,000 in addition to giving the Respondent his pension monies to invest. On weighing all of his evidence these are not actions, in our opinion, of an unsophisticated investor, as he would like us to believe, but someone who clearly understood what he was doing, where his money was being invested and accepted the risks notwithstanding his testimony to the contrary.

93. GC testified that margin calls were placed on his TD Canada Trust loan in January, March and July 2008, but that he did not open the letters regarding same until much later or if he did, he did not deal with the issue. In September 2008 after he had borrowed another \$100,000 from AGF Trust earlier that month he took a \$7000 cheque to the Respondent to cover the margin call.

94. He had attended the 2009 meeting held by the Respondent called because of investment losses the Respondent's clients had experienced as a result of the downturn in the market, yet he stated it was not until August of 2009 that he became aware of and concerned with the decrease of the value of some of his accounts. These are not the actions of someone who was blindly following the Respondent's recommendations as GC would lead us to believe. His claims that it was not until October of 2010, over 14 months later, when he went online and "discovered" the value of his accounts lack credibility.

95. Based on the evidence before us, we believe GC was fully aware of and accepted all of the risks associated with the Smith Manoeuvre which he admitted the Respondent had discussed with him. To state that he never understood the strategy the Respondent recommended and utilized for him, despite investing over \$325,000 with him between 2005 and 2010-11, is self-serving in our opinion and clearly made in an effort to support GC's claims for compensation that have been commenced in other legal proceedings as referenced at various times throughout this matter.

96. We acknowledge that this Panel has made findings which would support an element of similar fact evidence in respect of some of GC's claims. The fact that this Panel has found that the Respondent failed to explain the details of the Smith Manoeuvre to the other Complainants, and that he misstated KYC information on their account opening and loan application documents, provides some credence to GC's similar allegations in his case. Nevertheless, this Panel is tasked with evaluating each complaint separately based on its own facts and must be satisfied of the proof of each allegation on a balance of probabilities. The Panel had difficulty finding that the bulk of GC's allegations were proven, in light of his testimony as set out above, and given that the Panel finds that he was a more sophisticated investor than the other Complainants, who more likely than not understood the nature of the Smith Manoeuvre.

97. It was GC who the Respondent singled out as being the individual behind what the Respondent claims both in his defence and in his submissions was a continuing effort to undermine and disparage him in the community, both professionally and personally. No conclusive evidence was produced to substantiate any of these claims and certainly GC's actions involving the Respondent did not, in our opinion influence our assessment of the evidence of any of the other witnesses who appeared before us. The actions and conduct of the Respondent in this matter were evaluated by the Panel solely on the evidence that was before us.

98. We have weighed all the evidence presented in support of GC's complaints with a view to determine if it is sufficiently clear, convincing and cogent in determining whether it supports the MFDA allegations against the Respondent. On a balance of probabilities we find that it does not.

#### CH

99. CH testified that she and her former spouse, MB were referred to the Respondent by a neighbor in 2007. She has a BSc and worked for the Province of Nova Scotia as a Dietician. Her ex-husband MB has a BA and operated his own business, a health food franchise at the time.

100. When CH started dealing with the Respondent she testified she had no financial education or training, had never met a financial advisor before and had no experience with investing.

101. CH testified that:

- i) When they first met the Respondent he recommended an investment strategy called the Smith Manoeuvre to them and told them it would allow them to pay off the mortgage on their home in half the usual time while their investments kept growing.
- ii) She did not understand the strategy when the Respondent first recommended it and at the time of the hearing, she still did not. From their discussions with the Respondent, she understood that the strategy being recommended by the Respondent would not cost them anything out of pocket. There was no discussion regarding interest rate fluctuation or the consequences of same.

- iii) In describing the benefits of the strategy to them, the Respondent emphasized the tax benefits, but did not tell them of any risks. She understood from the Respondent that they could write off interest that they paid on loans on their taxes and they did so, but the amount was much less than they had been led to believe they would be able to write off.
- iv) The Respondent told them that over time, their investments could go up or down, but overall there will always be a gain. She stated he did not discuss with them the difference between investing one's own money versus investing borrowed money.
- v) In April 2007, the Respondent recommended that they apply for three investment loans from B2B Trust, two loans separately and one loan jointly, which they did. The Respondent did not discuss the risks or benefits of borrowing one amount versus another. When they met with the Respondent, he said that he thought they could get approved for \$50,000 each.
- vi) The Respondent selected the funds that were purchased and told them that the funds selected would pay them what he called "dividends", a key component of the strategy according to him.
- vii) At the time of the hearing, CH stated she had very limited investment knowledge. On cross-examination, CH testified that she did not know what a mutual fund was, nor what investments the Respondent had placed them in.
- viii) CH had also never heard of ROC funds. She did not recall the Respondent ever mentioning the term or having a discussion about them. On cross-examination, she confirmed that she had never heard of "return of capital". She was also asked whether she had ever heard of "capital refund mechanism" and testified she had not.
- ix) On December 13, 2007, she testified MB complained via email directly to the Respondent stating that he had not known that they had been placed in investments that returned their own capital. He wrote "Had I been informed that one of the fund choices was simply picked to provide enough cash flow to make the debt servicing versus the return look attractive, I would never have chosen the fund. I was a first-time investor and had I understood fully, I would not have moved forward with your choices."

- x) After the investment strategy was implemented by the Respondent, CH did not receive any contact or follow-up from him, and perceived that he was not interested in their "financial health". She and MB then met with another advisor from Keybase and their accounts were taken over by the new advisor.
- xi) In 2011 after separating from her husband and discussing her investments with family she complained to Keybase who advised her various items were inflated on the documentation completed by the Respondent and that her investment knowledge should have been recorded as "Novice".
- xii) In November 2011, Keybase responded to her complaint stating that "there was evidence that the financial data on the loan application was inflated by [the Respondent] to qualify the loan".
- xiii) At the time of the Hearing, the joint loan had been collapsed by Keybase, but CH and her ex-husband still had their individual loans at Keybase.
- xiv) At the time of the hearing, she was paying, out of pocket, \$125 per month to service the interest costs of her investment loan originally valued at \$49,000. The corresponding investments were valued at \$35,000, and she had ceased taking any monthly distributions.

102. CH testified that the Respondent misrepresented the KYC information on their account opening and loan application documents, including overstating their net worth, the value of their home, their investment knowledge, and understating their liabilities.

103. CH testified that the Respondent did not provide them with copies of the account opening documents at the time their 3 accounts were opened. She testified that when they later requested copies of the documents and saw the KYC entries that had been recorded for them by the Respondent, they were "embarrassed and shocked", especially when they had thought that the Respondent had had their best interests in mind as she stated.

104. Regarding their KYC information CH testified that in April 2007, her household net worth was recorded by the Respondent on her NAAF, Exhibit E-7 as "\$100,000-200,000"; however, she testified that this was wrong and that her the worth would have been under \$20,000 at that time.

105. In April 2007, MB's household net worth was recorded by the Respondent on his NAAF, Exhibit E-8, also as "\$100,000-\$200,000"; however, CH testified that this was not correct and that their net worth would have been "in the negative" because they had more debt than assets at that time.

106. In April 2007, her net worth was also incorrectly recorded by the Respondent on her B2B Trust loan application, Exhibit E-10, as \$172,000. She testified that this was not correct and that the net worth should have been shown as nil based on her assets versus her liabilities. On MB's B2B Trust application, Exhibit E-11, it shows the same \$172,000 net worth amount, but CH testified that this should have been a negative \$20-30,000 as a result of MB's student loan debt which was omitted.

107. CH testified that in April 2007, her "other income" was recorded by the Respondent on her B2B Trust investment loan application as being "\$8,000" however, she testified that they never had any such additional income, and there was no discussion with the Respondent of any such income.

108. She stated that in April 2007, MB's income was recorded by the Respondent on his NAAF, Exhibit E-10, as "\$75,000-\$99,999" however, this was not correct as MB, according to his income tax Notices of Assessment, had earned \$40,131 in 2005 and \$41,347 in 2004.

109. In April 2007, CH and MB's joint income was recorded by the Respondent on their joint account NAAF as both "\$100,000-\$124,999" and "\$125,000-\$200,000", as both boxes were checked off. CH testified that she did not know why both boxes were checked off, and that in any event, both were not correct as "\$75,000-\$99,999" for their joint income would have been more accurate. MB's "other income" was recorded by the Respondent on his B2B Trust loan application, Exhibit E-11, as "\$31,400"; however, CH testified that this was not accurate either, as he had just started a new company and, at the most, might have drawn an additional \$8,000.

110. CH testified that the value of their residence was recorded by the Respondent on CH's April 2007 B2B Trust investment loan application, Exhibit E-10, as \$340,000. CH testified that this was overstated, and testified that it had been purchased five months before in December 2006 for \$215,000. Furthermore the residence was appraised in 2015 for only \$285,000. CH testified that the overstated value of \$340,000 was also used on MB's B2B Trust loan application, Exhibit E-11, and on their joint B2B Loan Application, Exhibit E-12.

111. CH testified that in November 2011, she complained to Keybase, and provided various documents in support of her concerns including Exhibit E-6. According to a property assessment dated November 2, 2011 the value in 2007 for their residence was stated to be \$201,700.

112. The value of CH's "cash/liquid assets" was incorrectly recorded by the Respondent on CH's B2B Trust investment loan application in April of 2007, Exhibit E-10, as \$30,000 whereas she testified she had a small RRSP, of less than \$1,000, and approximately \$1,000 in her bank account.

113. At the same time, she testified the Respondent failed to record MB's student loans on his B2B Trust investment loan application, Exhibit E-11. When MB graduated in 2002, he had loans in the amount of \$40,000 and he estimated that by 2007, the amount owing on the loans would have still been \$20,000 to \$30,000.

114. CH testified that her investment knowledge was recorded by the Respondent on her NAAF, Exhibit E-7, as "good"; however, this was not correct as it should have been "Novice". She also testified that MB's investment knowledge was also recorded by the Respondent on his NAAF as "good"; however, this also was not correct either and should have been "novice to fair" as he had no prior experience with investing.

115. CH's risk tolerance in April of 2007 was recorded by the Respondent on her NAAF, Exhibit E-7, as "medium high"; however, she testified her risk tolerance was "medium low, medium". On cross-examination CH testified that while MB was more of a risk taker she denied he was aggressive as suggested by the Respondent but was rather "naïve and excitable".

116. CH's testimony was clear, convincing and forthright in our opinion. Clearly the investment strategy utilized by the Respondent was not appropriate for persons in their circumstances.

### **Michael Ford**

117. Michael Ford testified that at the time of the hearing he was a manager in the investigations group of the Enforcement Department of the MFDA, and had held that position since October 2013. He had been an investigator with the MFDA since 2005 and had been promoted to the position of senior investigator on July 1, 2007. Mr. Ford was the person responsible for conducting Staff's investigation of the Respondent which began in 2011.

118. Mr. Ford gave detailed evidence regarding the MFDA and the mutual fund industry outlining the interplay between investors, approved persons, members and their managers. He explained the various types of mutual funds, including conventional and ROC funds, how they generated income and how that income was intended to be distributed.

119. Mr. Ford explained the regulatory process and the steps undertaken by the MFDA in carrying out an investigation upon a complaint being filed. He testified as to the risks expected to be disclosed to clients who were investing using borrowed monies by approved persons and on cross examination addressed the purpose and contents of the MFDA regulatory notices issued at various times during the period in question. He gave detailed evidence regarding Staff's investigation of the Respondent.

120. Mr. Ford reviewed the National Registration Database document ("NRD"), Exhibit F-1, which set out the Respondent's registration history with the MFDA. Exhibit F-1 also disclosed that the Respondent was subject to terms and conditions effective November 30, 2009. As a result he could only recommend leverage to a client where it would not cause the client's liquid-to-net-worth ratio to exceed 30%, and required the accuracy of the client's net income and net worth to be verified in writing by the client. As well, the client had to meet various KYC criteria.

121. Mr. Ford gave detailed testimony on the interview he conducted with the Respondent during his investigation, a transcript of which was entered as Exhibit F-2 at the hearing. Notwithstanding the Respondent's insistence during the interview that he was using the Smith Manoeuvre properly and followed it by the book, it was Mr. Ford's evidence that none of the Respondent's clients whose accounts he reviewed were using the Smith Manoeuvre properly.

122. Mr. Ford gave detailed evidence on the Smith Manoeuvre and how it was intended to work. He also testified as to how the Respondent used it in his dealings with the complainants referring to many Exhibits that were entered in this matter in addition to highlighting the Respondent's answers given in his interview with the MFDA during its investigation.

123. Mr. Ford testified that the underlying principle behind the Smith Manoeuvre is to convert non-tax advantaged debt into tax-beneficial debt, the premise being one can convert a mortgage which is not tax deductible into a tax deductible form of debt. He indicated that theoretically a client would accomplish this by using a line of credit or some similar type of debt facility, and as they pay down their mortgage, they would make additional investments. For example, as they pay down the mortgage by \$1,000, they re-advance the debt via the line of credit making an investment of \$1,000, resulting in there being a continuous pay-down of one debt and an increase in the other. Under this strategy, with the loans advanced to the clients the Respondent then purchased ROC mutual funds on their behalf.

124. Mr. Ford explained in detail how ROC funds worked. He testified that when a ROC fund cannot make its target payout, due to the fund not performing such that it can pay the distribution promised under its distribution policy, the fund will take steps to pay out additional amounts of money to the client to make sure that they still meet their target payout. These additional funds paid out to the client are actually a return of the capital of the fund. In extreme cases he testified, a ROC fund could return 90-100% of the investors' own capital as distributions resulting in the net asset value of the portfolio dropping over time. The result being that the fund's assets are reduced if there is a continuing distribution shortfall over time between the fund goals and actual returns.

125. Mr. Ford also gave evidence as to the tax advantages that can accrue with ROC payments when they are classified as return of capital. He stated that as ROC payments are made, the adjusted cost base ("ACB") of the investment reduces in relation to the distributions being paid out. When ROC payments continue long enough, eventually the ACB will continue to drop to the point where it could conceivably drop to zero. Under this scenario, from a taxation point of view, everything that the investor takes out would be considered taxable as a capital gain.

126. Mr. Ford explained the analysis he undertook to calculate the clients' investment losses as he set out in Exhibit F-6 (set out below). He also reviewed the clients' documentation at the hearing including their account statements, the amounts they had initially borrowed and their portfolio values at the time of his investigation in 2011 when the Respondent departed Keybase. A portion of Exhibit F-6 showing the clients losses is reproduced below:

| Client | Total Amount Borrowed & Invested | Costs paid by client (including interest, margin call, DSC fees) | Distributions/ Redemptions | Market value November 2011 | Gain/loss November 2011 |
|--------|----------------------------------|------------------------------------------------------------------|----------------------------|----------------------------|-------------------------|
| FH     | \$275,000                        | \$52,463                                                         | \$99,647                   | 141,251                    | -\$88,116               |
| MC/ VC | \$100,000                        | \$26,104                                                         | \$41,446                   | \$54,217                   | -\$30,441               |
| LE     | \$355,500                        | \$82,067                                                         | \$99,698                   | \$230,663                  | -\$110,806              |
| MB/ CH | \$150,000                        | \$24,805                                                         | \$61,879                   | \$84,103                   | -\$34,223               |

127. While it was difficult at times to follow Mr. Ford's evidence regarding the actual client losses as he had calculated them what was not difficult to follow was that each of the clients' accounts decreased significantly in value. In any event the actual amount of the individual losses is not in dispute in this matter nor the basis of the MFDA complaints against the Respondent.

### **Respondent's Witnesses**

128. The Respondent called three witnesses, RS, DC, and RH. Each testified that they had previously dealt with the Respondent as he was their investment advisor.

129. RS testified that he worked for the Nova Scotia Government and was introduced to the Respondent by relatives who were dealing with the Respondent and who at the time of the introduction were engaged in leveraged borrowing with the Respondent. RS testified as to the process the Respondent went through to explain leveraged borrowing strategy to him based on his and his wife's financial situation. RS testified the Respondent cautioned him on this strategy, but, he explained he was a risk taker and accepted the risks. Overall, he told the Panel that he was pleased with the service and advice he had received from the Respondent.

130. DC testified that she was an auditor who had been a client of the Respondent for 7 or 8 years and that in her dealings with him he had always been professional. She testified that the Respondent had clearly explained the leveraging borrowing strategy he had recommended to her and that he did not have her sign forms in blank.

131. RH, DC's husband, testified that he was a plumber/pipefitter who had met the Respondent in 2008 where he was introduced to the "manoeuvre" as he called it, and the borrowing to invest strategy. He stated he was a bit nervous about the risks as they were moderate to high but his wife DC, being an accountant, was comfortable with it. He stated he did not sign forms in blank and attended the meeting with the Respondent held in 2009 after the 2008 drop in the market. He understood that in his words "investments are investments....it's a gamble".

132. Overall the Panel finds the evidence of the Respondent's witnesses to be of little assistance to it in determining the matters in dispute. Their evidence was lacking in details regarding how much each had borrowed to invest with the Respondent nor did they give any evidence as to whether they had engaged in the Smith Manoeuvre or whether they had purchased ROC mutual funds.

133. Other than very general comments that they accepted the risk associated with the leveraged borrowing strategy the Respondent had them in their testimony was lacking in details as to actually what the risks were as had been explained to them by the Respondent. While it was clear that the Respondent still had a very good relationship with these 3 former clients their testimony did not

offer any tangible evidence supporting the defence plead by the Respondent nor did their testimony assist in refuting the MFDA's allegations against him.

134. The foregoing are the basic findings of fact with regard to the testimony of the witnesses called in this matter. The Respondent did not testify and attempted, through cross-examination of the investor witnesses and through the direct testimony of the 3 witnesses he called, to refute the MFDA's evidence. The Panel finds the evidence of the investor witnesses, with the exception of GC, to be credible throughout. The credibility of the Respondent's witnesses was not called into question either. the Panel simply finds their evidence to be of no assistance to it in resolving the matters in dispute.

135. In conclusion it is clear to the Panel that the overall similarity of the Respondent's activities in setting up and managing his clients' (FH, VC/MC, LE and CH/MB) investments confirms their individual testimony regarding the improper manner in which the Respondent dealt with each of them and their accounts. Further, all of these clients had a common interest. None of them were experienced investors and each testified that they were led to believe by the Respondent that their investments were safe.

136. The Respondent promoted a leveraged borrowing strategy called the Smith Manoeuvre and assured these clients that the investments he had them in would meet their needs and would cover their investment loans with money to spare. For each one of them however it was clear that this did not happen. The leveraged borrowing strategy he employed was complex and not at all appropriate for these individuals who could easily be described as first time investors. They all suffered losses, as each one of them and Mr. Ford outlined in their testimony, which they could ill afford as their testimony confirmed.

## APPLICABLE RULES AND LAW

### MFDA Rules

137. 2.1.1 **Standard of Conduct.** Each Member and each Approved Person of a Member shall:

- a) deal 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 by the Corporation.

138. 2.2.1 **"Know-Your-Client".** Each Member and Approved Person shall use due diligence:

- a) to learn the essential facts relative to each client and to each order or account accepted;
- b) to ensure that the acceptance of any order for any account is within the bounds of good business practice;
- c) to ensure that each order accepted or recommendation made, including recommendations to borrow to invest, for any account of a client is suitable for the client based on the essential facts relative to the client and any investments within the account;
- d) to ensure that, notwithstanding the provisions of paragraph (c), where a transaction, including a transaction involving the use of borrowed funds, proposed by a client is not suitable for the client based on the essential facts relative to the client and the investments in the account, the Member or Approved Person has so advised the client before execution thereof and the Member or Approved Person has maintained evidence of such advice;
- e) to ensure that the suitability of the investments within each client's account is assessed:
  - i) whenever the client transfers assets into an account at the Member;
  - ii) whenever the Member or Approved Person becomes aware of a material change in client information, as defined in Rule 2.2.4; or
  - iii) by the Approved Person where there has been a change in the Approved Person responsible for the client's account at the Member;

and, where investments in a client's account are determined to be unsuitable, the Member or Approved Person so advises the client and makes

recommendations to address any inconsistencies between investments in the account and the essential facts relative to the client and the Member or Approved Person maintains evidence of such advice and recommendations;

f) to ensure that the suitability of the use of borrowing to invest is assessed:

- i) whenever the client transfers assets purchased using borrowed funds into an account at the Member;
- ii) whenever the Member or Approved Person becomes aware of a material change in client information, as defined in Rule 2.2.4; or
- iii) by the Approved Person where there has been a change in the Approved Person responsible for the client's account at the Member;

and, where the use of borrowing to invest by the client is determined to be unsuitable, the Member or Approved Person so advises the client and makes recommendations to address the inconsistency between the use of borrowed funds and the essential facts relative to the client and the Member or Approved Person maintains evidence of such advice and recommendations.

139. MFDA Rule 2.2.1 codified the “know-your-client” and “suitability” obligations that an approved person must comply with, the breach of which is considered an extremely serious matter. These Rules are basic and must be followed by any Approved Person when they deal with clients and their investments.

140. As has been described in various decisions (See *Re Marc Lamoureux* (2001), ABSECCOM 813127, paras 12-13 and *Daubney (Re)*, *Supra* paras 18-19) the reason that the know-your-client obligation is so important is because an Approved Person cannot properly evaluate or determine the suitability of an investment recommendation unless the Approved Person has learned the “essential facts and characteristics” of the client such that the Approved Person is knowledgeable concerning the client's:

- i. age/stage of life;
- ii. employment status;
- iii. financial position (including income, assets, net worth, and liabilities);
- iv. investment knowledge and experience;
- v. risk tolerance;
- vi. investment objectives; and

vii. investment time horizons

141. In *Re Daubney*, 2008 LNONOSC 338(0SC) at paras 15 and 16 the Panel described these obligations as follows:

15. The Commission has recognized that the know-your-client and suitability requirements "are an essential component of consumer protection and a basic obligation of a registrant, and a course of conduct by a registrant involving a failure to comply with them is an extremely serious matter." (*Re E. A. Manning Ltd. et al.* (1995), 18 O.S.C.B. 5317 at 5339)
16. The Alberta Securities Commission (the "ASC") described these two obligations as follows:

The "know-your-client" and "suitability" obligations are conceptually distinct but, in practice, they are so closely connected and interwoven that the terms are sometimes used interchangeably.

The "know-your-client" obligation is the obligation to learn about the client, their personal financial situation, financial sophistication and investment experience, investment objectives and risk tolerance.

The "suitability" obligation is the obligation of a registrant to determine whether an investment is appropriate for a particular client. Assessment of suitability requires both that the registrant understands the investment product and knows enough about the client to assess whether the product and client are a match. (*Re Marc Lamoureux* (2001), ABSECCOM 813127 ("Re Lamoureux") at 10.)

17. Canadian securities authorities have adopted a three-stage analysis of suitability, according to which a registrant is obliged to:
  - a) use due diligence to know the product and know the client;
  - b) apply sound professional judgement in establishing the suitability of the product for the client; and
  - c) disclose the negative as well as the positive aspects of the proposed investment. See *Re Lamoureux* 2001 LNABASC 433.

142. The decision in *Re Lamoureux* 2001 LNABASC 433 has been followed by Canadian securities authorities where the Alberta Securities Commission held that suitability must be assessed prior to any investment recommendations to a client, and that a three stage process must take place sequentially, as follows:

- i. use due diligence to know the product and know the client;
- ii apply sound professional judgment to determine the suitability of the investment for the client; and
- iii. make the client aware of the recommended investment, while disclosing the negative as well as the positive aspects of the proposed investment.

143. The Commission in *Re Lamoureux*, made additional comments on the "three stage process" at pages 18 and 19 which make the stages even more explicit:

### **Three-Stage Process**

Suitability is to be assessed prior to any investment recommendation by the registrant to a client. The process that culminates in a registrant's investment recommendation to a client has three component phases or stages that must occur in sequence.

The first-stage involves the "due diligence" steps undertaken by the registrant to "know the client" and to "know the product". Knowing the product involves carefully reviewing and understanding the attributes, including associated risks, of the securities that they are considering recommending to their clients. Knowing the client was discussed above.

Only after the "due diligence" of the first stage is completed, can the registrant move to the second stage in which they fulfil their obligation to determine whether specific trades or investments, solicited or unsolicited, are suitable for that client.

Suitability determinations, discussed in section IV(B) (d), will always be fact specific. A proper assessment of suitability will generally require consideration of such factors as a client's income, net worth, risk tolerance, liquid assets and investment objectives, as well as an understanding of particular investment products. The registrant must apply sound professional judgement to the information elicited from "know your client" inquiries. If, based on the due diligence and professional assessment the registrant reasonably concludes that an investment in a particular security in a particular amount would be suitable for a particular client, it is then appropriate for the registrant to recommend the investment to that client.

By recommending a securities transaction to a client, a registrant enters the third stage of the process. Whether a particular transaction has in fact been "recommended" is to be determined objectively, taking into consideration the content, context and manner of communication from a registrant to the client, to

assess whether it could reasonably be understood as a suggestion that the customer engage in a securities transaction. At this stage, when making the client aware of a potential investment, the registrant is obligated to make the client aware of the negative material factors involved in the transaction, as well as positive factors.

The disclosure of material negative factors in the third stage of the process is intended to assist the client in making an informed investment decision. It should be emphasized that such disclosure cannot ameliorate deficiencies in either of the first two stages of the process. If a registrant recommends securities that are not suitable for a particular client, then disclosure by the registrant during the third stage is irrelevant to their suitability obligation in stage two. The registrant's failure may have been the result of not knowing the client, or not knowing the securities, or an error in the suitability determination but, once the improper recommendation has been made, it does not matter whether or how the registrant discloses the material negative factors, or whether the client claims to understand and accept the risks involved in the investment. The registrant has failed to fulfil their obligations.

### **The Suitability Assessment**

The British Columbia Securities Commission had occasion to describe the suitability obligation in **Foerster**, (1997) 13 CCLS 274 [at page 292] as follows:

The second step in complying with the know your client rule is determining that the proposed investment is suitable for the client, that is, that it will achieve the investment objectives of the client while keeping within the level of risk determined by the client's comfort level and overall circumstances.

144. Rule 2.2.1(a) requires an Approved Person to "use due diligence" to learn the essential facts relative to each client and each account or investment accepted.

145. Previous hearing panels have confirmed that exercising "due diligence" by an Approved Person includes, at the very least, the obligation to know and fully understand the client's financial situation, current and continuing financial obligations, net worth, income, liquid assets, understanding the market, age relative to retirement, knowledge and the client's understanding of borrowing to invest and of ROC mutual funds and the ability to repay the borrowed amounts in the event of market changes to the value of the mutual funds and/or their distributions. See *Re Arseneau* MFDA File No.: 201115 at para 43; and *Re Pretty* MFDA File No.: 201128 at para 92.

146. In *Re Daubney*, *Supra* at paras 24-25, the Ontario Securities Commission held that a particular investment approach, such as a leveraging strategy, is part of "the product", stating:

With respect to "knowing the product," we agree that a particular investment approach, such as the leveraging strategy recommended by Daubney, is part of the "product." Where a registrant recommends leveraging, i.e. borrowing money to invest in a recommended product, the registrant is obliged to assess whether the client's circumstances are such that they have the ability to meet debt obligations and tolerate losses under different market scenarios. Because leveraging can magnify losses, it is critical that the registrant ensures the client understands the risks of borrowing to invest, in particular the risks of using collateral, including investments made with monies borrowed, as security for loans.

147. The MFDA has published guidance for its membership on these points as well. The know-your-product obligation is addressed in MFDA Member Staff Notice 0048, which states:

Members and 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 and supervisory staff of the Member also fully understand the products that are being recommended to clients.

148. MFDA Member Staff Notice 0069, also provides guidance on how Approved Persons are expected to establish a suitability framework in order to meet their suitability obligation. It sets out that in order to meet the obligations under Rule 2.2.1, Approved Persons must obtain and maintain complete, timely, and accurate KYC information because without this information, a determination cannot be made as to whether a recommendation is suitable for a client.

149. The Respondent argues that because the MFDA Suitability Guidelines were only introduced in April 2008 (MFDA Member Regulation Notice (MR-0069)) they cannot be applied retroactively to the facts before the Panel and he is not bound by the guideline as it was published after a number of the clients were already invested in the leveraged borrowing strategy with him. This notional challenge was clarified in *Pretty*, *Supra*, where Counsel for the Respondent there contended that the MFDA Suitability Guidelines were only introduced in April 2008 (MFDA Member Regulation Notice (MR-0069)) and cannot be applied retroactively.

150. As was held by the panel in *Re Pretty* as well, there is no merit here to the Respondent's contention that the suitability requirement does not apply under these circumstances. The MFDA

Rules in this regard are simply a codification of long standing requirements of the investment industry that predate the April 2008 MFDA Member Regulation Notice (MR-0069) of which the Respondent would have been fully aware. He was in the industry well before the events here and these were basic requirements that have existed throughout the industry for years. See *Re DeVuono*, MFDA File No. 201102, a decision out of Vancouver British Columbia; *Re Arseneau*, *Supra* and *Re Pretty*, *Supra*.

151. Previous MFDA hearing panels have observed that there are special considerations that an Approved Person should be aware of when evaluating the suitability of a leveraging strategy for a client, including:

- i) whether the client has sufficient income or unencumbered liquid assets to be able to:
  - a) withstand a market downturn without jeopardizing their financial security (including their ability to maintain their home);
  - b) meet a margin call, where applicable; and
  - c) satisfy all loan obligations (both principal and interest) associated with the strategy;regardless of the performance of the investments purchased as a result of the strategy and without relying on anticipated income from the investments; and
- ii) whether there is any reason to expect the client's current sources of income to be reduced in the short term, bearing in mind the client's stage of life (including age and anticipated retirement date), employment status, and personal circumstances (for example, disability, pregnancy, or any known risk of imminent anticipated job loss).

152. In *Re Lamoureux*, *Supra* at Section IV(3)(d)(4), the Securities Commission held that where the Approved Person reasonably determines that an investment product or strategy would be appropriate for the client, he must make disclosure of all material factors relevant to the product

or strategy, including negative factors and risks involved in the transaction, prior to executing a trade on the client's behalf.

## **ANALYSIS AND DECISION**

### **Know-Your-Client Forms**

153. We find that the evidence, as specifically set out above regarding each of the witnesses, FH, VC/MC, LE and CH/MB, establishes that the Respondent misrepresented the KYC information on the account opening documents and loan applications. He overstated their net worth, income, assets, and risk tolerance and understated their liabilities and investment knowledge:

- a) FH testified her risk tolerance started at “medium” when she first met the Respondent and then reduced to “low” as time went on however the Respondent had incorrectly recorded it as being “medium high”. He also overstated her income;
- b) VC testified the respondent overstated the value of her house; recorded her investment knowledge as “good” when it should have been “novice”; recorded she and her husband’s risk tolerance as “Medium-high” on their 2007 and 2008 NAAFs when it should have been “low”;
- c) LE testified the Respondent overstated the value of both her house and her income on the various documents he prepared: he recorded her investment knowledge as “good” when it should have been “novice” or “fair” on one KYC form; recorded it as “good” on her NAAFs when it was between “novice and fair”; recorded her volatility as “moderate” when it was “low” and recorded her risk tolerance as “medium-high” when it should have been “medium” on Exhibit C-1 and recorded it as “medium-high” on a 2007 NAAF when it should have been “low or medium-low”;
- d) CH testified that the Respondent overstated she and her husband’s net worth and income on their NAAFs and loan applications; overstated their assets and understated their liabilities on the loan applications he completed for them; recorded their investment knowledge on their NAAFs as “good” when it should

have been “novice” or “novice to fair” and recorded their risk tolerance on Exhibit E-7 as “medium-high” when it should have been “medium low, medium”.

154. FH, VC and MC testified that they signed the account opening and loan application documents either prior to the Respondent populating the relevant portions of the KYC information on the documents and where the clients signed the documents after the Respondent had populated the information, they did so relying on the Respondent's assurances that he had populated the documents in a manner consistent with the information they had provided to him.

155. On LE's documents, initials or signatures were affixed on the documents, while she testified she had not placed the initials or signatures there, and had no information about how they had gotten there.

156. Staff argues that the effect of all of the documented misrepresentations increased the likelihood that the lenders would approve the clients' investment loans and the Members would approve, or otherwise not question, the implementation of the leveraged investment strategy in the clients' accounts. We agree with this position.

### **Suitability Assessment**

157. The panel in *Re Pretty*, Supra at paras 100-105, described the basic elements of the suitability obligation and its applicability to an Approved Person:

100. Turning to the suitability obligations, these have been considered in numerous cases which establish the basic elements of this obligation. Essentially, the suitability obligation entails using the information from the client to fulfil the Know-Your-Client obligation and using it to identify investment products and strategies appropriate in the light of the client's personal and financial circumstances.
101. The suitability obligation rests solely on the Approved Person and cannot be substituted, avoided or transferred to the client even by obtaining from the client acknowledgement that they are aware of negative material factors or risks.
102. The suitability obligation is a particularly important protection for clients whose investment experience and sophistication is insufficient to enable them to fully recognize or assess the risks inherent in an investment or strategy. Further, an investment product or strategy is not appropriate for a client unless the client has

the sophistication necessary to understand the risk, the willingness to accept the risk and the capacity to withstand the potential adverse consequences.

103. As well, an Approved Person must know what probability of loss is acceptable to the investor, i.e. the Approved Person must truly "know his client". While only foreseeable factors fall into suitability determination, it ought to be reasonably foreseeable to any investment advisor that there might, at any given time, be a market downturn that might prove to be of minor or major proportion and would impact, potentially substantially, the performance of an equity based mutual fund. Such an event would not necessarily be foreseeable to an investor.
104. These comments are all derived from a series of previous cases. See:

*Re Lamoureux*, Supra

*Re Daubney* 2008 LNONOSC 338

*Re Bilinski* 2002 LNBCSC I

*Re Gareau* 2001 LNOCRVCVM 53

*Rhoads v. Prudential-Bache Securities Canada Ltd.* 63 BCLR (2d) 256

105. The foregoing obligations apply to each and every client investment made through an Approved Person. However, in the case of leveraged investments, there are a number of additional considerations, such as:

- a) whether the client has sufficient income or unencumbered liquid assets to be able to:
  - i) withstand a market turndown without jeopardizing their financial security;
  - ii) satisfy all loan obligations associated with the strategy regardless of the performance of the investments purchased as a result of the strategy and without relying on anticipated income from the investments; and
- b) whether there is any reason to expect the client's current sources of income to be reduced in the short term bearing in mind the client's stage of life (age, anticipated retirement date), employment status and personal circumstances.

See *Daubney*, Supra; *Re Wealthstreet Inc.* 2011 LNABSC 290 at paras 135 and 136; and *Bilinski*, Supra

158. In order to establish the suitability of a leveraging strategy for the clients, prior to recommending such a strategy the Respondent was required to:

- i) perform the necessary due diligence to learn the essential KYC facts and information about the clients;
- ii) record accurate KYC information on the clients' account documents and investment loan application documents;
- iii) understand the operational features and risks of borrowing to invest in conjunction with the ROC mutual funds that he recommended that the clients purchase with the proceeds of the investment loans that he advised them to obtain;
- iv) understand the risks of the leveraging strategy that he recommended; and
- v) fully and adequately explain the risks, benefits, material assumptions, costs and features of a leveraged investment strategy to the clients such that they could understand, and did understand, all material risks associated with the strategy in order to enable them to make an informed decision as to whether or not to proceed with the strategy.

159. The Respondent presented himself to these 6 clients as a seasoned financial advisor who would help them pay down their mortgage at an accelerated pace; realize substantial tax benefits for them while at the same time allowing them to accumulate wealth, none of which happened. The evidence establishes that the Respondent's plan for these clients was to have them purchase mutual funds through excessive leveraging. However there was never a discussion as to how much to borrow, which lender to use, what investments to purchase, what the recommended asset allocation was, how DSC fees worked, or realistic return objectives taking into account each of these investor's investment knowledge, time horizon, and risk tolerance, all of which should have been discussed with his clients.

160. As was also apparent from his MFDA interview the Respondent himself did not understand the risks inherent in the leveraging strategy he proposed. He did not understand that when distributions are made, it could result in a decrease in the net asset value ("NAV") of the units of the fund (excluding market fluctuations), such that in a declining market, the strategy may not be sustainable. The Respondent relied on the flawed assumption that the unit value and the distributions would stay the same, and that the NAV would not decrease;

161. Notwithstanding that the Respondent recommended the Smith Manoeuvre to the clients, both in his verbal and written presentations, as Mr. Ford and the witnesses testified, the Respondent failed to advise, instruct or follow-up with these witnesses regarding the full implementation of the Smith Manoeuvre thus rendering many aspects of the strategy ineffective.

162. Based on the evidence given by the witnesses, it is clear that the Respondent also misrepresented, failed to adequately explain, or omitted to explain the risks, benefits, material assumptions, features, and costs of the leveraged investment strategy and its underlying investments that he recommended and implemented in the clients' accounts. Specifically the Respondent misrepresented, failed to fully or adequately explain, or omitted to explain the following:

- i) the definition and nature of an ROC mutual fund, including the nature of the distributions that the ROC mutual funds paid to investors as was apparent from the evidence given by almost all the clients that they understood they were receiving monthly "profits" generated by their investments;
- ii) that a substantial portion of the distributions paid to investors may consist of a return of the investors' own capital;
- iii) the risk that the funds might decline in value over time, particularly if the clients used their distributions to pay their investment loans, mortgages, or lines of credit, or for discretionary expenses instead of reinvesting the distributions;
- iv) the risk that if the funds declined in value, the clients might not be able to sell the funds to pay back the entirety of their investment loans or cover investment losses, and in any event, would incur fees if they were able to sell the funds;
- v) the risk that the funds might reduce, suspend, or cancel the monthly distributions, such that the clients would be forced to incur out-of-pocket expenses to make the payments on their investment loans and sustain the leveraged investment strategy; and
- vi) that the purported tax benefits might be subject to change, or just generally not be realized by a given client due to the client's income or other factors.

163. The clients testified that during his discussions with them, he focused on the positive aspects of the strategy and did not discuss all of the risks and potentially negative outcomes. While he appeared to have discussed some limited risks (for example, the possibility of interest rates rising), he seriously downplayed the likelihood of the risks materializing and also minimized the consequences for the clients were the risks to materialize referencing to some that they would only be in jeopardy if a similar situation like the stock market crash of the 1930's happened again.

164. During the course of recommending the leveraged investment strategy to the clients, the Respondent presented and relied on written illustrations and graphs that he presented to them, Exhibit A-22. These written illustrations and graphs were misleading in our opinion and it was obvious that the clients were clearly confused by them even during their testimony. The graphs in fact only showed positive financial outcomes and contained no substantial information regarding possible risks or downsides of the leveraged investment strategy.

165. The Respondent also created personalized spreadsheets, for some of the clients, Exhibits R-3, E-5. Again, these spreadsheets were misleading, as they predicted unrealistic outcomes that the clients relied upon as justification for continuing in the strategy. The Spreadsheets used illustrations and calculations which assumed specific rates for interest on the investment loan and the line of credit, the tax rate, the monthly distribution amount, and the price per unit of the investment, without disclosures alerting the client to the possibility of changes which could negatively impact the strategy.

166. The effect of the Respondent's misrepresentations and omissions, including on the documents he prepared and presented to the clients, were that they believed that:

- i) the leveraged investments they purchased would increase in value significantly while also generating a continuous monthly cash flow consisting of profits;
- ii) the strategy did not carry great risk, was suitable for them, and their investments would be secure and create great wealth; and
- iii) they would not have to incur any out-of-pocket expenses in order to implement and sustain the leveraged investment.

167. It appears clear from the evidence that the Respondent did not undertake a proper analysis of any of the three stages required to be carried out for FH, VC/MC, LE and CH/MB, in order to determine their suitability for the leveraged investment strategy he had these clients engaged in. None of these clients were sophisticated investors but for the most part were first time investors who had very little investing experience and who had certainly never borrowed to invest before. All testified the risks of the Smith Manoeuvre strategy were not explained to them by the Respondent such that they ever understood it.

168. We agree with Staff's submission that the evidence before us supports the fact that rather than first gathering the clients' KYC information, assessing their investment needs and interests, and then providing them with investment recommendations, he instead "matched" these clients to the leveraged investment strategy from the outset.

169. Rather than meeting with and asking questions of the clients and collecting their KYC information, including their goals and objectives, investment knowledge, and risk tolerance, before deciding on the appropriate investment strategy, the Respondent simply directed the clients to the Smith Manoeuvre he was promoting from the outset, and advised them that if they wished to invest in the strategy, they had to assume a 'medium-high' risk profile, as he admitted during his MFDA interview with Mr. Ford:

A. "Q. I want to talk to you now about the collection of KYC information, or Know Your Client information. When in the process that you described in dealing with clients would you collect the clients' KYC information and, more particular, meaning the types of information you were required, risk tolerance, level of knowledge, income, all of that?

A. Well, the financials I would have had upon doing an analysis, so I would have those documents. I'd have a very clear picture of what their net worth was, I'd have a very clear picture of what their time horizon was. I would explain to them that in our first and second meetings and third meetings -- I explained the strategy would require a medium to high risk tolerance and did they feel that that would be appropriate in their circumstance. So, either by information I had already gathered or specifically asking the questions as we go through the KYC.

Q. So, is it fair to say then that it was not a matter of addressing -- not a matter of assessing the clients' risk tolerance to determine what to recommend to them, it was more of make a

presentation to them and ask them, 'Okay, you need to be a medium to high risk tolerance for this work for you, and does that apply to you?'

A. That's correct."

170. For each investor, it was obvious he had only one strategy in mind, regardless of their situation, which was the "borrow to invest strategy". He pursued it with vigour, regardless of each client's situation and interest in the investments. As their financial advisor he knew or should have known of his client's potential for significant losses which ultimately did occur. It was not acceptable, as the Respondent attempted to elicit from Mr. Ford on cross-examination to promote a strategy to the clients before gathering their KYC information.

171. The excessive leveraging strategy recommended was entirely unsuitable for the clients based on the facts that:

- i) they did not have sufficient income or unencumbered liquid assets to be able to respond to any market downturns or other adverse changes, such as interest rate or tax treatment changes, or a decrease or cessation of their distributions;
- ii) for most of the clients, their homes were their main or only asset;
- iii) some of the clients were contemplating retirement or work reduction, or within a short amount of time of implementing the strategy became unable to work;
- iv) some of the clients, including LM, VC, MC, CH and MB, had never met with a financial advisor before meeting with the Respondent, and therefore, were at a disadvantage as to what to expect or ask of an advisor;
- v) the clients had very limited or no investing experience and, even those that had some experience, such as FH and GC, had previously had a 'hands off' approach, where they entrusted the advisor to guide their investing decisions and act in their best interest; and
- vi) the clients consistently advised the Respondent that they wanted low risk investments that would not cause them to ever have to go out of pocket.

172. The Respondent's recommendations were also unsuitable in that:

- (i) without any rationale for the amounts being sought, the Respondent focused on seeking the maximum number of loans for the maximum dollar values for the clients, and had all the loans established as interest only and with various lenders; and
- (ii) the Respondent invested 100% of the clients' portfolios in ROC mutual funds, with no explanation to the clients of choices of funds, which funds were being purchased, what allocations were being assigned, or what associated fees existed, for example DSC fees.

173. There is no evidence that the Respondent explained the risks to the clients of borrowing to invest generally, or of the leveraged investment strategy he recommended specifically. Rather the converse is true. The clients gave evidence (corroborated both by each other and the documents) that the Respondent focused on wealth accumulation, accelerating the rate at which one's mortgage would be paid down, tax benefits, high rates of return, and virtually disregarded or ignored the risks.

174. In light of the fact that the leveraging strategy that the Respondent recommended incorporated the use of ROC funds, the additional risks should have been taken into account by him and properly explained to the clients, including:

- i) the receipt by the investor of distributions from an ROC fund is not an indication that the investments are making a "profit" or a positive return because all or part of the distribution payments received may be comprised of return of capital (the money that the investor initially invested in the fund) rather than income or capital gains generated by the investments;
- ii) if underlying investments in the ROC fund do not generate a return that is equal to or greater than the distribution payments promised to the investor, the distributions will be paid via "return of capital" and will likely result in a decline in the NAV of the fund, which may then leave an insufficient amount of money available to the investor to repay their loans; and

- iii) in some cases, the sustainability of the fund may ultimately be jeopardized if the fund is committed to paying regular distributions even where the underlying investments held by the fund do not generate adequate returns to support such distributions.

175. The strategy was unsuitable for the clients due to the facts that:

- i) it was unsuitable considering their actual personal and financial circumstances;
- ii) the investment loans were excessive relative to their actual net worth;
- iii) the clients did not have the investment knowledge or experience to understand the nature and the risks of the strategy, and it was not explained sufficiently or at all to them;
- iv) borrowing to invest is already associated with some risk, and the risk was magnified based on the particulars of the strategy, including the purchase of ROC mutual funds.

176. The Respondent, being an Approved Person who was recommending a leveraging strategy, was expected to discuss with any client the basic risks inherent to this type of investing, as well as the following specific risks before having his clients engage in a leveraging strategy, including:

- i) potential magnification of losses when borrowing money, especially if the investment goes down;
- ii) the client always has to repay the loan;
- iii) explanation of margin call risk, where applicable;
- iv) the risk of interest rate changes, i.e. if interest rates go up, the cost of borrowing goes up, and the cost of the overall strategy goes up to clients as well; and
- v) the risks of investing in a ROC fund should be carefully discussed with clients including that the distributions could change, be cut, or cease altogether;
- vi) the effect of ROC when the markets are not doing well, and how that may affect their investment and the NAV; and
- vii) the potential tax issues in respect of ROC funds.

177. Mr. Ford testified that in his interviews with the clients (and as was also confirmed in their own evidence) it was not explained by the Respondent, and the clients did not understand that:

- i) there might be a return of their own capital;
- ii) there was a risk that the distributions would not be sustainable; and
- iii) there could be potential negative tax implications to using the strategy.

178. During his MFDA interview, the Respondent attempted to blame the market for the clients' outcomes, and denied any connection between their losses and the unsuitability of the leveraged investment strategy he was using in his clients' portfolios. This rationale was raised by the Respondent on a number of occasions during his cross-examination of the witnesses. Based on the evidence before us we give no weight to this suggestion.

179. On cross-examination of the witnesses the Respondent suggested that the clients themselves were partly to blame for their unsuitable investments and that they exercised some sort of wilful blindness and accepted the risks of the strategy as they were attracted by the opportunity to potentially make significant returns. As was stated in *Daubney*, Supra at para 210, "[w]hile investors are well advised to be cautious in choosing investments, [securities legislation] places the duty of care on the registrant, who is better placed to understand the risks and benefits of any particular investment product. That duty cannot be transferred to the client." In our opinion the evidence did not support the Respondent's allegations in this regard.

180. The Respondent also suggested both on cross-examination of some of the witnesses and in his closing argument that the actions by his former employer in terminating him, which the witnesses were given notice of, was the underlying reason for the complaints that were before the Panel. While it was clear from the evidence that he was dismissed, there was no evidence before the Panel that this fact had any bearing on any of the evidence we heard or received in this matter.

181. The Respondent seemed to at times suggest there was some sort of underlying conspiracy against him as a result of the actions of former employees of Keybase which had resulted in separate legal proceedings that the Respondent referred to during these proceedings. We heard no

specific evidence regarding this and put no weight on these arguments. We have assessed the Respondent's actions and the allegations solely on the evidence and testimony we heard from FH, VC/MC, LE, CH/MB, Mr. Ford and the documents entered in support of their evidence.

182. There is absolutely no evidence before the panel that the clients received suitable investment advice from the Respondent that they then disregarded. All testified that they followed his recommendations and advice and trusted him to help them with their investment decisions.

183. The performance of the market was not the underlying issue here, rather it was the unsuitable investment advice received by the clients from the Respondent. What is clear is that the risks associated with using the leveraged investing strategy were not adequately explained to the clients FH, VC/MC, LE, and CH/MB, such that they understood and accepted by the risks.

184. In the Panel's opinion the Respondent's answers given in his MFDA interview with Mr. Ford clearly support the MFDA's allegations on a number of points:

- i) Regarding FH, it was clear that the Respondent failed to implement the Smith Manoeuvre as he stated to Mr. Ford during his interview that he "dropped the ball" as all he did was apply for the investment loans and purchase the mutual funds. The steps of taking the excess distributions, paying down the loan, and re-advancing them back into the investments were never completed.
- ii) The Respondent relied on the unreasonable and flawed assumption that the unit value and the distributions would stay the same.
- iii) The Respondent did not fully turn his mind to all of the risks inherent to the strategy, and admitted this during his interview with Mr. Ford.

185. The Respondent admitted in his Reply that he matched the clients to the strategy rather than conducting an appropriate KYC information gathering process. In his Reply he pleaded: "I clearly stated at all times that in order to participate in this strategy client must be comfortable with a medium to high risk tolerance which these clients agreed to."

186. Accordingly we find that the evidence before us clearly establishes that on a balance of probabilities the Respondent failed to recommend suitable investments for the 6 clients referred to above and in any event based on the misrepresentations he recorded on the clients' KYC forms he could not have recommended suitable investments to them. Furthermore the investments he did recommend and had his clients invest in were entirely unsuitable for them. As a result we find that the allegations brought by the MFDA against the Respondent with respect to FH, VC/MC, LE and CH/MC have been proven.

**DATED** this 28<sup>th</sup> day of November, 2018.

“Edward W. Keyes”

---

Edward W. Keyes, QC  
Chair

“Ann C. Etter”

---

Ann C. Etter  
Industry Representative

“Robert Malcolm”

---

Robert Malcolm  
Industry Representative

DM 645681