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

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

Re: Joseph Daniel Laurie

Heard: August 18, 2015 in Halifax, Nova Scotia
Reasons for Decision: October 26, 2015

REASONS FOR DECISION

Hearing Panel of the Atlantic Regional Council:

Thomas J. Lockwood, Q.C.	Chair
John Maguire	Industry Representative
Susan Nixon	Industry Representative

Appearances:

Lyla Simon	)	For the Mutual Fund Dealers Association of Canada
Ron Chisholm	)	For the Respondent
Joseph Daniel Laurie	)	In Person

THE ALLEGATIONS

1. By Notice of Hearing, dated the March 10, 2014, , the following allegations were made against Joseph Daniel Laurie ("Respondent"):

(a) Allegation #1: Between 2005 and 2011, the Respondent misrepresented the know-your-client ("KYC") information on the account opening and loan application documents of 16 clients and failed to identify the accounts of two of those clients as leveraged, 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.

(b) Allegation #2: Between 2005 and 2011, 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 16 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.

(c) Allegation #3: Between 2005 and 2011, the Respondent recommended and facilitated the implementation of a leveraged investment strategy in the accounts of 16 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.

B. HISTORY OF PROCEEDINGS

2. The first appearance took place via teleconference on May 21, 2014, before a public representative acting on behalf of a Hearing Panel of the Atlantic Regional Council, pursuant to section 19.13(b) of MFDA By-law No. 1. A procedural Order was made. The Hearing on the Merits was scheduled to take place on January 12-16 and 19-23, 2015, in Nova Scotia, at a venue to be announced.

3. The Respondent served and filed a Reply to the Notice of Hearing, dated June 13, 2014.

4. On October 21, 2014, a second appearance took place via teleconference before a fully empaneled Hearing Panel, at which time Staff of the MFDA ("Staff") indicated an intention to amend the Notice of Hearing. After hearing submissions, the Hearing Panel vacated the January 2015 Hearing dates and scheduled the Hearing on the Merits to take place on June 1-5 and 8-12, 2015, in Nova Scotia, at a venue to be announced. A procedural Order was made with respect to, *inter alia*, the amendment of the Notice of Hearing.

5. On February 6, 2015, Staff of the MFDA served and filed an Amended Notice of Hearing. The amendment increased the number of clients purportedly affected by the alleged conduct of the Respondent from 16 to 25.

6. A third appearance took place via teleconference on March 20, 2015, at which time Counsel for the Respondent advised of a conflict of interest and sought the Hearing Panel's permission to withdraw.

7. A fourth appearance took place via teleconference on March 27, 2015, at which time submissions were made by Staff and the newly retained Counsel for the Respondent. A further procedural Order was made.

8. On April 16, 2015, the Respondent served and filed an *Amended* Reply to the *Amended* Notice of Hearing.

9. A fifth appearance took place via teleconference on April 21, 2015. After considering the submissions made by Staff and Counsel for the Respondent, the Hearing Panel vacated the June 2015 hearing dates and scheduled the Hearing on the Merits to take place on August 17-21, 2015, November 2-6 and 9-13, 2015 (except for November 11, 2015) at a specified location in Halifax, Nova Scotia.

10. On August 7, 2015, it was announced that the Hearing on the Merits would take place at the same specified location in Halifax, Nova Scotia, but only on August 18, 2015.

11. On August 11, 2015, a Settlement Agreement was entered into between Staff of the MFDA and the Respondent. On August 11, 2015, the MFDA announced that the Settlement Hearing would take place on August 18, 2015, at the location in Halifax, Nova Scotia, which had been previously designated for the Hearing on the Merits.

12. Rule 15.2(1) of the MFDA *Rules of Procedure* requires that there be at least 10 (ten) days' notice of the Settlement Hearing with the notice specifying:

(a) the date, time and place of the settlement hearing; and
(b) the purpose of the settlement hearing with sufficient information to identify the Member or person involved and the general nature of the allegations which are the subject matter of the settlement.

13. The notice issued by the MFDA, on August 11, 2015, clearly complied with the content provisions of Rule 15.2. It did not and could not comply with the time requirements, as the

Settlement Agreement was only executed on August 11, 2015, and the Settlement Hearing was scheduled for August 18, 2015.

14. The public, however, had been made aware in April of 2015 of the August hearing dates as well as the name of the Respondent and what Allegations were going to be considered by the Hearing Panel.

15. Rule 1.5(1)(b) of the *Rules of Procedure* permits the Hearing Panel to waive or vary any of the Rules "at any time, on such terms as it considers appropriate."

16. We are satisfied that the Settlement Hearing, which we conducted in Halifax on August 18, 2015, was properly convened.

C. THE SETTLEMENT HEARING

17. At the commencement of the Settlement Hearing, on August 18, 2015, the Hearing Panel granted a joint Motion by Counsel for Staff and the Respondent to move the proceedings "in camera" while we considered the Settlement Agreement, as well as the written and oral submissions for Staff and the oral submissions of the Respondent.

18. After a detailed review of the Settlement Agreement, as well as a consideration of the submissions of the parties, we concluded that it was in the public interest that the Settlement Agreement be accepted.

19. On August 18, 2015, the Hearing Panel executed an Order giving effect to the terms of the Settlement Agreement. At this time, we stated that we would provide written Reasons for our Decision. These are those Reasons.

D. THE SETTLEMENT AGREEMENT

20. The salient portions of the Settlement Agreement are as follows:

“AGREED FACTS

Registration History

7. From March 1, 2007 to present, the Respondent has been registered as a dealing representative (formerly referred to as a “mutual fund salesperson”) in Alberta, New Brunswick, Newfoundland and Labrador, Nova Scotia, Nunavut, Ontario, and Prince Edward Island with Keybase Financial Group Inc. (“Keybase”) a Member of the MFDA.

8. At the material times giving rise to the events described in this Settlement Agreement, the Respondent carried on business from Springhill, Nova Scotia.

9. From March 2005 to February 2007, the Respondent was registered as a mutual fund salesperson (now known as a “dealing representative”) in Alberta, New Brunswick, Newfoundland and Labrador, Nova Scotia, Ontario, and Prince Edward Island with Global Maxfin Investments Inc. (“Global Maxfin”), a Member of the MFDA.

10. From June 2003 to March 2005, the Respondent was registered as a mutual fund salesperson with Dundee Private Investors Inc., a Member of the MFDA.

11. From October 2001 to June 2003, the Respondent was registered as a mutual fund salesperson with Cartier Partners, formerly a Member of the MFDA.

12. Prior to October 2001, the Respondent was registered as a mutual fund salesperson with various mutual fund dealers.

13. From 1994 to present, the Respondent has also been licensed to sell insurance.

Overview

14. This settlement concerns the Respondent recommending and implementing a leveraged investment strategy in the accounts of 25 clients that was unsuitable for the clients having regard to their personal and financial circumstances, including their age, low investment risk tolerance, limited investment knowledge, and inability to make the payments on their investment loans in the event the leveraged investment strategy did not perform as the Respondent represented it would.

15. The leveraged investment strategy recommended by the Respondent was based on the premise that the investments purchased by the clients with their investment loans would generate sufficient returns to pay the clients' borrowing costs, as well as provide them with the ability to pay down their mortgages more 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. The Respondent did not adequately explain to the clients the risks inherent in using borrowed monies to invest generally, or the risks specific to the leveraged investment strategy he recommended.

16. Relying on the Respondent's recommendation, the clients borrowed far in excess of the amount they could reasonably afford to finance and invested the borrowed monies in return of capital mutual funds ("ROC mutual funds").

17. 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 the lenders would approve their investment loans and the Members would approve the implementation of the leveraged investment strategy in the clients' accounts.

18. By late 2008 or early 2009, the unit values of the ROC mutual funds purchased by the clients had declined and the distributions paid by the ROC mutual funds to investors were reduced. As a result, in some cases, the clients were unable to continue to make the payments on their investment loans using only the distributions they received from the ROC mutual funds. In all cases, the investment losses the clients incurred and the reduced distributions they received

from the ROC mutual funds jeopardized the financial security of the clients and caused them significant financial hardship.

The Leveraged Investment Strategy

19. In or about late 2005 to early 2006, while registered with Global Maxfin, the Respondent learned of a leveraged investment strategy that used ROC mutual funds.

20. The leveraged investment strategy that the Respondent subsequently recommended to his clients both at Global Maxfin and later at Keybase, involved the following steps:

(a) the Respondent would:

i. refer a client (or prospective client) to a mortgage broker or lender for the purposes of determining how much the lender was willing to lend the client and establishing a mortgage or a line of credit ("LOC") for the client in that amount; or

ii. have a client (or prospective client) referred to him from a mortgage broker, who had already established a mortgage or a LOC for the client (or prospective client);

(b) under either scenario, the mortgage broker/lender would determine the client's "available equity" based on an amount equal to at least 75% of the value of the client's home, less any debt owed on the home. The client would then take out a mortgage or LOC secured against the client's home in an amount generally equivalent to the client's "available equity";

(c) relying upon the Respondent's recommendation, the client used the proceeds from the mortgage or LOC to purchase investments for the client's account and, in many instances, to fund the client's portion of a 2:1 or 3:1 investment loan obtained from an

investment loan company.[1] Where the client utilized a 2:1 or 3:1 investment loan, the net effect was to significantly increase the total amount of money borrowed by the client above what the client otherwise qualified for based upon their "global limit" or "available equity";

(d) the Respondent recommended that the client's investment loan(s) be structured as an interest only loan(s) (as opposed to principal and interest loans) in order to reduce the client's monthly payment obligations. The Respondent also recommended that the clients apply for "no margin" loans[2], with margin loans only being taken out by a client if the lender required it for a particular client;

(e) the Respondent recommended that the clients invest all of the borrowed monies in ROC mutual funds, based on his opinion that they paid investors a regular income stream;

(f) the Respondent arranged for the distributions paid by the ROC mutual funds to be deposited in the client's bank account. The Respondent directed the client to use the distributions to make the monthly payments on their mortgage or LOC, as well as their investment loan(s), and, in some cases, to also make an accelerated (i.e. additional) payment on their mortgage. The Respondent advised the client that the client could treat any remaining cash as a supplementary source of income to be used for discretionary purposes; and

(g) the Respondent also recommended that the client purchase a life insurance policy from him using either their regular income or by using the distributions paid by the ROC mutual funds. The Respondent's rationale for this was that once the client's mortgage or LOC was paid off, the client would have the option of not paying down the principal on

[1] With a 2:1investment loan, a lending institution agrees to lend two dollars to a borrower for investment purposes for every one dollar the borrower contributes to the investment. For example, with a 2:1 loan, the client contributes $50,000 and the lending institution contributes $100,000. Similarly, with a 3:1 investment loan, a lending institution agrees to lend three dollars to a borrower for investment purposes for every one dollar the borrower contributes to the investment.

[2] A margin loan is a loan where the client is required to provide and maintain a specified amount of collateral, or "margin" in the account holding the investments.

their investment loan (i.e. the client could continue to pay only interest on the investment loan), allowing the client to carry the investment loan indefinitely while using the distributions received from the ROC mutual funds primarily for other purposes. When the client passed away, the proceeds from the life insurance policy would be applied to repay the investment loan.

Misrepresentation of Client Information

21. Between 2005 and 2011, the Respondent misrepresented the know-your-client information recorded on client's account opening and loan application documents by, among other things:

(a) misrepresenting the client's risk tolerance, investment knowledge, and time horizon;
(b) overstating the client's income; and
(c) overstating the client's assets and understating the client's liabilities.

a) Misrepresenting risk tolerance, investment knowledge, and time horizons

22. From 2005 to 2011, the Respondent "matched" 25 clients to the leveraged investment strategy he placed them in by populating virtually identical risk tolerances, investment knowledge levels, and time horizons on their account opening documents as follows:

#	Client	Risk Tolerance	Investment Knowledge	Time Horizon
1	HA	Medium	Good	10-20 years
2 & 3	B&C B	Medium-High	Good	11-20 years
4	JH	Medium-High	Good	11-20 years
5 & 6	AB & MDM	Medium-High	Good	11-20 years
7 & 8	K&S M	Medium-High	Good	11-20 years
9 & 10	P&B M	Medium-High	Good	10-20 years
11 & 12	A&E M	Medium-High	Good	11-20 years
13 & 14	B&B M	Medium-High	Good	10-20 years

#	Client	Risk Tolerance	Investment Knowledge	Time Horizon
15	CW	Medium-High	Good	11-20 years
16	NW	Medium-High	Good	11-20 years
17 & 18	H&R F	Medium-High	Good	10-20 years
19 & 20	S&N G	Medium-High	Good	11-20 years
21 & 22	C&P M	Medium-High	Good	11-20 years
23 & 24	A&C P	Medium-High	Good	11-20 years
25	JR	Medium-High	Good	20 years

23. The Respondent recorded the information on the clients' account opening documents at the time that he recommended the leveraged investment strategy to them when he knew or ought reasonably to have known that:

(a) all 25 clients had a far more modest tolerance than "medium-high", ranging from very low to medium and, based on the Respondent's misrepresentations, believed the leveraged investment strategy was low risk and secure;
(b) most of the clients had limited or no investment knowledge; and
(c) most of the clients had time horizons of less than 10 years, based on their age, health issues, and need for liquidity.

b) Overstating income

24. The Respondent overstated the income on the account opening and loan application documents of six clients who implemented the leveraged investment strategy in their accounts.

25. The Respondent recorded the inflated income information on the six clients' account opening and loan application documents when he knew or ought reasonably to have known that their actual incomes were materially less.

c) Overstating assets and understating liabilities

26. The Respondent overstated the assets and understated the liabilities (including in some instances not recording liabilities altogether) on the account opening and loan application documents of 19 clients who implemented the leveraged investment strategy in their accounts.

27. The Respondent misrepresented the 19 clients' assets and liabilities on their account opening and loan application documents when he knew or ought reasonably to have known that their actual assets and liabilities were materially different.

28. The Respondent failed to perform the necessary due diligence to learn the essential facts relative to each client or, if he did perform the necessary due diligence, he ignored, or failed to properly record, the information on the client's account opening and loan application documents.

29. The clients signed the account opening and loan application documents either prior to the Respondent populating the relevant know-your-client information on the documents or, if the clients signed the documents after the Respondent had populated the information on the documents, they did so relying on the Respondent's representations, express or implied, that he had populated the documents in a manner consistent with the information the clients had provided to him.

30. The Respondent did not review or explain the concepts (e.g. risk tolerance) and information required to be filled in on the account opening and loan application documents with the clients sufficiently or at all in order to ensure the clients understood the concepts and information, the importance of recording it accurately, and its relevance to determining whether the leveraged investment strategy was suitable for them.

31. As such, the Respondent presented a more favorable depiction of the clients' personal and financial circumstances to the Members and to the investment loan providers in a manner which increased the likelihood that the Members would not query or reject the leveraged investment

strategies recommended by the Respondent to the clients and the lender would approve the clients' investment loan applications.

Failure to Explain Leveraged Investment Strategy

32. From 2005 to 2011, the Respondent misrepresented, failed to fully and 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 accounts of 25 clients. In particular, the Respondent, at various times, misrepresented, failed to fully and adequately explain, or omitted to explain:

(a) the nature of the distributions that the ROC mutual funds paid to investors, that is, that the distributions represented *profits* generated by the ROC mutual funds, when in fact a substantial portion of the distributions paid to investors consisted of a return of the investors' own capital;

(b) the risk that the ROC mutual funds might decline in value over time, particularly if the clients used the distributions paid to them by the ROC mutual funds to pay their investment loans, mortgages or LOC or for discretionary expenses instead of reinvesting the distributions;

(c) the risk that if the ROC mutual funds declined in value, the clients might not be able to sell the ROC mutual funds to pay back the entirety of their investment loans or cover investment losses; and

(d) the risk that the ROC mutual funds might reduce, suspend or cancel altogether the distributions paid to investors due to declining market conditions, poor investment performance or other factors, 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.

33. During the course of recommending the leveraged investment strategy to the clients, the Respondent created and provided hand drawn illustrations entitled "Summary" to some or all the clients which variously identified the following potential expected outcomes of the leveraged investment strategy as:

(a) "excess money";
(b) "free money"; or
(c) "income".

34. During the course of recommending the leveraged investment strategy to the clients, the Respondent created and provided spreadsheets ("Spreadsheets") to some or all the clients that showed only positive financial outcomes, and did not contain any information regarding possible risks or downsides of the leveraged investment strategy, including investment losses, and/or the possibility that the clients would be paid distributions by the ROC mutual funds that would be insufficient to cover the costs of servicing their investment loans.

35. The Respondent did not present the leveraged investment strategy in the Summaries and Spreadsheets he provided to the clients in a fair and balanced manner. The Respondent failed to include performance projections based on more conservative rates of return or declining market conditions, including a negative rate of return (i.e. investment losses), which would have demonstrated to the clients the potential range of outcomes that might arise if they chose to implement the leveraged investment strategy and in particular, the consequences if the leveraged investment strategy did not generate distributions sufficient to cover the clients' costs of servicing their investment loans.

36. During his discussions with clients, the Respondent focused on the positive aspects of the leveraged investment strategy and did not disclose or discuss all of the attendant risks and potentially negative outcomes. The Respondent either did not disclose and discuss the likelihood of any risks materializing, or if he did discuss such risks and the likelihood of the risks materializing, he did so in a manner that downplayed the likelihood of the risks arising and the potential consequences for the clients if the risks did materialize.

37. As a result of the Respondent's misrepresentations and omissions, including the Summaries and Spreadsheets he prepared and provided to the clients, the clients believed that:

(a) the leveraged investments they purchased would increase in value significantly while also generating a continuous monthly cash flow;
(b) the leveraged investment strategy was low risk and their investments were secure; and
(c) they would not have to incur any out-of-pocket expenses in order to implement and maintain the leveraged investment strategy in their accounts.

Unsuitable Leveraging Recommendations

38. From 2005 to 2011, the leveraged investment strategy that the Respondent recommended and implemented in the accounts of 25 clients was not suitable and appropriate for the clients having regard to the clients' "know-your-client" information and financial circumstances including, in particular:

(a) the ability of the clients to afford the costs associated with the investment loans, regardless of the performance of the investments and without relying on anticipated income or gains from the investments;
(b) the ability of the clients to withstand investment losses without jeopardizing their financial security if the leverage investment strategy did not perform as represented; and
(c) the clients':

(a) age;
(b) risk tolerance;
(c) investment knowledge;
(d) net worth;
(e) employment status (most of the clients were retired and/or on fixed or limited incomes);

(f) health issues; and

(g) investment time horizons.

39. The 25 clients borrowed between $50,000 and $1,260,000 each, resulting in excessive loan-to-net-worth ratios[3]. After receiving the investment loans, 22 of the 25 clients had loan-to-net-worth ratios of at least approximately 50% to 150% as follows:

#	Client	Est. Age at Time of Loan	Date of Loan	Amount Borrowed	Loan to Net Worth Ratio
1	HA	53	2011	$485,000	31%
2 & 3	B&C B	46 & 37	2007	$148,000	75%
4	JH	68	January 2008	$440,000	51%
	JH	68	2009	$140,000	61%
5 & 6	AB & MDM	71 & 65	July 2005	$504,000	--
	AB & MDM	74 & 68	2008	$50,000	70%
7 & 8	K&S M	Both 61	January 2007	$750,000	--
	K&S M	Both 61	April 2007	$1,000,000	150%
9 & 10	P&B M	Both 71	2008	$450,000	93%
11 & 12	A&E M	52 & 51	2005	$320,671	--
	A&E M	52 & 51	2006	$617,500	87%
13 & 14	B&B M	50 & 48	2008	$140,000	41%
15	CW	58	October 2007	$850,000	61%
16	NW	44	2006 & 2007	$523,000	Est. 50%+
17 & 18	H&R F	41 & 42	July 2008	$152,000	69%
19 & 20	S&N G	60 & 62	2005	$140,000	Est. 140%
21 & 22	C&P M	49 & 48	May 2007	$280,000	--
	C&P M		July 2007	$30,000	--

[3] The loan to net worth ratios are excessive based on the clients' net worth calculated using the information recorded on the clients' KYC's. However, if the clients' loan to net worth ratios are calculated based on their actual net worth (as reported by the clients), the loan to net worth ratios are generally even higher, making the leveraged investment strategy even more unsuitable.

#	Client	Est. Age at Time of Loan	Date of Loan	Amount Borrowed	Loan to Net Worth Ratio
	C&P M		October 2007	$30,000	--
	C&P M		March 2008	$30,000	112%
23 & 24	A&C P	48 & 53	January 2007	$585,000	--
	A&C P		April 2007	$195,000	--
	A&C P		June 2007	$75,000	--
	A&C P		September 2007	$120,000	--
	A&C P		November 2007	$150,000	--
	A&C P		March 2008	$135,000	78%
25	JR	42	June 2008	$141,606	__

40. The Respondent knew, or ought to have known, that the investment loans were excessive having regard to the resulting debt servicing obligations that would be imposed on the clients and the potential for the client's obligation to repay the investment loans to erase a substantial portion, and potentially all, of the clients' net worth in the event the strategy did not perform as the Respondent represented it would.

41. All 25 of the clients who implemented the leveraged investment strategy were relying entirely upon the distributions generated by the ROC mutual funds to pay all of the costs of servicing their investment loans. Many of the clients were retired seniors or individuals living on fixed or limited incomes. Some of the clients were in poor health such that they had limited capacity to earn income, or limited to no opportunity to re-enter the work force should it be necessary to earn additional employment income. Many, if not all, of the clients did not have the means to cover the costs of servicing the investment loans in the event the leveraged investment strategy did not perform as the Respondent represented it would.

42. Most of the clients had limited or no investment knowledge, such that they were incapable of understanding and appreciating the potential risks of the leveraged investment strategy before

agreeing to implement it in their accounts. The Respondent exacerbated the effect of the clients' limited investment knowledge by leading the clients to believe, through his representations and omissions, that the leveraged investment strategy was a safe and secure manner of investing.

43. Most of the clients had investment risk tolerances ranging from very low to medium, at best, such that the leveraged investment strategy generally exceeded the level of risk that the clients were willing to assume, had they understood and appreciated the true risks of the strategy.

44. Most of the clients had investment time horizons of less than 10 years, based on their age, health issues, and need for liquidity, such that the leveraged investment strategy exceeded the investment time horizon of those clients.

45. As a result of implementing the leveraged investment strategy, almost all of the clients incurred significant investment losses attributable to both a decline in the value of the ROC mutual funds they purchased and a reduction in the distributions paid by the ROC mutual funds to investors (which required the clients to draw on other sources of assets or income to sustain the leveraged investment strategy).

Additional Factors

46. The Respondent is 59 years old, and has worked in the financial services industry for his whole career.

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

48. The Respondent has cooperated with Staff throughout the course of Staff's investigation and these proceedings.

49. By entering into this Settlement Agreement, the Respondent has saved the MFDA significant time and resources associated with conducting a fully contested hearing on the merits.

50. The Respondent states that he has errors and omissions insurance coverage, which is serving to respond to claims that have been commenced by clients with financial losses in this matter.

51. The Respondent has expressed remorse for his actions.

CONTRAVENTIONS

52. The Respondent admits that:

(a) between 2005 and 2011, he misrepresented the know-your-client information on the account opening and loan application documents of 25 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;

(b) between 2005 and 2011, he 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 25 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; and

(c) between 2005 and 2011, he recommended and facilitated the implementation of a leveraged investment strategy in the accounts of 25 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.

TERMS OF SETTLEMENT

53. The Respondent agrees to the following terms of settlement:

(a) the Respondent shall be suspended from conducting securities related business in any capacity while in the employ of or associated with any MFDA Member for a period of 2½ years (30 months) commencing from the date of the final Order herein, pursuant to s. 24.1.1(c) of MFDA By-law No. 1;

(b) the Respondent shall be permanently prohibited from engaging in any leveraging activities with clients, including recommending or applying for investment loans for clients, pursuant to s. 24.1.1(f) of MFDA By-law No. 1;

(c) the Respondent shall pay a fine in the amount of $40,000, pursuant to s. 24.1.1(b) of MFDA By-law No. 1;

(d) the Respondent shall pay costs in the amount of $10,000, pursuant to s. 24.2 of MFDA By-law No. 1;

(e) the Respondent shall in the future comply with MFDA Rules 2.2.1 and 2.1.1; and

(f) the Respondent shall attend in person at the Settlement Hearing.**"**

E. THE LAW RELATING TO SETTLEMENT AGREEMENTS

21. Section 24.4.3 of MFDA By-law No. 1 provides the Hearing Panel with only two options when considering a Settlement Agreement. The Panel must either accept or reject the Settlement Agreement. It does not have the power to modify or vary any part of it.

22. In a contested hearing, the Hearing Panel strives to impose the correct penalty in light of the evidence adduced before it. In a Settlement Hearing, the Hearing Panel should not reject the settlement unless it views the penalty sought to be imposed as clearly falling outside a "reasonable range of appropriateness".

Re: *Milewski (Re)*, [1999] I.D.A.C.D. No. 17 at p. 11, Ontario District Council Decision, dated July 28, 1999.

23. Settlements do assist the MFDA in fulfilling its regulatory objective of protecting the public. They advance this objective by proscribing activities which are harmful to the public, while enabling the parties to reach a flexible remedy to address the interests of both the regulator and the Respondent.

Re: *British Columbia Securities Commission v. Seifert*, 2007 B.C.C.A. 484 at para. 31.

24. Past MFDA Hearing Panels have set out a number of considerations which should be taken into account when determining whether a proposed settlement should be accepted. These include:

(a) whether acceptance of the settlement agreement would be in the public interest and whether the penalty imposed will protect investors;
(b) whether the settlement agreement is reasonable and proportionate, having regard to the conduct of the Respondent as set out in the settlement agreement;
(c) whether the settlement agreement addresses the issues of both specific and general deterrence;
(d) whether the proposed settlement will prevent the type of conduct described in the settlement agreement from occurring again in the future;
(e) whether the settlement agreement will foster confidence in the integrity of the Canadian capital markets;
(f) whether the settlement agreement will foster confidence in the integrity of the MFDA; and

(g) whether the settlement agreement will foster confidence in the regulatory process itself.

Re: *Snyder (Re),* 2015 LNCMFDA 15, Decision of the Atlantic Regional Council, dated March 13, 2015, at para. 20.

25. Past MFDA Hearing Panels have also delineated a number of factors which should be considered when determining whether a proposed penalty is appropriate. These include:

(a) the seriousness of the allegations proved against the respondent;
(b) the respondent's past conduct, including prior sanctions;
(c) the respondent's experience and level of activity in the capital markets;
(d) whether the respondent recognizes the seriousness of the improper activity;
(e) the harm suffered by investors as a result of the respondent's activities;
(f) the benefits received by the respondent as a result of the improper activity;
(g) the risk to investors and the capital markets in the jurisdiction, were the respondent to continue to operate in capital markets in the jurisdiction;
(h) the damage caused to the integrity of the capital markets in the jurisdiction by the respondent's improper activities;
(i) the need to deter not only those involved in the case being considered, but also any others who participate in the capital markets, from engaging in similar improper activity;
(j) the need to alert others to the consequences of inappropriate activities to those who are permitted to participate in the capital markets; and
(k) previous decisions made in similar circumstances.

Re: *Headley (Re)*, 2006 LNCMFDA 3, at para. 85.

26. The MFDA Penalty Guidelines, while not mandatory, are an additional source which Hearing Panels can refer to in determining the appropriateness of the proposed penalties.

F. CONSIDERATIONS IN THE PRESENT CASE

(i) Nature of Misconduct

27. MFDA Rule 2.2.1 (in force at the relevant period of time) states, in part, as follows:

> 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; and
> (c) 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; and
> (d) to ensure that, notwithstanding the provisions of paragraph (c), where a transaction proposed by a client is not suitable for the client and in keeping with the client's investment objectives, the Member has so advised the client before execution thereof.

28. This Rule codified the "Know-Your-Client" and "suitability" obligations recognized by securities regulators. In E.A. Manning Ltd. et al (Re), the Ontario Securities Commission held that "these requirements are an essential component of the consumer protection scheme of the Act and a basic obligation of a registrant, and a course of conduct by a registrant involving the failure to comply with them is an extremely serious matter."

Re: *E.A. Manning Ltd. et al (Re)*, 1995 LNONOSC 377 (OSC) at p. 30.

29. In Lamoureux (Re) [2001] A.S.C.D. No. 613 at p. 11, the Alberta Securities Commission stated that:

> "The "know your client" and "suitability" objectives 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 on 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."

30. In Lamoureux, the Alberta Securities Commission indicated that suitability must be assessed prior to any investment recommendation to a client. It set out the following sequential, three-stage process:

(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.

Re: *Lamoureux* at pp 16-17.

31. This three-stage approach has been followed in numerous subsequent decisions including:

(a) *Daubney (Re)*, 2008 LNONOSC 338 (Ontario Securities Commission).

(b) *De Vuono*, 2012 LNCMFDA 103, Decision of the Pacific Regional Council.

32. MFDA Staff Notice 0069 provides guidance to both Members and Approved Persons on how to establish a suitability framework. One of the basic elements of this framework is that Members and Approved Persons must obtain and maintain complete, timely and accurate know your client information. Without this information, a determination cannot be made as to whether a recommendation is suitable for a client.

33. In the present case, the Respondent admitted that, between 2005 and 2011, he misrepresented the know your client information on the account opening and loan application documents of 25 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.

34. It is also clear that when an Approved Person recommends a leveraging strategy, there is an obligation to properly explain all of the material risks of the strategy. It is critical that the client understands the risk of borrowing monies to invest given that leveraging can magnify the losses suffered by the client.

> Re: *Mytting (Re)*, 2012 LNIIROC 45.
> Re: *Daubney*, at para. 25.

35. Here the Respondent admitted that, between 2005 and 2011, he 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 25 clients, 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.

36. In Lamoureux, it was stated that:

> "The suitability of an investment product for any prospective investor will be determined to a large measure by comparison of the risks associated with the investment product with the risk profile of the investor. This comparison is probably the most critical element in the registrant's suitability obligation."
>
> *Lamoreux* at p. 18.

37. The Respondent before us admitted that, between 2005 and 2011, he recommended and facilitated the implementation of a leveraged investment strategy in the accounts of 25 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.

38. In our view, the misconduct admitted to by the Respondent is serious. It involved 25 clients and occurred over a significant period of time.

ii) Client Harm

39. The clients, collectively, applied for and borrowed over $8 million in order to implement the leveraged investment strategy recommended by the Respondent. They incurred significant investment losses.

40. In the Settlement Agreement, the Respondent states that:

> "he has errors and omissions insurance, which is serving to respond to claims that have been commenced by clients with financial losses in this matter."

iii) Benefits Received by the Respondent

41. By borrowing to invest, based on the Respondent's recommendations, the clients increased the amount of monies invested in mutual funds, which had the effect of generating additional sales commissions or other payments, thereby benefitting the Respondent financially.

iv) Deterrence

42. It is the position of Staff that the proposed penalties and costs will serve the goals of both specific and general deterrence.

v) The Respondent's Past Conduct

43. The Respondent is 59 years of age and has spent his entire career in the financial services industry. He has not been the subject of any previous MFDA disciplinary proceedings. In our

view, this was a strong mitigating factor when we were considering the appropriateness of the proposed penalty.

vi) The Respondent's Recognition of the Seriousness of his Misconduct

44. In his appearance before us, the Respondent expressed extreme remorse for his actions.

45. Another mitigating factor on the issue of penalty is that the Respondent accepted responsibility for his misconduct by entering into this Settlement Agreement. This avoided the necessity of the MFDA conducting a full Disciplinary Hearing with its attendant expenditure of time and resources.

vii) Penalty Guidelines

46. Staff provided the Hearing Panel with excerpts from the Penalty Guidelines dealing with breaches of MFDA Rule 2.2.1 and 2.1.1. While stressing that the Guidelines were not mandatory, Staff submitted that the proposed penalties are consistent with them. We agree.

viii) Previous Decisions Made in Similar Circumstances

47. Staff submitted that this is only the second MFDA proceeding involving a settlement where an Approved Person failed to adequately explain the risks and benefits of a leveraged investment strategy to clients, failed to meet the know your client obligations and made unsuitable leveraging recommendations. The first case was Snyder (Re), *supra*, a 2015 Decision of the Atlantic Regional Council. While there were differences in the penalties proposed, the cases were similar to each other.

48. Staff did concede that there are Decisions involving breaches of suitability and know your client requirements, which were not resolved by way of a settlement agreement, where harsher penalties were imposed by MFDA Hearing Panels. Staff submitted that the settlement process inherently involves negotiation and compromise and the penalty imposed following a settlement hearing will typically be less onerous. We agree with this submission.

49. We were provided with a comprehensive chart setting out the relevant facts, the amount of leverage, the type of hearing and the Hearing Panels' Decisions. In addition to Snyder, these cases included:

(a) *Gragasin*, 2014 LNCMFDA 44, Decision of the Prairie Regional Council, dated July 9, 2014.

(b) *Sobrevilla*, MFDA Case No. 201351, Decision of the Prairie Regional Council, dated July 9, 2014.

(c) *Sulkers*, 2014 LNCMFDA 46, Decision of the Prairie Regional Council, dated July 9, 2014.

(d) *Sarker*, 2014 LNCMFDA 17, Decision of the Central Regional Council, dated February 28, 2014.

(e) *Pretty*, 2014 LNCMFDA 6 (Misconduct), Decision of the Atlantic Regional Council, dated January 30, 2014, and 2014 LNCMFDA 56 (Penalty), Decision of the Atlantic Regional Council, dated July 2, 2014.

(f) *DeVuono*, 2012 LNCMFDA 103 (Misconduct), Decision of the Pacific Regional Council, dated November 22, 2012, and MFDA 2013 LNCMFDA 34 (Penalty), Decision of the Pacific Regional Council, dated May 27, 2013.

(g) *Arseneau*, 2012 LNCMFDA 93, Decision of the Atlantic Regional Council, dated September 28, 2012.

(h) *Mytting*, 2012 IIROC 45, Decision of the Pacific District Council, dated July 30, 2012.

(i) *Gareau*, 2011 LNIIROC 53 (Misconduct), Decision of the Saskatchewan District Council, dated September 26, 2011, and 2011 LNIIROC 72 (Penalty), Decision of the Saskatchewan District Council, dated January 2, 2012.

(j) *Harding*, 2011 IIROC 65, Decision of the Ontario District Council, dated December 16, 2011.

50. As in Snyder, the admitted circumstances of this case show the disastrous results which can occur by the failure of an Approved Person to follow the dictates of MFDA Rule 2.2.1.

51. As indicated above, the Respondent engaged in serious misconduct. Were it not for the enumerated mitigating factors, we would have been inclined to impose harsher penalties.

G. DECISION

52. After a detailed consideration of the Settlement Agreement, the applicable law, as well as the factors specific to this Respondent, we concluded that it was in the public interest that this Settlement Agreement be accepted.

H. PENALTIES IMPOSED

53. As a result of the acceptance of the Settlement Agreement, the following penalties were imposed upon the Respondent:

(a) the Respondent shall be suspended from conducting securities related business in any capacity while in the employ of or associated with any MFDA Member for a period of 2 ½ years (30 months) commencing from the date of the final Order herein, pursuant to s. 24.1.1(c) of MFDA By-law No. 1;

(b) the Respondent shall be permanently prohibited from engaging in any leveraging activities with clients, including recommending or applying for investment loans for clients, pursuant to s. 24.1.1(f) of MFDA By-law No. 1;

(c) the Respondent shall pay a fine in the amount of $40,000, pursuant to s. 24.1.1(b) of MFDA By-law No. 1;

(d) the Respondent shall pay costs in the amount of $10,000, pursuant to s. 24.2 of MFDA By-law No. 1;

(e) the Respondent shall in the future comply with MFDA Rules 2.2.1 and 2.1.1; and

(f) if at any time a non-party to this proceeding requests production of, or access to, any materials filed in, or the record of this proceeding, including all exhibits and transcripts, the MFDA Corporate Secretary shall not provide copies of, or access to, the requested documents to the non-party without first redacting from them

any and all intimate financial or personal information, pursuant to Rules 1.8(2) and (5) of the MFDA *Rules of Procedure.*

DATED this 26th day of October, 2015.

"Thomas J. Lockwood"

Thomas J. Lockwood, Q.C.
Chair

"John Maguire"

John Maguire
Industry Representative

"Susan Nixon"

Susan Nixon
Industry Representative

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