

Re Liu

IN THE MATTER OF:

The Mutual Fund Dealer Rules

and

Zinan Liu

2023 CIRO 36

Heard: January 23, 2023 by electronic hearing in Vancouver, British Columbia

Decision: January 23, 2023

Reasons for Decision: December 8, 2023

Hearing Panel:

Joseph A. Bernardo, Chair

Barbara Fraser, Industry Representative

Guenter Kleberg, Industry Representative

Appearances:

Justin Dunphy, Senior Enforcement Counsel for CIRO

Nicole Chang, Counsel for the Respondent

Zinan Liu, Respondent

REASONS FOR DECISION

¶ 1 On January 1, 2023, the Mutual Fund Dealer's Association (MFDA) and the Investment Industry Regulatory Organization of Canada merged to form a new self-regulatory organization, which subsequently adopted the name and is now known as the Canadian Investment Regulatory Organization (CIRO).

¶ 2 Under CIRO's transitional provisions, the conduct addressed by these reasons remains subject to the rules and bylaws of the MFDA that were in force at the time the conduct occurred.

Overview

¶ 3 The Respondent was registered as a dealing representative with CIBC Securities Inc. (CIBC), a Member of the MFDA.

¶ 4 On December 22, 2021, the staff of the MFDA (Staff) issued a Notice of Hearing alleging that:

- (a) between May 2018 and February 2020, the Respondent engaged in personal financial dealings with clients that gave rise to a conflict or potential conflict of interest she failed to address as required, contrary to MFDA Rules 2.1.4 and 2.1.1;
- (b) between January 2018 and February 2020, the Respondent engaged in unapproved outside activities, contrary to CIBC's policies and procedures and MFDA Rules 1.3, 2.1.1, 2.5.1, and 1.1.2; and
- (c) in or about January 2019, the Respondent made false representations to CIBC, contrary to MFDA Rule 2.1.1.

¶ 5 An electronic disciplinary hearing concerning these allegations was held on January 23, 2023. At the commencement of the hearing the parties submitted an agreed statement of facts (ASF), which is attached as

Appendix A.

¶ 6 After receiving submissions from both parties, the Hearing Panel ordered sanctions against the Respondent. The Order is attached as Appendix B.

¶ 7 These are the reasons for the Panel's decision.

Evidence

¶ 8 In the ASF, the Respondent admitted the contraventions alleged in the Notice of Hearing on the basis of the following material facts:

- (a) In January 2015, the Respondent became registered as a dealing representative with CIBC, subsequent to which she conducted business in Burnaby, British Columbia.
- (b) The Respondent serviced the accounts of Clients A, B, C, and JH.
 - i) These clients were all close friends the Respondent had known prior to assuming responsibility for servicing their accounts.
 - ii) Client A had been a friend since the 1990s, before the Respondent had become registered with the MFDA.
 - iii) Client JH was an Approved Person and colleague who worked out of the same branch as the Respondent, and had been her friend prior to Client JH's registration with CIBC.
- (c) CIBC's policies and procedures prohibited Approved Persons from borrowing from clients and, also, required them to seek CIBC's approval prior to engaging in outside business activities.

Client Loan

¶ 9 In or around October 2018, the Respondent borrowed \$105,000 from Client A to use towards the Respondent's purchase of her family home. The loan was undocumented and interest free. The Respondent repaid the loan several months later, sometime around February 2019.

¶ 10 The Respondent did not disclose the loan to CIBC.

¶ 11 Client A did not register a complaint about the loan arrangement with either CIBC or the MFDA, and there is no evidence of any adverse consequences to the client.

Outside business

¶ 12 Client JH asked the Respondent to invest in a daycare business in Burnaby.

¶ 13 In 2018, the Respondent, Clients B and C, and Client JH each contributed funds to establish the business. Client JH contributed \$87,175 and Clients B and C collectively contributed \$67,996. The Respondent contributed \$17,435, which was deposited into Client JH's personal bank account.

¶ 14 The Respondent's contribution was proportional to her 10% beneficial interest in the business, which was held by a company formed by her for that purpose. She was the sole director and shareholder of the company. Client JH, and Clients B and C held beneficial interests in the business of 51%, and 29% and 10%, respectively.

¶ 15 The Respondent did not disclose to CIBC either her participation in the daycare business or that she had formed and controlled a corporation for business purposes.

¶ 16 As of February, 2020, the Respondent has not derived any revenue from the daycare business.

¶ 17 Clients B and C have not registered a complaint about the Respondent's role in the business, and there is no evidence they have suffered a financial loss by investing in it.

¶ 18 Beginning in October 2018, the Respondent began to receive rental income generated by her family home and another property registered in her spouse's name.

¶ 19 The Respondent did not disclose to CIBC that she was engaged in outside business in her capacity as a

recipient of real estate rental income.

Attestation

¶ 20 CIBC required the Respondent to complete an annual attestation that confirmed she had sought and obtained CIBC's approval for any outside business activity conducted by her.

¶ 21 In January 2019, the Respondent submitted her annual attestation even though she had failed to notify CIBC and obtain its consent regarding her involvement in the daycare business and receipt of rental income. She did not understand at the time that she was required to do so.

Other

¶ 22 In February 2020, CIBC terminated the Respondent's registration and since that time she has not been registered in the securities industry in any capacity.

¶ 23 The Respondent has not previously been the subject of MFDA disciplinary proceedings, and cooperated with the MFDA's investigation.

Liability

¶ 24 An Approved Person is required by MFDA Rule 2.1.1 to observe high ethical standards, which includes refraining from business conduct that is unbecoming or detrimental to the public interest.

¶ 25 This general ethical obligation overlaps with the more specific requirements the Rules impose on an Approved Person. For present purposes, the relevant Rules are these:

- (a) Rule 2.1.4 (as it was prior to its amendment on June 30, 2021), which obligates an Approved Person who becomes aware of any conflict or potential conflict of interest to immediately disclose it to their employing Member, whereupon they are jointly required to inform the client in writing and address the issue by exercising responsible business judgment influenced only by the best interests of the client.
- (b) Rule 1.3, which prohibits an Approved Person from carrying on any business outside of their employment duties without their employing Member's prior written approval.
- (c) Rules 1.1.2 and 2.5.1, which obligate an Approved Person to follow their employing Member's supervisory policies and procedures.

¶ 26 As an Approved Person, the Respondent was under an obligation to be aware of these Rules. She was also required to know about and take seriously the MFDA's guidance regarding personal financial dealings with clients.

¶ 27 MFDA Staff Notice #MSN-0047 issued on October 3, 2005 explicitly states that borrowing from a client places an Approved Person in a significant and direct conflict of interest. It also states that any kind of outside business arrangement with clients has the potential to create a conflict of interest.

¶ 28 By entering into the ASF, the Respondent unambiguously acknowledged the facts, and expressly accepted liability for the contraventions alleged, in the Notice of Hearing.

Sanction analysis

¶ 29 The only substantive issue before the Panel, therefore, was to decide what consequences the Respondent should face as a result of her misconduct.

Deterrence

¶ 30 The essential purpose of securities legislation is to establish a comprehensive regulatory framework that protects the investing public. As a component of this framework MFDA, and now CIRO, enforcement proceedings are required to be forward looking, which is to say preventative and not retrospective or punitive in orientation. A hearing panel's sanction decision must be based in a rationally defensible determination that the sanctions will serve to prevent future harm. In making this determination, general deterrence is a critical consideration.

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

Cartaway Resources Corp. (Re), [2004] 1 S.C.R. 672 at para. 61.

¶ 31 The degree to which general deterrence deserves to be emphasized in a sanction decision turns on the circumstances of the case. To be reasonable, a penalty must be supported by analysis that establishes it as proportional to the misconduct.

Cartaway, supra, at para. 64.

Submissions of the parties

¶ 32 Senior Enforcement Counsel on behalf of Staff acknowledged that none of the clients had sustained financial losses and were all friends of the Respondent, and that by entering into the ASF the Respondent had accepted responsibility for her misconduct, demonstrated remorse, and spared CIRO the time and expense of a fully contested disciplinary hearing. Nonetheless, in Staff's submission any failure by an Approved Person to properly address conflicts of interest and personal financial dealings with clients is by definition serious misconduct that requires a firm deterrent response.

¶ 33 Given the nature of the infractions, counsel submitted that the following sanctions would be appropriate:

- (a) a suspension of at least five years;
- (b) a fine of at least \$25,000; and
- (c) an order for costs of \$5,000, which was supported by a bill that evidenced over double that amount in actual incurred costs.

¶ 34 Against this, defence counsel submitted the Respondent's misconduct had arisen from an honest but mistaken misunderstanding about the scope of her disclosure obligations regarding personal financial dealings with individuals who had been longstanding friends before becoming clients. While this did not excuse the misconduct, it justified giving significant weight to the genuine remorse the Respondent had demonstrated by choosing to admit her liability without qualification. In light of these considerations, counsel argued that the five year prohibition sought by Staff was excessive and would effectively amount to an unreasonable termination of the Respondent's career.

¶ 35 In defence counsel's submission, the Respondent's misconduct when seen in its proper context should attract relatively lenient sanctions:

- (a) a suspension of one month;
- (b) a fine of \$10,000; and
- (c) an order for costs of \$2,500.

¶ 36 Staff referenced the following sanction precedents to support its position:

Boker (Re), 2022 LNCMFDA 37.

Hsu (Re), 2022 LNCMFDA 139.

Rahman (Re), 2021 LNCMFDA 75.

Luong Dao (Re), 2021 LNCMFDA 43.

Notis (Re), 2019 LNCMFDA 193.

Chang (Re), MFDA File No. 2016106, January 5, 2018.

¶ 37 Defence counsel relied on the following sanction decisions:

Wolfenden (Re), 2017 CanLII 83862 (CA MFDAC).

Kendrick (Re), 2018 CanLII 65335 (CA MFDAC).

Greigson (Re), 2019, MFDA File No. 201884, February 27, 2019.

Vu (Re), 2019 CanLII 122236 (CA MFDAC).

¶ 38 Each counsel critiqued the cases cited by the other as distinguishable from the present case. As Senior Enforcement Counsel observed in the course of his remarks, there do not appear previous MFDA sanction decisions where the circumstances can be said to be genuinely analogous to those of the present case.

¶ 39 In the cases relied upon by Staff, the sanctions included suspensions that ranged from four to seven years, fines ranging between \$20,000 to \$35,000, and costs orders of \$5,000 (except in *Luong Dao, supra*, where a permanent prohibition was ordered, the fine was in the amount of \$50,000, and costs of \$10,000 were ordered). Although the cases cited by Staff can be characterized as involving somewhat similar misconduct, the personal financial dealings addressed by them were either more extensive or aggravated by elements of purposeful deception. Moreover, the sanctions ordered in the Staff precedents were not formulated by hearing panels exercising their own sanctioning discretion but, with the exception of *Chang, supra*, were the outcomes of negotiated settlement agreements.

¶ 40 As for the precedents relied upon by the Respondent, the common theme is not so much their similarity to the present case as the leniency of their outcomes. *Greigson, supra*, and *Vu, supra*, were settlements in which the principal misconduct consisted of engaging in unapproved referrals of clients and other individuals to outside mortgage businesses. *Kendrick, supra*, was a disciplinary hearing that proceeded by ASF where the respondent had referred clients to exempt securities offered outside of the auspices of her employing Member. The sanctions in these cases were suspensions that ranged from one week to three months, fines ranging between \$1,000 and \$36,000, and costs orders of either \$2,500 or \$5,000. The only precedent that involved conflict of interest was *Wolfenden, supra*, a disciplinary hearing case where the panel declined to order a suspension of any kind and ordered a fine of \$5,000 and costs in the same amount against a respondent who had borrowed a total of \$100,000 in two separate transactions involving different clients.

¶ 41 If there is any guidance to be gleaned from the precedents referenced by both counsel, it is that when exercising its sanctioning discretion a hearing panel must, above all, attend to the specific facts of the case before it.

¶ 42 Assisting hearing panels in that task is the very purpose of the analytical framework established by the MFDA's sanction guidelines. Central to those guidelines is the principle of proportionality articulated in *Pezim, supra*, and *Cartaway, supra*. Given the particular circumstances of the Respondent's misconduct, the key guidelines to be considered in this case are that:

- (a) Public confidence requires sanctions to be proportionate to the misconduct.
- (b) Distinctions should be drawn between negligent and deliberately deceptive conduct, and between isolated and repeated incidents.
- (c) Sanctions should reflect whether or not the misconduct resulted in the respondent receiving benefits or investors sustaining harm.
- (d) A respondent's prior disciplinary history should be considered when determining sanctions.

Mutual Fund Dealers Association of Canada Sanction Guidelines, dated November 15, 2018.

Relevant factors

¶ 43 Members are under a supervisory responsibility to ensure that Approved Persons do not engage in outside business activities that conflict with the best interests of their clients. CIBC was prevented from exercising this responsibility by the Respondent's failure to seek its approval before she invested in the daycare business and before she began receiving rental income from the family owned properties. These disclosure failures were plainly contraventions of Rule 1.3.

¶ 44 However, the bare fact that infractions have taken place does not by itself answer the question of whether a deterrent response is necessary or desirable, which very much depends on the character of the contraventions and their objective factual circumstances.

¶ 45 In this regard, the evidence relating to the daycare business discloses two noteworthy facts.

- (a) One is that the Respondent did nothing to promote the daycare business to any of her clients or, for that matter, to anyone else. It was another Approved Person who happened to be both a close friend and a client, namely Client JH, who promoted the investment to the Respondent.
- (b) The other important fact is that the Respondent was never in a position to direct the daycare business. It was Client JH who held a 51% controlling beneficial interest in the venture. Moreover, it was Client JH's personal bank account into which the Respondent's investment was deposited. It was the Respondent who was vulnerable to Client JH's business judgments, not the other way around.

¶ 46 As for the Respondent's receipt of rental income, the ASF does not disclose a nexus with her clients or how they might have been put at risk by the simple fact that the Respondent and her spouse were renting out family properties. This is not a distinction found in the language of Rule 1.3. Rather, it is a question about the gravity of the contravention that arises when one considers the purpose of MFDA enforcement proceedings. The point of enforcement is to obtain deterrent sanctions when the circumstances of a contravention indicate a need for them. It is not to prosecute infractions for their own sake.

¶ 47 If the Respondent's failure to disclose these particular outside business activities had been her only contravention, it is difficult to imagine the MFDA would have chosen to address it by issuing a Notice of Hearing charging it as a stand-alone allegation. The same can be said of the incorrect attestation, which, it should be recalled, the MFDA in the ASF accepted as arising from the Respondent's misunderstanding of the full scope of her disclosure obligations.

¶ 48 With respect to the foregoing contraventions, the Panel is not persuaded it is in the public interest to order sanctions for either specific or general deterrence purposes.

¶ 49 The conflict of interest arising from the Respondent obtaining an undocumented loan of \$105,000 from Client A is another matter entirely.

¶ 50 That the Respondent repaid the loan in a matter of a few months, that Client A did not suffer any adverse consequences, and that the Respondent and Client A had been friends since the 1990s are all relevant considerations. But they are not mitigating factors. Rather, they establish the absence of two seriously aggravating factors, namely, dishonesty and client harm.

¶ 51 For sanctioning purposes, the key fact is that by borrowing money from a client the Respondent put herself in a position where her financial interests were necessarily and, given the amount of money involved, materially in conflict with those of Client A.

¶ 52 In doing so, the Respondent failed to follow MFDA guidance that explicitly directs Approved Persons to avoid entering into financial dealings with clients that create conflicts of interest. The harm in this case is not that a client sustained financial losses at the hands of an Approved Person, but that the Respondent exposed Client A to the risk of it.

¶ 53 Nothing in the record suggests this misconduct was the consequence of improper motives. The ASF instead establishes that the Respondent's misconduct was unintentional, and her unequivocal admission of fault indicates that the enforcement process has already brought her to a more complete understanding of the obligations placed on Approved Persons by the Rules. The Panel is therefore satisfied that specific deterrence is not a concern in this case. The sole justification for sanctions in this case is the need to deter Approved Persons generally from falling into similar failures of judgment in the future.

Sanction decision

¶ 54 In the Panel's view, neither the sanctions sought by Staff nor those asked for by the Respondent are proportionate to the objective gravity of the misconduct.

¶ 55 The five year suspension and \$25,000 fine sought by Staff do not sufficiently account for the isolated

nature of the misconduct, its short duration, the lack of harm to clients, and the fact the misconduct was not deliberate but the result of negligence.

¶ 56 The one month suspension and \$10,000 fine proposed by the Respondent do not account for the serious risk of loss and sheer vulnerability imposed on a client who made a substantial undocumented loan to an Approved Person on the strength of their personal relationship.

¶ 57 For these reasons, the Panel ordered that the Respondent:

- (a) be prohibited from conducting securities related business in any capacity while in the employ of or associated with any MFDA Member for a period of two years;
- (b) pay a fine of \$15,000; and
- (c) pay costs of \$5,000.

Dated at Vancouver, this 8 day of December, 2023

“Joseph Bernardo” _____

Joseph A. Bernardo (Chair)

“Barbara Fraser” _____

Barbara Fraser, Industry Representative

“Guenther Kleberg” _____

Guenther Kleberg, Industry Representative

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