



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: Arthur George Pretty

Heard: May 23, 2014 by teleconference
Decision and Reasons (Penalty): July 2, 2014

**DECISION AND REASONS
(Penalty)**

Hearing Panel of the Atlantic Regional Council:

The Honourable D. Merlin Nunn, Q.C.	Chair
Susan Nixon	Industry Representative
Ann C. Etter	Industry Representative

Appearances (by teleconference):

Francis Roy)	Enforcement Counsel, Mutual Fund Dealers
Maria Abate)	Association of Canada
James Bennett)	Counsel for the Respondent

The initial Hearings regarding the allegations of the Mutual Fund Dealers Association of Canada (the “MFDA”) against Arthur George Pretty (the “Respondent”) took place in Corner Brook, Newfoundland, June 24 to 28, 2013 and October 7 and 8, 2013. During these times, Staff of the MFDA (“Staff”) presented the *viva voce* testimony of the clients of the Respondent affected by his conduct supported by 15 large volumes of documentary evidence, as well as, an expert witness. As it closed its case, no evidence was tendered by or on behalf of the Respondent.

The Panel released its written Decision and Reasons (Misconduct) on these allegations on January 30, 2014 (the “Merits Decision”). It had been agreed that the Panel would deal first with the allegations and, if proven, then a further Hearing on Penalty would be held later.

Meeting the schedules of all involved resulted in the Hearing being scheduled for May 23, 2014 and, in view of the significant costs of holding the Hearing in Corner Brook, Newfoundland, the Parties and the Panel agreed to the Hearing by teleconference on the May date, with supplemental written briefs.

In the Merits Decision, the Panel concluded that the MFDA had proven that the Respondent had violated certain MFDA Rules and By-Laws which were alleged as follows:

1. Between March 2005 and July 2008, he recommended and facilitated a leveraged investment strategy for clients MB and CB, CH and TH and PM and PM, 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 the clients’ investment objectives, contrary to MFDA Rules 2.2.1 and 2.1.1,
2. Between March 2005 and July 2008, he misrepresented or failed to adequately explain the benefits, risks, material assumptions and features of a leveraged investment strategy and its underlying investments to clients MB and CB, CH and TH and PM and PM;

thereby failing to present the leveraged investment strategy to the clients in a fair and balanced manner, contrary to MFDA Rule 2.1.1.,

3. Commencing September 14, 2010, he failed to comply with multiple requests to provide a written statement to the MFDA in response to client complaints and to attend at an interview requested by the MFDA during the course of the investigation, contrary to section 22.1 of MFDA By-Law No. 1.

In the Merits Decisions, we set out in detail the Respondent's conduct with the six clients for whom evidence was presented, the requirements of due diligence, Know-Your-Client and suitability and where the Respondent had fallen short in his obligations.

Since this Hearing was concerned only with Penalty, there is no reason to repeat what we have already covered in the Merits Decision. Suffice it to say that the breaches of the Rules and By-Laws we found to have occurred were very serious.

Staff has proposed the following penalties to be applied in this matter:

1. A fine in the range of \$125,000 to \$150,000, pursuant to s. 24.1.1(b) of MFDA By-law No. 1;
2. A permanent prohibition on the Respondent's authority to conduct securities related business in any capacity over which the MFDA has jurisdiction, pursuant to s. 24.1.1(e) of MFDA By-law No. 1 (the "Suspension"); and
3. Costs of at least \$20,000.

In support, Staff submits that these sanctions would reflect the seriousness of the Respondent's misconduct and are consistent with the mandate of the MFDA to enhance investor protection and strengthen public confidence in the Canadian mutual fund industry. Further, these penalties will foster and improve overall compliance by mutual fund industry participants, especially relating to leveraged investing practices and emphasize the importance of providing

skilled and careful advice when dealing with vulnerable clients. Similarly, Staff submits that these penalties will prevent any further misconduct by the Respondent and will discourage other industry participants from failing to comply with their fundamental duties to know their clients and encourage the performance of proper suitability assessments when recommending and implementing particular investments and, also very important, to cooperate with Staff during the course of an investigation.

Staff referred the Panel to the Decision in *Re Arnold Tonnies* (MFDA File No. 200503), which reviewed in detail the factors which should be taken into account in determining an appropriate sanction as indicated and outlined in the decisions of other tribunals. Those are set out as:

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

While these are general, that decision goes on to particularize some considerations of other Hearing Panels, such as:

- a. the seriousness of the allegations proved against the respondent;
- b. the respondent's past conduct, including prior sanctions;
- c. the respondent's experience in the capital markets;
- d. whether the respondent recognizes the seriousness of the improper activity;
- e. the harm suffered by investors as a result of the respondent's activities;
- f. the benefits received by the respondent as a result of the improper activity;
- g. the risk to investors and the capital markets in the jurisdiction, were the respondent to continue to operate in capital markets in the jurisdiction;
- h. the need to alert others to the consequences of inappropriate activities to those who are permitted to participate in the capital markets; and
- i. previous decisions made in similar circumstances.

This Panel agrees with the application of these factors to Penalty considerations in determining appropriate penalties.

Staff also referred to the MFDA Penalty Guidelines though indicated that they were guidelines only. They are:

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|---------------------------------------|------------------------|
| (a) Suitability and Know-Your-Client: | Minimum Fine \$10,000. |
| (b) Product Selection/Due Diligence: | Minimum Fine \$10,000. |
| (c) Standard of Conduct: | Minimum Fine \$5,000. |
| (d) Failure to cooperate: | Minimum Fine \$50,000. |

This last one also adds permanent prohibition while the others refer to suspension and permanent prohibition.

In its brief, Staff emphasized the Respondent's failure to fulfil his basic Know-Your-Client duties and obligations and his pursuit of a Leveraged Investment Strategy to clients, without explanation, when he knew or should have known that his strategy was totally unsuited to their situations and was contrary to their initial instructions to him. As well, Staff emphasized the total lack of financial sophistication of each of the clients and the obvious disregard of the trust they placed in the Respondent as their financial advisor to his financial advantage and their significant losses.

As indicated in the Merits Decision, the losses of the clients concerned here totalled approximately \$540,000 while the Respondent's commissions were just short of \$48,000. Staff asserts that at a minimum, any fine imposed by the Panel should offset any financial benefit received by the Respondent.

With regard to the failure to cooperate, Staff suggests a fine of \$50,000 as a minimum, emphasizing the significant importance of cooperating with the regulatory Rules and By-Laws for the integrity of the industry and the protection of the public.

In addition to the monetary penalties, Staff also submitted that the Panel should impose a permanent prohibition against the Respondent ever being employed in the industry by any member of the MFDA.

The Staff brief included a list of previous Hearings and the Penalties awarded as a guide to the Panel.

Mr. Bennett, the Respondent's counsel, in his brief to the Panel indicated that the Respondent is 62 years of age, married with two grown children and resides in Corner Brook, Newfoundland with his wife of 40 years. Prior to 2010, he was a mutual funds sales representative, but was dismissed by his employer at that time for reasons that resulted in these matters which came before the Panel.

He has not worked in the financial services industry since his dismissal and has been unemployed or able to secure menial work since that date.

No issue is taken in the brief with the purpose of Securities Regulation as being the protection of the investor, the protection of the public interest in the integrity of the capital markets and assuring that these capital markets are both fair and efficient.

However, Mr. Bennett does take issue with inferences Staff have made regarding the Respondent's decision not to testify or present any evidence in his defence. His position is that in hearings involving charges and penalties a person is not required to testify and no inferences are to be drawn from the decision not to testify, nor can any fault be found against the Respondent for not conceding to any disputed facts or allegations in the matter, which left Staff in the position whereby it had to provide witnesses and documentation to prove the facts and allegations alleged.

In his brief, Mr. Bennett indicates the purpose of a penal sanction is to deter future conduct by the individual being penalized and, as well, deter others from engaging in similar conduct thereby protecting the public in general. He agrees that Staff's proposal of a fine,

prohibition and costs is a reasonable approach. However, he suggests that the amounts of fines and duration of any prohibition are at the upper end of the similar cases suggested to the Panel and those upper amount cases are clearly distinguishable as involving much greater amounts of losses.

As a result, Mr. Bennett suggests a fine at the low end of the range of cases submitted, together with a midrange prohibition which, for the Respondent, would effectively be permanent.

On costs, Mr. Bennett suggests the Respondent called no evidence and did nothing to obstruct the Hearing and only the low end of the cases submitted should apply so as to produce a maximum of \$5,000.

The Panel met together and discussed fully the submissions of both Staff and Mr. Bennett, as well as, the significant factors in the evidence involving due diligence, Know-Your-Client and Suitability. We also considered the Respondent's failure to act in accordance with the instructions of his clients, his complete disregard of their lack of financial investments knowledge, his use of leveraging investing when he knew or should have known that it was totally unsuitable to these clients.

As indicated, the Panel accepts and agrees with the factors set out earlier which should be considered in determining penalty. The protection of the investing public, maintaining and assuring the integrity of the securities markets, deterrence both specific and general are the key factors under which all the other factors flow.

It is unnecessary to repeat here the facts which form the basis of our decision on the merits with regard to the relationship between the Respondent and the clients, the personal situation of each client, their reasons for investing, their views on risk, their total reliance on the Respondent as their financial advisor, his recommendations and their losses. However, the Panel has taken all this into consideration in its deliberations using the factors listed earlier as a guide.

The Panel agrees that the starting point here is that a proper fine should offset any financial benefit the Respondent received so, to start, a fine of \$50,000 is warranted.

A very significant addition to that amount must be made to reflect the Respondent's deliberate and intentional disregard to his Know-Your-Client obligations and duties, despite being made well aware of their financial situation, their ages and family obligations, their reasons for investing, their unwillingness to accept risks and their investment and financial knowledge. In addition, his complete failure to consider the suitability of his recommendations to use a leveraging strategy for each client. He paid no attention to the absolutely necessary considerations any financial advisor must follow in recommending leveraging as a financial strategy. (See Paragraph 114 of the Merits Decision) The Panel, therefore, assesses an additional \$50,000 for these breaches of his obligations.

Therefore, at this point the fine is \$100,000. Now we must consider the failure to cooperate finding for which Staff suggests another \$50,000 fine. The Panel dealt with this allegation in Paragraphs 115 and 125 of the Merits Decision and, while it did find the allegation proved, it did indicate evidence of at least a dozen voice mail calls by the Respondent to Mr. Ford and that several letters which Mr. Ford sent referred to a complaint that did not refer to the Respondent.

The Panel is of the opinion that this matter could have been handled differently and, though there was a failure to cooperate, the Respondent should receive the benefit of a lesser penalty for the number of times he tried to reach Mr. Ford and the errors in the letters. Therefore, the Panel sets the Penalty for this at \$25,000.

Added to the previous amounts, the total fine assessed is \$125,000.

The Panel is of the opinion that a proper prohibition period in this matter is 10 years. To automatically apply permanent prohibition is overkill and, in the Panel's opinion, may very well detract from the deterrent effect. In the present matter, the 10 year prohibition period for a 62

year old man is, in effect, permanent, but it does not set a precedent of ordering permanent prohibitions.

Therefore the Panel imposes a 10 year prohibition on the Respondent to conduct securities related business with a MFDA Member.

Finally, the Panel fixes costs payable by the Respondent in the amount of \$5,000.

In summary, the Panel assesses the following:

- (a) A fine of \$125,000;
- (b) A 10 year prohibition on the Respondent to conduct securities related business with a MFDA Member; and
- (c) Costs in the amount of \$5,000.

DATED this 2nd day of July, 2014.

“D. Merlin Nunn”

The Honourable D. Merlin Nunn, Q.C.
Chair

“Susan Nixon”

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Industry Representative

“Ann C. Etter”

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