



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: International Capital Management Inc., John Paul Sanchez and
Javier Andreas Sanchez**

Heard: June 21, June 26 and June 29, 2018 in Toronto, Ontario
Reasons for Decision: July 13, 2018

REASONS FOR DECISION

Hearing Panel of the Central Council:

Martin L. Friedland, CC, QC	Chair
Brigitte J. Geisler	Industry Representative
Paige A. Wadden	Industry Representative

Appearances:

Shelly Feld)	Counsel for the Mutual Fund Dealers
David Babin)	Association of Canada
)	
Barry B. Papazian QC)	Counsel for the Respondent
Michael Krygier-Baum)	
)	

Background

1. This is a Settlement Hearing under Section 24.4 of By-law No. 1 of the Mutual Fund Dealers Association of Canada (the “MFDA”). The hearing was held on Thursday, June 21, 2018. The full Settlement Agreement, dated June 29, 2018, entered into between Staff of the MFDA and International Capital Management Inc. (“ICM” or “the Member”), John Paul Sanchez (“John Sanchez”), and Javier Andreas Sanchez (“Javier Sanchez”) (collectively, the “Sanchez brothers”) is available on the MFDA website. This Settlement Agreement, dated June 29, 2018 is a slightly modified version of the draft Settlement Agreement that had been originally presented to us on June 21, 2018.

2. The facts in this case are complex and the Settlement Agreement runs to 38 pages. Only the most salient details will be set out in these reasons. For a fuller picture of the case, readers should consult the Settlement Agreement.

3. In brief, this disciplinary hearing involves the distribution of promissory notes by John Sanchez and Javier Sanchez – the president and vice-president of ICM respectively – to raise funds for several businesses run by the Sanchez brothers. The transactions were done outside the Member and were not on the books of the Member and therefore outside the purview of the MFDA.

4. The Panel reserved its decision and accepted the proposed Settlement Agreement, dated June 29, 2018 at a further hearing on June 29, 2018, with reasons to follow. These are our reasons for the decision.

Prior Registration History

5. ICM has been a Member of the MFDA since 2002. Previously, it had been registered as a mutual fund dealer and limited market dealer/exempt market dealer in Ontario. Since February 2013 it has also been registered as a mutual fund dealer in Alberta.

6. ICM is and always has been jointly owned by John and Javier Sanchez. Since December 1996 John has been registered with ICM and has been its President, a director and the primary

directing mind of ICM. Since February 2002, John has also been the Chief Compliance Officer of ICM and since December 2009 has been ICM's Ultimate Designated Person. John's younger brother, Javier, has been registered in Ontario as a mutual fund salesperson (now known as a dealing representative) and since December 1996 has been registered with ICM and has been its Vice-President and a director. Since February 2002 Javier has been designated as a branch manager and alternative Chief Compliance Officer of ICM. At all material times, the Respondents conducted business at ICM's head office located in Toronto, Ontario.

Facts

7. During a compliance examination of ICM conducted by MFDA Staff in 2004, Staff discovered that promissory notes appeared to have been issued to ICM clients as an exempt product distributed by an Offering Memorandum. The notes were being offered by a company, Invoice Payment Systems (or "IPS"). The Sanchez family had a majority control (75%) of IPS. Neither of the brothers is, however, an employee, officer or director of IPS, but they both frequently attended and participated in meetings of the board of directors.

8. The company, IPS, was involved in what is called 'factoring,' that is, purchasing accounts receivables from other companies at a discount and then taking steps to collect the full value of the accounts receivable. The funds from the notes were used to finance the factoring business. The notes were not secured by any collateral; and investors were not provided any written disclosure, such as a prospectus or offering memorandum to investors concerning the risks of the investment, how the money would be used, the financial position of IPS or the compensation that the Respondents would receive for soliciting investors in the IPS notes. Since IPS was incorporated in 2003, the Respondents have been the exclusive distributors of IPS notes.

9. It should be noted, as stated in paragraph 2 of the Settlement Agreement, only the Respondents and the MFDA are parties to this proceeding. Other individuals and entities, such as IPS and Energentium, have not admitted to the facts or contraventions set out in the Agreement. Such individuals and entities are not subject to the jurisdiction of the MFDA and no findings or admissions in this proceeding are binding on them.

10. MFDA Staff were concerned about the activity noted above. Were the IPS notes an exempt product? Were the risks adequately disclosed? Were the products suitable for the clients? Did this give rise to a conflict of interest?

11. As a result of this examination, ICM entered into an Agreement and Undertaking with Staff in October 2006. They undertook to follow a number of procedures in the future, such as advising the clients that the notes were high-risk investments, obtaining signed acknowledgments from clients about the high risk, the rate of commission, and potential conflicts of interest. Further, ICM had to refund the full amount of the original investment and any accrued interest for clients who requested reimbursement. Moreover, a written report had to be made to the MFDA about the steps that had been taken by ICM.

12. Between 2006 and 2016, without the MFDA's knowledge, the Respondents continued to distribute IPS notes to clients. They also distributed notes of a company controlled by the Sanchez family, Energentium Inc. ("Energentium"), that had been incorporated in 2012 and dealt with recycling of waste products. Again, the notes were unsecured and there was no written disclosure of the risks involved in the investments. Paragraph 68 of the Settlement Agreement gives some examples of what was not disclosed, such as the fact that between 2013 and 2015, Energentium incurred losses in excess of \$700,000 per year and that as of May 31, 2016, Energentium's liabilities included more than \$1 million owed on a mortgage obtained from an institutional lender and more than \$1.2 million in outstanding shareholder loans.

13. These distributions were not disclosed to the MFDA. During this period, the Respondents submitted nine responses to MFDA annual Membership Questionnaires, which included questions about the types of investments held by clients. The Respondents did not disclose the sale of IPS notes in any of these responses. Moreover during compliance examinations conducted at ICM's office in 2009, 2012 and 2015, John and Javier Sanchez participated in interviews with Staff during which they did not disclose their roles, relationships or activities in respect of IPS or Energentium and stated that they were not engaged in any outside activities. In April 2011, for example, (see paragraph 76 of the Settlement Agreement) the Respondents admit that in response to specific

inquiries from MFDA Staff about the extent of their continuing involvement with IPS, the Respondents had denied that they had an existing relationship with IPS, and denied that they were receiving compensation in connection with the distribution of IPS notes.

14. Between 2006 and 2016, as stated in paragraph 40 of the Settlement Agreement, the Respondents sold or facilitated the sale of at least \$25.8 million of investments in IPS notes to at least 170 ICM clients and between 2012 and 2016, as stated in paragraph 48 of the Settlement Agreement, the Respondents sold or facilitated the sale of at least \$1.64 million of investments in Energentium notes to approximately 21 ICM clients. The transactions relating to IPS and Energentium notes were not recorded on the books and records of ICM, were not carried on the for the account of ICM, and were not processed through the facilities of ICM.

15. The Sanchez brothers received substantial commissions. Between September 2005 and February 2017, John and Javier Sanchez, through holding companies they controlled, were paid commissions of 2% per year in every year that money was invested attributable to the distribution of IPS notes to ICM clients. In total, during that period, their holding companies received approximately \$3 million in commission income from the solicitation of investments by ICM clients in the IPS notes and just under \$200,000 in Energentium notes.

Present Status

16. The Settlement Agreement sets out in detail (see paragraphs 93 and following of the Settlement Agreement) what happened to ICM after the MFDA discovered in 2016 the existence of outstanding IPS notes and Energentium notes. On November 16, 2016 Staff designated ICM “in early warning on discretionary grounds pursuant to MFDA Rule 3.4.2(a)(v)”. Consequently, from that date ICM was subject to early warning requirements. Pursuant to these Rules, ICM was not permitted to make direct or indirect payments to its officers, directors and shareholders, including John and Javier Sanchez. Accordingly, the Sanchez brothers have not received income from ICM since that time.

17. On November 18, 2016 the Sanchez brothers were both independently interviewed by MFDA Counsel and Staff and further to undertakings given at their respective interviews, the Respondents produced substantial amounts of information, including financial information relating to IPS and Energentium and the role of the Respondents in connection with those companies.

18. Paragraph 95 of the Settlement Agreement reads: “The Respondents state that in compliance with the December 16, 2016 order of a hearing panel...the Respondents have discontinued their involvement with the operations and solicitation of investments in IPS and Energentium except for efforts undertaken to facilitate the sale of property owned by Energentium in order to repay amounts borrowed from creditors, including Energentium noteholders.”

19. See also paragraph 21 of the Settlement Agreement, which describes the actions of an earlier MFDA Hearing Panel (2016107) which “issued an order requested by Staff imposing requirements and restrictions on the Respondents as interim relief to address the conduct of the Respondents...Among other things, the order prohibited ICM and its Approved Persons including John and Javier from engaging in outside business activities without prior authorization from the MFDA or facilitating the sale of investments other than prospectus qualified mutual funds and Guaranteed Investment certificates...In particular, the order prohibited the Respondents from directly or indirectly selling or facilitating investments in or loans to financially related entities including ICM, [IPS and Energentium.]” Paragraph 21 goes on to state that the Ontario Securities Commission then “imposed terms and conditions on ICM’s registration prohibiting ICM from selling exempt market products.”

20. Paragraphs 96 to 100 of the Settlement Agreement outlines what happened to IPS. It has continued its practice of renewing promissory notes to investors, including the former clients of ICM. According to the Respondents, IPS has not defaulted on requests by investors to redeem their notes or to receive interest that is due. Further, the Respondents no longer provide advice to investors about IPS promissory notes, and have received acknowledgment documents about the finder’s fees, the fact that the loan is considered high risk, and that IPS is a related entity of ICM. To date, the MFDA has not received any complaints asserting that investors in IPS have been

denied repayment of the principal amounts that they invested in IPS or interest that they were promised.

21. In terms of Energentium, paragraphs 101 to 106 outline that after December 2016 Energentium ceased to operate as a going concern, that on February 8, 2018 its property was sold and the proceeds were sufficient to pay the mortgage and repay Energentium noteholders the principal amount that they had invested in Energentium. The noteholders did not, however, receive any of the interest that was promised when their initial investments were made. The note holders, however, executed final releases of any further amounts owing.

22. ICM is no longer a Member of the MFDA. On July 20, 2017 the MFDA issued Bulletin 0727M, indicating that Staff had received notification from ICM of its intention to resign from membership in the MFDA. Paragraph 11 of the Settlement Agreement states:

“In January 2018, ICM agreed to a voluntary suspension of its membership in the MFDA as a term and condition of the approval of a sale of its client list and the transfer of its client accounts to a portfolio manager registered in the securities industry. In November 2017 and again in January 2018, the Ontario Securities Commission (the “OSC”) and the MFDA, respectively, approved the sale transaction and the transfer of client accounts from ICM to the portfolio manager. The voluntary suspension of ICM’s membership in the MFDA took effect on April 2, 2018. As a consequence of the voluntary suspension of ICM’s membership in the MFDA, ICM’s registration with the OSC as a mutual fund dealer was also suspended.”

23. Paragraph 22 of the Settlement Agreement describes ICM’s position before the transfer described in the previous paragraph:

“Prior to the sale of its client list and voluntary suspension, ICM managed a total of approximately \$150-185 million in assets under administration (‘AUA’) consisting of a variety of investments including mutual funds, GICs and exempt market products. Many clients of ICM also purchased segregated funds and other insurance products from the dual licensed advisors who were Approved Persons of ICM (including John and Javier). ICM serviced between 1,200 and 1,300 accounts for its clients. It was the practice of Approved Persons of ICM (including the Respondents John and Javier) to prepare and monitor financial plans for ICM clients.”

Contraventions

24. The Notice of Hearing in the present case, dated May 30, 2017, sets out 7 allegations against the three Respondents. The Respondents admit in the Settlement Agreement to all 7 allegations. Paragraphs 110 to 117 of the Settlement Agreement read:

“Paragraph 110: The Respondents admit that between 2006 and 2016, the Respondents engaged in securities related business that was not carried on for the account of ICM, through the facilities of ICM or recorded on the books and records of ICM by:

- a) selling or facilitating the sale of at least \$25.8 million of investments in a non-arm’s length company to at least 170 ICM clients; and
- b) selling or facilitating the sale of at least \$1.64 million of investments in a non-arm’s length company to 21 ICM clients;

contrary to MFDA Rules 1.1.1 and 2.1.1.

Paragraph 111: The Respondents admit that since 2006, John and Javier have engaged in outside activities that were not approved by ICM in writing or reflected on the books and records of ICM, contrary to MFDA Rule 1.3.2(c).

Paragraph 112: The Respondents admit that since 2006, John and Javier solicited at least \$27.44 million from ICM clients for investment in two non-arm’s length companies, thereby engaging in conduct that gave rise to conflicts of interest which the Respondents failed to address by the exercise of responsible business judgment influenced only by the best interests of the clients, contrary to MFDA Rules 2.1.4 and 2.1.1.

Paragraph 113: The Respondents admit that between 2006 and 2016, the Respondents recommended that at least 170 ICM clients purchase investments distributed by two non-arm’s length companies, without conducting adequate due diligence to know the products and did not maintain sufficient records to demonstrate that they complied with the obligation to Know-Your-Client (‘KYC’) and ensure that the products recommended and the orders obtained from clients were suitable, contrary to MFDA Rule 2.2.1.

Paragraph 114: The Respondents admit that after October 2006, the Respondents did not comply with the terms of an Agreement and Undertaking entered into between the Respondents and Staff, thereby engaging in conduct contrary to MFDA Rule 2.1.1 and engaging the authority of the Hearing Panel to impose a penalty on the Respondents pursuant to sections 24.1.1 and 24.1.2 of MFDA By-law No. 1.

Paragraph 115: The Respondents admit that between 2008 and December 2016, the Respondents failed to cooperate with Staff’s investigations into their conduct by providing inaccurate or misleading information and statements to Staff and withholding information about some of their business activities in response to questioning by MFDA compliance

staff and by MFDA enforcement staff during investigations of their conduct, and by initially withholding access to electronic records including emails stored on ICM's systems during an on-site inspection of ICM's office conducted by Staff on November 15, 2016, contrary to sections 22.1 and 22.2 of MFDA By-law No. 1.

Paragraph 116: The Respondents admit that since February 2009, the Respondents have not:

- a) established, implemented and maintained policies and procedures required to ensure adequate head office account supervision;
- b) maintained adequate records of trade supervision that was conducted including inquiries made, responses received from Approved Persons and resolutions achieved as a result of supervisory inquiries; and
- c) established, implemented and maintained adequate policies and procedures to ensure the identification of trends in trading activity,

contrary to MFDA Rules 2.5.1 and 2.5.7, and MFDA Policy No. 2.

Terms of Settlement

25. Paragraph 117 of the Settlement Agreement sets out the following terms of settlement:

- a) the Respondent John Paul Sanchez shall be permanently prohibited from conducting securities related business while in the employ of, or associated with, any Member of the MFDA;
- b) the Respondent Javier Andreas Sanchez shall be permanently prohibited from conducting securities related business while in the employ of, or associated with, any Member of the MFDA;
- c) the Respondent John Paul Sanchez shall pay a fine in the amount of \$100,000;
- d) the Respondent Javier Andreas Sanchez shall pay a fine in the amount of \$50,000;
- e) the Respondents John Paul Sanchez and Javier Andreas Sanchez shall jointly pay costs in the amount of \$25,000 on the date this Settlement Agreement is accepted by a Hearing Panel of the MFDA;
- f) the membership in the MFDA of the Respondent ICM shall be terminated effective on the date that this Settlement Agreement is accepted by a Hearing Panel of the MFDA and thereafter ICM shall cease to have any of the rights and privileges of Membership in the MFDA; and

- g) the Respondents John Paul Sanchez and Javier Andreas Sanchez will attend the Settlement Hearing in person.

26. Paragraphs 118 and 119 provide for terms for the payment of the fine: “John Paul Sanchez shall pay \$30,000 of his \$100,000 fine on the date that this Settlement Agreement is accepted by a Hearing Panel of the MFDA and shall pay the balance in equal installments of \$5,833.33 payable on the first day of each month between August 1, 2018 and July 1, 2019... Javier Andreas Sanchez shall pay \$20,000 of his \$50,000 fine on the date that this Settlement Agreement is accepted by a Hearing Panel of the MFDA and shall pay the balance in equal installments of \$2,500 payable on the first day of each month between August 1, 2018 and July 1, 2019.

Acceptance of Settlement Agreement

27. As stated above, the Panel accepted the terms of the Settlement Agreement. A Panel can either accept or reject a Settlement Agreement. It cannot modify it.

28. Settlements can be important and useful in achieving outcomes which further the goals of the securities regulatory context. The British Columbia Court of Appeal stated with respect to a settlement by the B.C. Securities Commission (*B.C. Securities Commission v. Seifert* [2007] B.C.J. No. 2186, para. 49 (B.C.C.A.)):

“Settlements assist the Commission to ensure that its overriding objective, the protection of the public, is met. Settlements proscribe activities that are harmful to the public. In so doing, they are effective in accomplishing the purposes of the statute. They provide means of reaching a flexible remedy that is tailored to address the interests of both the Commission and the person under investigation.”

29. The conduct in this case was very serious. The Sanchez brothers clearly knew that their conduct was improper. Promissory notes are securities. See, for example, a similar MFDA case from 2009: *Re Farm Mutual Financial Services Inc.* 2009 LNCMFDA 12. See also *Re Van Der Velden* 2005 LNCMFDA 14 and the recent Ontario Court of Justice decision, *Ontario (Securities Commission) v. Michelle Dunk*, decided April 23, 2018.

30. The distribution in the present case involved a wide range of misconduct. A text book could be written for the industry about what not to do based on the facts of this case. This was not a single slip-up by one person, but a decade and a half of deceit, deception, non-cooperation, selling potentially unsuitable products, conflicts of interests, breach of undertakings, failure to implement procedures to record trade supervision, failure to cooperate, attempts to destroy incriminating evidence, and more. On November 15, 2016, for example, (see paragraph 79 to 85 of the Settlement Agreement) the Respondents removed 30 gigabytes of electronic data from their hard drives, at the very time a MFDA computer expert was waiting in the office of ICM to copy those electronic records. Fortunately, the MFDA was able to restore the removed material. Moreover, this was not the first disciplinary proceeding involving ICM. See *Re International Capital Management* 201565, in which a fine of \$30,000 was imposed on ICM for an unrelated matter.

31. It is clear that the Sanchez brothers have to be expelled from the securities industry. It is not necessary for us to explain in detail why the conduct is prohibited. Transactions have to be done through the Member in order for the Member and the MFDA to supervise the activities of the participants, including ensuring that the products offered to clients are suitable and to ensure that they are suitable for each client. Conflicts of interest should be avoided and at a bare minimum be clearly and adequately disclosed. Selling products of a company in which the salesperson has a substantial interest requires the highest standard of disclosure to potential purchasers. Not cooperating with the regulators and attempting to destroy records cannot be tolerated in any system of regulation. The rules against such conduct are well known to everyone in the industry.

32. The monetary penalty that is set out in the Settlement Agreement – a total of \$150,000 for the Sanchez brothers – is not, however, at the high end, but rather at the midrange of the scale of penalties in the many cases that were cited to us by Counsel. Should the monetary penalty have been higher?

33. In mitigation, counsel for the MFDA points out that the Respondents eventually cooperated with the MFDA and acknowledged their wrongdoing. The Settlement Agreement is some evidence of this. As it is often stated in Settlement Hearings, by entering into a Settlement Agreement the Respondents have accepted responsibility for their misconduct, recognize its seriousness, and have

exhibited remorse. And by entering into the Settlement Agreement, the Respondents saved the MFDA the time, resources and expense associated with conducting a full hearing of the allegations. It would have been a lengthy hearing – five days had been set aside for the hearing. Moreover, there is certainty of outcome with a Settlement Agreement. One can never be sure about a hearing.

34. Moreover, again in mitigation, none of the purchasers of the notes complained to the MFDA. The holders of the IPS notes have not, in fact, at this stage suffered any financial losses. Further, the holders of the Energentium notes were made whole, except for not receiving the interest payments. The Respondents disposed of the Energentium building to provide funds for the repayment. It should also be noted that the Respondents received no payments from ICM for the past year and a half.

35. John Sanchez was permitted by the Panel to make a statement to the Panel at the end of the hearing in which he was clearly remorseful, and, while not excusing their conduct, he explained that the firm tried to have a diversified portfolio for their clients and these notes made up only a relatively low percentage of each clients' portfolio. Counsel for the MFDA did not challenge this statement. This case, then, is unlike those cases where the clients were told to invest a large percent of their portfolio in a potentially unsuitable investment.

36. The Respondents have worked with the MFDA for many months trying to reach a settlement in this case. We were told that for the past six weeks there was an extensive process of negotiation, with almost daily discussions. Unlike many other cases, the Respondents did not walk away from the wreck, leaving everyone to fend for themselves. They appeared at the Hearing, which often does not occur in such cases. And the Respondents and the MFDA came up with a penalty which the Respondents are able to pay in instalments. There is every indication that the fine will be paid.

37. The combination of a substantial fine and removal from the industry is consistent with the MFDA penalty guidelines and provides a strong measure of deterrence to others in the industry.

38. Hearing Panels should respect settlements worked out by the parties. A Panel does not know what led to a settlement, what was given up by one party or the other in the course of the negotiations, and what interest each party has in agreeing to resolve the matter. The Panel cannot go beyond the Settlement Agreement. There are almost always facts that play a role in the settlement which are not set out in the Settlement Agreement or brought to the attention of the Panel.

39. As a Panel stated (*Re Keshet*, File No. 201419 at paragraph 7), to take one of many such cases: “It is well established that hearing panels should not interfere lightly in negotiated settlements and should not reject a settlement agreement unless it views the proposed penalty clearly falling outside a reasonable range of appropriateness.” There are many similar statements by MFDA Panels stemming from the leading decision of *Re Milewski* [1999] I.D.A.C.D. No. 17, which stated: “A District Council considering a settlement agreement will tend not to alter a penalty that it considers to be within a reasonable range, taking into account the settlement process and the fact that the parties have agreed. It will not reject a settlement unless it views the penalty as clearly falling outside a reasonable range of appropriateness.” This is particularly so, we should add, when, as in the present case, experienced counsel have been the negotiators.

40. The penalty agreed to in this case clearly falls within “a reasonable range of appropriateness.”

41. For the above reasons we accepted the Settlement Agreement.

DATED this 13th day of July, 2018.

“Martin L. Friedland”

Martin L. Friedland, CC, QC
Chair

“Brigitte J. Geisler”

Brigitte J. Geisler
Industry Representative

“Paige A. Wadden”

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Industry Representative

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