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: Rodney M. Warren

Heard: May 3-5, 2016 in Vancouver, British Columbia
Reasons for Decision: October 27, 2016

REASONS FOR DECISION

Hearing Panel of the Pacific Regional Council:

Stephen D. Gill	Chair
Holly Millar	Industry Representative
Brian Cheung	Industry Representative

Appearances:

Christopher Corsetti	)	Counsel for the Mutual Fund Dealers Association of Canada
Leah Shepherd	)	Counsel for the Respondent

THE ALLEGATIONS

1. By a Notice of Hearing dated October 15, 2015 (the "Notice of Hearing"), the Mutual Fund Dealers Association of Canada ("MFDA") alleged that Rodney M. Warren (the "Respondent") committed the following violations of the By-laws, Rules or Policies of the MFDA:

> **Allegation #1**: Between August 2006 and January 2013, the Respondent failed to ensure that his leveraged investment recommendations were suitable for clients DZ and EZ and clients HN and MN having regard to the clients' "Know Your Client" information and financial circumstances, including but not limited to, the clients' age, employment status, ability to afford the costs associated with the investment loans, and ability to withstand investment losses, contrary to MFDA Rules 2.2.1 and 2.1.1.
>
> **Allegation #2**: This allegation was withdrawn.
>
> **Allegation #3**: Between May 22, 2012 and September 17, 2012, the Respondent failed to report a complaint to the Member and attempted to negotiate a settlement with two clients without the Member's knowledge or approval, which prevented the Member from complying with its complaint handling obligations and conducting a reasonable supervisory investigation, contrary to MFDA Policy No. 6, subsection 4.1(a), MFDA Policy No. 3, and MFDA Rules 2.1.1, 1.1.2, and 2.5.1.

2. By an Agreed Statement of Facts dated April 29, 2016 (the "ASF"), Staff of the MFDA ("Staff") and the Respondent were able to set out significant facts, and admissions and simplified matters such that the only evidence that was called was on Allegation #3.

3. It is appropriate to reproduce the ASF at this point.

> **"AGREED STATEMENT OF FACTS**
>
> **I. INTRODUCTION**

1. By Notice of Hearing dated October 15, 2015, the Mutual Fund Dealers Association of Canada (the "MFDA") commenced a disciplinary proceeding against Rodney M. Warren (the "Respondent") pursuant to ss. 20 and 24 of MFDA By-law No. 1.

II. IN PUBLIC / IN CAMERA

2. The Respondent and Staff of the MFDA ("Staff") agree that this matter should be heard in public pursuant to Rule 1.8 of the MFDA Rules of Procedure.

III. ADMISSIONS AND ISSUES TO BE DETERMINED

3. The Respondent has reviewed this Agreed Statement of Facts and admits the facts set out in Part IV herein. The Respondent admits that the facts in Part IV constitute misconduct for which the Respondent may be penalized on the exercise of the discretion of a Hearing Panel pursuant to s. 24.1 of MFDA By-law No. 1.

4. Staff agrees to withdraw Allegation #2 in the Notice of Hearing.

5. Staff and the Respondent agree that both parties may to adduce evidence with respect to Allegation #3 in the Notice of Hearing, and any penalties to be considered by the Hearing Panel with respect to the misconduct admitted in this Agreed Statement of Facts and Allegation #3 in the Notice of Hearing (if the Hearing Panel makes a finding of misconduct with respect to this allegation).

IV. AGREED FACTS

6. Staff and the Respondent agree that submissions made with respect to the misconduct admitted in this Agreed Statement of Facts will be based only on the agreed facts in Part IV below and no other facts or documents. In the event the Hearing Panel advises one or both of Staff and the Respondent of any additional facts it considers necessary to determine the issues described below, Staff and the Respondent agree that such additional facts shall be provided to the Hearing Panel only with the consent of both Staff and the Respondent. If the Respondent is not present at the hearing, Staff may disclose additional relevant facts, at the request of the Hearing Panel.

7. Nothing in this Part IV is intended to restrict the Respondent from making full answer and defence to any civil or other proceedings against him.

Registration History

8. The Respondent has been registered in the mutual fund industry since January 2, 1992.

9. From January 2, 1992 to September 30, 2008, the Respondent was registered in British Columbia as a mutual fund salesperson (now known as a dealing representative) with AEGON Dealer Services Inc. ("AEGON"), a former Member of the MFDA.

10. From March 4, 2003 to August 31, 2008, the Respondent was registered in British Columbia as a Branch Manager with AEGON.

11. On September 30, 2008, AEGON amalgamated with Investia Financial Services Inc. ("Investia"), a Member of the MFDA.

12. From September 30, 2008 to August 31, 2009, the Respondent was registered in British Columbia, Alberta, Ontario, Quebec, and Newfoundland and Labrador as a mutual fund salesperson with Investia.

13. Since August 31, 2009, the Respondent has been registered in British Columbia, Alberta and Ontario as a mutual fund salesperson with Portfolio Strategies Corporation ("PSC"), a Member of the MFDA.

14. At all material times the Respondent has conducted business in Langley, British Columbia.

Allegation #1: Unsuitable Leveraging Recommendations

Client DZ and EZ

15. Clients DZ and EZ are spouses. Since about March 1997, the Respondent has serviced the mutual fund accounts of clients DZ and EZ.

16. In 1997, through their previous dealing representative, clients DZ and EZ obtained an investment loan in the amount of $5,000. In 2002, clients DZ and EZ increased the amount of the investment loan to $18,000. Clients DZ and EZ invested these monies (i.e., $18,000) in mutual funds recommended by the Respondent[1].

17. In 2006, clients DZ and EZ attended a seminar on leveraging presented by the Respondent. Clients DZ and EZ subsequently met with the Respondent on several different occasions to discuss the use of leverage as an investment strategy.

[1] These investment loans were recommended by the Respondent before the MFDA had jurisdiction over his conduct. MFDA Staff does not allege that the Respondent engaged in misconduct with respect to these loans.

18. The Respondent states that during these discussions, the Respondent provided background information on leverage.

19. At the material time, clients DZ and EZ indicated on the AEGON Know Your Client Form dated August 28, 2006 that their:

    a. investment knowledge was good;
    b. investment objective was long term growth;
    c. risk tolerance was high risk; and
    d. time horizon was long term (+10 years).

20. At that time, the Respondent recommended a leveraged investment strategy to clients DZ and EZ whereby the clients would borrow monies to purchase mutual funds.

21. On August 28, 2006, based upon the Respondent's recommendation, clients DZ and EZ applied for, and obtained, an interest-only investment loan in the amount of $100,000 from AGF Trust Company ("AGF") in order to implement the leveraged investment strategy[2].

22. Concurrently on August 28, 2006, based upon the Respondent's recommendation, clients DZ and EZ applied for, and obtained, an interest-only investment loan in the amount of $100,000 from B2B Trust Company ("B2B") in order to implement the leveraged investment strategy.

23. At the time the clients DZ and EZ implemented the leveraged investment strategy, the Respondent arranged for clients DZ and EZ to begin drawing monies from their Registered Retirement Income Fund ("RRIF") accounts in September 2006 which was used to pay some of the principal and interest payments on the loans.

24. On January 16, 2007, based upon the Respondent's recommendation, clients DZ and EZ applied for, and obtained, a margin call investment loan in the amount of $38,000 from AGF (the "AGF Margin Call Loan").

25. At about the same time clients DZ and EZ obtained the AGF Margin Call Loan, the clients paid off the $18,000 investment loan they had obtained in 2002.

26. Clients DZ and EZ used the monies from the three investment loans, namely $238,000, to purchase mutual funds recommended by the Respondent. Approximately half of the mutual funds purchased by the

[2] An "interest-only" loan is a loan where the borrower is only obligated to pay the interest owing on the principal balance of the loan monthly, bi-weekly, etc. The borrower is not required to make any payments on account of principal until the loan is retired or the lender is entitled to make demand for repayment.

clients consisted of return of capital ("ROC") mutual funds. The ROC mutual funds paid a distribution which assisted in covering the principal and interest payments of the investment loans.

27. In 2007, 2009 and 2010, clients DZ and EZ indicated on Know Your Client forms which they signed that their:

    a. investment knowledge was good or fair;
    b. risk tolerance was high risk;
    c. investment objectives was growth; and
    d. time horizon was long term.

28. By the time of the third investment loan in January 2007, clients DZ and EZ:

    a. were 71 years old and 73 years old, respectively;
    b. had been retired since August 2002;
    c. received an annual income of approximately $38,000 (or $3,167 monthly) from their government pensions;
    d. owed approximately $1,247.50 each month in order to pay the interest costs associated with the investment loans;
    e. had a mortgage of $86,600 and a monthly mortgage payment of $479;
    f. had a total debt service ratio of 58%[3];
    g. had a net worth of approximately $221,000; and
    h. had a loan-to-net-worth ratio of 108%[4].

29. The interest rate listed on all three of the investment loan applications was 6%.

30. Commencing in 2008, both the value of the underlying mutual funds purchased with the investment loans and the distributions generated by these mutual funds began to decline.

31. On January 26, 2009, clients DZ and EZ received a margin call[5] on the AGF Margin Call Loan. Clients DZ and EZ restructured the $38,000 AGF Margin Call Loan to a no margin call interest only investment loan.

32. On September 1, 2009, the Respondent became registered as a mutual fund salesperson with PSC. Clients DZ and EZ transferred their accounts to PSC.

[3] Total debt services ratio is the percentage of gross annual income required to cover payments associated with the investment loans, mortgage payments, and other debts and obligations such as car loans and credit cards.

[4] Loan to net worth ratio is the size of the investment loan as a percentage of the client's net worth (i.e., total assets less total liabilities).

[5] A "margin call" is a demand by the lender to the borrower to deposit additional money or securities so that the margin account is brought up to the minimum amount of required margin as calculated by the lender.

33. By July 2010, clients DZ and EZ had depleted the balance of their RRIF accounts in part because they used the funds to pay the monthly cost of the investment loans. Clients DZ and EZ began withdrawing monies from their joint non-leveraged account.

34. By September 2012, clients DZ and EZ had depleted the balance of their joint non-leveraged account. At that time, clients DZ and EZ submitted a complaint to PSC with respect to the Respondent's leveraging recommendations.

35. In January 2013, PSC assisted clients DZ and EZ to sell their investments, collapse their investment loans and terminate the leveraged investment strategy.

36. On December 12, 2013, clients DZ and EZ entered into a settlement with Investia regarding the investment losses of $73,463, they sustained as a result of the leveraged investment strategy during the period clients DZ and EZ held accounts with Investia.

37. Clients DZ and EZ have been compensated for investment losses incurred as a result of the leveraged investment strategy recommended to them by the Respondent during the period they held accounts with Investia.

38. Investia's policies and procedures for determining the suitability of leverage included the following factors:

    a. the client's debt payments should not exceed 41% of client's gross income;
    b. the client's investment loan should not exceed 30% of the client's net worth; and
    c. leveraging may not be considered suitable for clients at or near retirement.

39. On January 27, 2012, a Hearing Panel accepted a Settlement Agreement between Investia and the MFDA with respect to deficiencies detected by MFDA Staff during a compliance examination of Investia's Head Office and branch locations during the period August 1, 2007 and April 30, 2009. The Settlement Agreement addressed deficiencies regarding inadequate supervision of leveraging, trading activity, new accounts, and outside business activities. The Settlement Agreement included the implementation of a leverage review action plan by Investia to specifically address its compliance deficiencies with respect to leverage.

40. The above noted leveraging strategy was not suitable for clients DZ and EZ on the basis of:

a. clients DZ and EZ's age;
b. employment status (retired);
c. ability to afford the costs associated with the investment loans; and
d. ability to withstand investment losses,

contrary to MFDA Rules 2.2.1 and 2.1.1.

Clients HN and MN

41. Clients HN and MN are spouses.

42. In or about early 2007, clients HN and MN attended a seminar on leveraging presented by the Respondent.

43. On or about April 2, 2007, clients HN and MN became clients of the Respondent. Subsequently clients HN and MN met with the Respondent on several different occasions to discuss the use of leverage as an investment strategy.

44. At the time, clients HN and MN indicated on the AEGON Know Your Client Form dated April 02, 2007 that their:

a. investment knowledge was good;
b. investment objective was long term growth;
c. risk tolerance was high risk; and
d. time horizon was long term (10 +years).

45. On or about April 2, 2007, the Respondent recommended that clients HN and MN borrow $300,000 to purchase mutual funds.

46. At that time, the Respondent recommended that clients HN and MN obtain a home equity line of credit ("HELOC") in the amount of $100,000 on a townhome they owned and use these monies to apply for a 2-for-1 investment loan in order to borrow an additional $200,000.

47. In or about April 2007, based upon the Respondent's recommendation, clients HN and MN applied for, and obtained, a HELOC on their townhome. Clients HN and MN then borrowed $100,000 available through the HELOC.

48. On or about April 13, 2007, based upon the Respondent's recommendation, clients HN and MN used the $100,000 from the HELOC

to apply for, and obtain, a 2-for-1 margin call investment loan in the amount of $200,000 from MRS Trust Company ("MRS").

49. Clients HN and MN borrowed a total of $300,000 through the HELOC and the 2-for-1 investment loan in order to implement the leveraged investment strategy recommended by the Respondent. Clients HN and MN used these monies to purchase mutual funds recommended by the Respondent. Approximately half of the mutual funds purchased by the clients consisted of ROC mutual funds. The ROC mutual funds paid a distribution which assisted in covering the principal and interest payments of the investment loans.

50. In June 2008, the Respondent reviewed the leveraging investment strategy with clients DZ and EZ.

51. In 2008 and 2009, clients HN and MN indicated on updated Know Your Client Forms which they signed that:

    a. that their investment knowledge was good or moderate;
    b. that their investment objective was long term growth;
    c. that their risk tolerance was high; and
    d. that their time horizon was long term or five years plus.

52. At the time of they borrowed the monies, clients HN and MN:

    a. were 59 years old and 54 years old, respectively;
    b. owned a townhome with a value of approximately $250,000 (which the HELOC was secured against);
    c. owed approximately $1,000 each month in order to pay the interest costs associated with the investment loans;
    d. had a net worth of approximately $321,000; and
    e. had a loan-to-net-worth ratio of 89%.

53. The interest rate listed on the April 13, 2007 loan application was 6%.

54. Commencing in 2008, both the value of the underlying mutual funds purchased with the investment loans and the distributions generated by these mutual funds began to decline.

55. On October 8, 2008, clients HN and MN received a margin call on the $200,000 investment loan from MRS. On or about February 23, 2009, clients HN and MN received another margin call on the MRS investment loan. The two margin calls totaled approximately $44,000. Clients HN and MN increased the amount of the HELOC in order to come up with the funds to satisfy the margin calls.

56. On or about November 28, 2014, clients HN and MN sold their investments, collapsed their investment loans and terminated the leveraged investment strategy.

57. As a result of the leveraged investment strategy recommended by the Respondent, clients NH and MN suffered net investment losses of $42,391 during the period they held accounts with Investia.

58. On June 8, 2015, clients HN and MN entered into a settlement with Investia regarding the investment losses they sustained as a result of the leveraged investment strategy during the period clients HN and MN held accounts with Investia. Clients HN and MN have been compensated for investment losses suffered as a result of the investment strategy during the period they held accounts with Investia.

59. The above noted leveraging strategy was not suitable for HN and MN on the basis of:

    a. client HN and MN's age;
    b. employment status (near retirement);
    c. ability to afford the costs associated with the investment loans;
    d. and ability to withstand investment losses,

    contrary to MFDA Rules 2.2.1 and 2.1.1.

Other

60. This is the first time the Respondent has been the subject of a MFDA disciplinary hearing.

61. The Respondent has cooperated with the MFDA's investigation into the allegations made against him in this matter, as set out in the Notice of Hearing.

Misconduct Admitted

62. By engaging in the conduct described above, the Respondent admits that, between August 2006 and January 2013, he failed to ensure that his leveraged investment recommendations were suitable for clients DZ and EZ and clients HN and MN having regard to the clients' "Know-Your Client" information and financial circumstances, including but not limited to, the clients' age, employment status, ability to afford the costs associated with the investment loans, and ability to withstand investment losses, contrary to MFDA Rules 2.2.1 and 2.1.1.

Execution of Agreed Statement of Facts

63. This Agreed Statement of Facts may be signed in one or more counterparts which together shall constitute a binding agreement.

64. A facsimile copy of any signature shall be effective as an original signature."

4. As can be seen, in the ASF the Respondent has admitted to Allegation No. 1 re: Suitability. Further, the Respondent admits that the facts in Part IV of the ASF constitutes misconduct for which the Respondent may be penalized on the exercise of the discretion of the Hearing Panel pursuant to Section 24.1 of MFDA By-law No. 1.

5. Extensive documentary evidence was introduced by the parties in the form of a binder entitled "Joint Book of Documents", which contained twenty one tabs and an index describing what was contained in each tab. This included copies of various MFDA policies, various e-mails, interview transcripts of the Respondent and complainants DZ and EZ, correspondence from the lawyer retained by DZ and EZ, copies of the policies and procedures manual of PSC issued in 2008 and 2012, etc. Extensive reference to the Joint Book of Documents was made when evidence was led.

6. As part of its evidence, counsel for the MFDA read into the record portions of an August 12, 2014 interview of DZ and EZ. The interview was conducted principally by Ms. Patricia West, a very experienced senior investigator at the MFDA. Ms. West conducted the investigation after the Zs' daughter e-mailed a complaint with respect to the Respondent's conduct in relation to her parents' investments and leverage strategy. The e-mail referenced her parents' $230,000.00 loan for investments at a time when they were in their early seventies and their only income was a low fixed pension. At the time of the e-mail (July, 2013) EZ was 80 and DZ was 78. (Exhibit 5).

7. Ms. West conducted an extensive interview of DZ and EZ on August 12, 2014 and September 16, 2014.

8. With respect to the Respondent's knowledge that the Zs were making a complaint, in the interview of DZ and EZ on August 12, 2014 (Exhibit 7) the following exchange occurred:

> "MS. WEST: And did that discussion with him about taking over – potentially taking over your loan as a solution, come after KZ had sent him a lengthy e-mail explaining that he thought that this was a concern?
>
> MR. Z: Yes, it would have been after KZ was involved, yes.
>
> MS. WEST: Would it have been after – where Rod was expressing some distress to you guys about getting – talking to KZ about your investments and wondering what KZ wanted out of it?
>
> MR. Z: I think maybe, but – yes. I can't give it exactly the sequence here, but it was certainly in that context.
>
> MS. WEST: Do you think he understood that you were complaining about your investments at that point?
>
> MR. Z: Rod?
>
> MS. WEST: Yes, that you were deeply concerned that this could be considered a complaint as opposed to we have a problem, let's find a solution?
>
> MR. Z: Well, I think he could have interpreted it as a real concern. I don't know, you know, the difference between that and complaint. I guess it could have been seen as a complaint. Like, we were very unsettled by it, lost a lot of sleep over it."
>
> (Pages 54 and 55)

9. In the interview Ms. West conducted on September 16, 2014 with the Zs, DZ confirmed that both he and KZ (their son) sent e-mails to the Respondent, and that "if KZ sent the e-mail, we did some consultation with him before he sent them, yes."

10. Mr. Z also stated:

> "MS. WEST: Okay, thanks, that's completely understandable also. Did you ever tell Mr. Warren to ignore requests from KZ when KZ was looking for documents or information?

MR. Z: No, we did not. We felt that KZ – whatever – we were in a sort of a desperate situation and in the course of them, then also we engaged a lawyer, which I think is also on record."

(September 16, 2014 interview, page 5)

11. Further, in the September 16, 2014 interview, Mr. Z confirmed to Ms. West that during this period the family was having very open discussions with respect to the Respondent and the portfolio. Mr. Z told Ms. West:

"MR. Z: …we did not feel that we were getting satisfactory responses from Rod Warren because he would give us some indication that well, maybe he could take the portfolio over and there wasn't – it wasn't satisfactory to us. And so KZ may well I think have suggested we need to take it another step if we're not going to get satisfaction from Mr. Warren."

MS. WEST: And at this point you had already been dealing with Mr. Warren since May of 2012; is that correct?

MR. Z: We dealt with him much earlier than that.

MS. WEST: Regarding the actual – KZ's involvement, though.

MR. Z: Oh, I see. Yes, I guess – yes, I don't have the time in my mind real clear, but if it's on record like that, that's when it would have been, yes.

MS. WEST: Yes, there's some notes there that indicate kind of mid-May is when KZ first contacted Mr. Warren and you authorized Mr. Warren to talk to him, so four months have gone by and it's fair to say you weren't getting resolution so you escalated it one more step?

MR. Z: Right."

(MFDA Interview with the Zs September 16, 2014, Exhibit 8, pages 6 and 7.)

12. The Respondent, in his MFDA interview on September 26, 2014 (Exhibit 6) said that DZ and EZ's son KZ got involved early in the summer, and there was a joint phone call between KZ, DZ and the Respondent. He said KZ wanted to find out the nature of the investments and discuss

what was going on with them so that he could help advise his parents what to do. (Exhibit 6, Page 18 and 19).

13. MFDA Policy No. 6, subsection 4.1(a) sets out the approved person reporting requirements as follows:

> "4.1. An Approved Person shall report the following events to his or her current Member in such detail as required by the Member, within 2 business days:
>
> (a) the Approved Person is the subject of a client complaint in writing;
> (b) the Approved Person is aware of a complaint from any person, whether in writing or any other form, and with respect to him or herself, or any other Approved Person…"

14. MFDA Policy No. 3 defines a complaint:

> "A "complaint" shall be deemed to include any written or verbal statement of grievance, including electronic communications from a client, former client, or any person who is acting on behalf of a client,…alleging a grievance involving the Member, Approved Person of the Member…"

15. In paragraph 9 of MFDA Policy No. 3, it states:

> "1. All client complaints and supervisory obligations must be handled by qualified sales supervisors/compliance staff. **An individual who is the subject of a complaint must not handle the complaint unless the Member has no other supervisory staff who are qualified to handle such complaints.** (emphasis added)
>
> 2. Each Approved Person **must report certain complaints and other information relevant to this Policy to the Member as required under MFDA Policy No. 6."** (emphasis added)

16. Further, paragraph 10 of MFDA Policy No. 3 states:

> "No Approved Person shall, without the prior written consent of the Member, enter into any settlement agreement with, pay any compensation to or make any restitution to a client."

17. With respect to the Member, at all material times PSC's policies and procedures required its Approved Persons, including the Respondent, to immediately report any client complaints to PSC. PSC's Policy 6.03 entitled "Prohibition against Settlement by Advisor or Branch Manager" states:

> "No Advisor or branch manager shall enter into any settlement of a complaint with a client, whether the settlement is in the form of a monetary payment, delivery of securities, reduction of commissions or any other form. Settlement of a complaint may only be negotiated and entered into by the CCO."

18. Further, in Section 6.04 of the Policy and Procedures Manual, it provides that "all complaints from clients must be reported, immediately upon receipt, to the applicable branch manager…" and provided that the branch manager would forward all written or documented verbal complaints to the CCO. (Exhibit 9).

19. The Respondent acknowledged that he was bound by the MFDA Rules and Policies, and acknowledged reading PSC's policy manual. (Exhibit 10).

20. By an e-mail to the Respondent on May 22, 2012, KZ made a complaint to the Respondent with respect to his handling of the accounts of DZ and EZ and the suitability of the leverage investments strategy the Respondent recommended to them. (Exhibit 14). The Respondent did not disclose this to PSC.

21. The Respondent, in an e-mail on June 18, 2012 to DZ, EZ and KZ, stated:

> "I have been doing some thinking, praying, consulting, and researching, and it is too early to say conclusively, but there may be a possible resolution. It is too theoretical to say yet and will require some discussion, but there may be a way out that not only can be "loss free" but may even provide a positive end result. An idea or two came to me today that could work, and it would need to be discussed as an option. I do not mean to be vague, but my idea would require more research to confirm it is onside before I detail anything. One thing I would like to say up front is that whatever path is chosen, it only makes sense if it is win–win. I am committed to do everything in my power to help [DZ] and [EZ] to get through this with a good end result, but there may need to be flexibility and willingness in order for it to work. If there are strict parameters imposed or unwillingness to be

> flexible then my hands will be tied and I may not be able to do anything to help. Of course I want to help and if I can I will, but it will require a cooperative spirit. I do not want to get into a scenario that is adversarial, and I do not want to get into a scenario where people are unwilling to flex on some options that just may need to be considered in order to have the opportunity for a positive resolution. I just cannot step forward to try to help if I have feelings that I am working with an adversary or if I feel that I am being threatened, whether in context of financial, reputation, or otherwise. I want to help [DZ] and [EZ] and would do so willingly and joyfully, but not if I feel that there is simultaneously a feeling that I am being investigated, challenged, or threatened. In whatever manner of help I am able to provide, it must be received on win-win cooperative terms, not on terms that sound like "help out or else…". (Exhibit 15).

22. In an e-mail to DZ and EZ on July 11, 2012, the Respondent stated:

> "2) The proposal is quite simple: That I would assume the investment loan package (both loan and investments); this would relieve you of the obligation for the investment loan balance and the associated monthly payments. As the fund value is currently lower than the loan, I would also assume that loss as well." (Exhibit 16, page 1).

23. As no resolution was forthcoming from the Respondent, DZ and EZ retained a lawyer, Lawrence Smith of Kuhn LLP. In a letter dated July 19, 2012 to the Respondent at PSC, Mr. Smith advised that he was counsel representing DZ and EZ and requested copies of the Respondent's entire files for both DZ and EZ. He attached an authorization for the release of this information. Mr. Smith also stated:

> "We understand from our consult with [DZ] and [EZ] that you are prepared to make the required interest payments on the leveraging loans until this matter is resolved through mediation. This offer is accepted. …"

Mr. Smith also advised that the Zs did not object to continued direct communications with the Respondent. He asked that any e-mail correspondence be copied to him. The Respondent did not disclose this letter to PSC. (Exhibit 19).

24. In a letter to the Respondent dated August 13, 2012 Mr. Smith referenced his letter of July 19, 2012 and noted that he had not received the requested files, and enquired when he could expect to receive the files. Further, he advised that the Zs now wished only to communicate

through counsel. Mr. Smith requested that the Respondent no longer contact the Zs directly. He stated "All communication should come through our office." (Exhibit 20). The Respondent did not report this letter to PSC.

25. By a letter dated August 22, 2012, sent by fax and e-mail, Mr. Smith again wrote to the Respondent on behalf of his clients the Zs. Mr. Smith confirmed that he had not received a response to his request for documents and files, but set out, in twenty-one numbered paragraphs, what he understood to be the "facts". This included matters such as the original investment of $116,000, Zs attending a seminar hosted by the Respondent that dealt primarily with leverage investing, the fact the Zs were encouraged to borrow $200,000 in order to participate in the leveraging investments, and the fact the Zs raised concerns at the time of the loans about their age and limited financial position. Mr. Smith went on to set out his view of the law that related to the Zs and the Respondent, and the Respondent's duties and responsibilities to the Zs. He stated:

> "Our opinion is that there is an arguable case that you owed a fiduciary duty to the Zs and failed to discharge the duty properly. Such a claim may include damages to put the Zs in as good a position as they would have been had the breach not occurred, including expectation loss. The full amount of that claim for damages would require calculation based on the investments between 1997 and 2006 in an alternative investment plan that was suitable given the Zs' investment goals, but it could be substantial." (Exhibit 21).

This letter advising of potential legal action against the Respondent was not reported to PSC.

26. In an email on August 31, 2012 to DZ and EZ, copy to Mr. Smith, the Respondent attempted to respond to the request for documentation. However on September 4, 2012 DZ and EZ sent an e-mail to the Respondent in which they stated *(inter alia)*:

> "After careful thought and extensive legal and otherwise professional counsel and the now four month old attempt to have clarity regarding our retirement investments portfolio, we are providing the following solution. It is also an immediate follow-up to your most recent, August 31st email addressed to us with copy to Lawyer, Lawrence Smith, to which you attached Mr. Smith's previous letter to you.

> Given the events over the approximately fifteen years in our retirement dealings with you, as outlined in Lawrence Smith's letter to you; and given that at our ages of 79 and 77 we simply can no longer live under the stress and high risk financial uncertainty that our retirement portfolio brings into our lives, we require the following:
>
> That we receive from you payment in the amount of $116,000, the amount initially invested with you, and that we are freed from payment of any negative spread, fees or penalty for walking away from the portfolio. If you can agree to this solution there will be no further legal action taken on our part and we need assurance that neither will you pursue legal action. If you decide against this solution then we must advise you that we will need to turn the matter over to our legal counsel. ...". (Exhibit 22).

27. As part of her investigation, Ms. West found that between July 2012 and September 2012, the Respondent had telephone conversations and exchanged e-mails with DZ and EZ and/or their lawyer attempting to negotiate a settlement of the complaint. In his interview with Ms. West, DZ confirmed that it was his practice to e-mail KZ and his lawyer after each call with the Respondent during this period, to report the conversation. In his MFDA interview on August 12, 2014 DZ told Ms. West that he sent these e-mails very soon after his conversation with the Respondent and that he would jot down notes during his conversations with the Respondent; however he did not keep the notes. With reference to the e-mail dated July 12, 2012, DZ told Ms. West:

> "Right. Oh, yes, I remember about this. Rod called to reassure me that he is prepared to make the approximately $833 payment in August to keep the account afloat as he works at taking over the portfolio – and so on. Yes, this was the discussion that I mentioned earlier, where he was considering or trying, whatever. That never happened, he never did pay anything." (Exhibit 7).

28. PSC did not become aware that the Respondent had received the complaint from DZ and EZ, or that the Respondent had attempted to settle their complaint, until about September 17, 2012 when KZ contacted PSC's Chief Compliance Officer, Ken Parker, and informed him of these events. By an e-mail dated September 18, 2012 to KZ, Mr. Parker acknowledged receiving a complaint about the Respondent on September 17, 2012 in a telephone call from KZ, regarding the accounts of DZ and EZ. Mr. Parker advised that he would be handling the complaint. (Exhibit 13).

29. On September 24, 2012 the Respondent advised Mr. Parker that he had received the September 4th e-mail from DZ and EZ and in a reply e-mail to the Respondent Mr. Parker stated:

> "In the future, you can safely assume that any time a client tells you (whether you agree or not) that you owe them money due to the way their account has been handled, it is a "complaint". The Zs' complaint fits within the criteria in MFDA Policies 3 and 6 so I have filed it with the MFDA on their "event tracking" system. I will let you know if they have any questions." (Exhibit 24).

THE APPLICABLE RULES AND LAW

30. MFDA Policy No. 6, subsection 4.1(a) states:

> "4.1. An Approved Person shall report the following events to his or her current Member in such detail as required by the Member, within 2 business days:
>
> (a) the Approved Person is the subject of a client complaint in writing;…"

31. MFDA Policy No. 3, in paragraph 1 Complaints, section 2 Definition states:

> "A "complaint" shall be deemed to include any written or verbal statement of grievance, including electronic communications from a client, former client, or any person who is acting on behalf of a client…alleging a grievance involving the Member…if the grievance involves matters that occurred while the Approved Person was an Approved Person of the Member."

32. MFDA Rule 2.1.1, dealing with business conduct, states:

> "2.1.1. **Standard of Conduct.** Each Member and each Approved Person of a Member shall:
>
> (a) deal fairly, honestly and in good faith with its clients;
> (b) observe high standards of ethics and conduct in the transaction of business;
> (c) not engage in any business conduct or practice which is unbecoming or detrimental to the public interest; and

(d) be of such character and business repute and have such experience and training as is consistent with the standards described in this Rule 2.1.1, or as may be prescribed by the Corporation."

33. MFDA Rule 1.1.2 states:

"Compliance by Approved Persons. Each Approved Person who conducts or participates in any securities related business in respect of a Member in accordance with Rule 1.1.1.(c)(i) or (ii) shall comply with the By-laws and Rules as they relate to the Member or such Approved Person."

34. MFDA Rule 2.5.1 states:

"Member Responsibilities. Each Member is responsible for establishing, implementing and maintaining policies and procedures to ensure the handling of its business is in accordance with the By-laws, Rules and Policies and with applicable securities legislation."

35. With respect to onus and standard of proof, the Supreme Court of Canada in *F.H. v. McDougall* (2008) S.C.J. No. 54 stated:

"**(4) <u>The Approach Canadian Courts Should Now Adopt</u>:**

40. Like the House of Lords, I think it is time to say, once and for all in Canada, that there is only one civil standard of proof at common law and that is proof on a balance of probabilities. Of course, context is all important and a judge should not be unmindful, where appropriate, of inherent probabilities or improbabilities or the seriousness of the allegations or consequences. However, these considerations do not change the standard of proof… .

45. To suggest that depending upon the seriousness, the evidence in the civil case must be scrutinized with greater care implies that in less serious cases the evidence need not be scrutinized with such care. I think it is inappropriate to say that there are legally recognized different levels of scrutiny of the evidence depending upon the seriousness of the case. There is only one legal rule and that is that in all cases, evidence must be scrutinized with care by the trial judge.

46. Similarly, evidence must always be sufficiently clear, convincing and cogent to satisfy the balance of probabilities test. But again, there is no

objective standard to measure sufficiency. … If a responsible judge finds for the plaintiff, it must be accepted that the evidence was sufficiently clear, convincing and cogent to that judge that the plaintiff satisfied the balance of probabilities test."

"**(5) <u>Conclusion on Standard of Proof</u>:**

49. In the result, I would reaffirm that in civil cases there is only one standard of proof and that is proof on the balance of probabilities. In all civil cases, the trial judge must scrutinize the relevant evidence with care to determine whether it is more likely than not that an alleged event occurred."

36. The two key principals in Rule 2.2.1 are Know-Your-Client and Suitability. In *Re Daubney*, 2008 LNONOSC 338 (OSC) the Commission stated:

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

16. The Alberta Securities Commission (the " ASC") described these two obligations as follows:

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

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

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

17. Canadian securities authorities have adopted a three-stage analysis of suitability, according to which a registrant is obliged to:

(a) use due diligence to know the product and know the client;

(b) apply sound professional judgment in establishing the suitability of the product for the client; and
(c) disclose the negative as well as the positive aspects of the proposed investment."

See *Lamoureux* 2001 LNABASC 433.

37. On the facts of this case, it was critical that the Respondent use his best professional judgment to assess whether a leveraged investment strategy was suitable for clients DZ and EZ, and HN and MN. In the Agreed Statement of Facts the Respondent admits that the leveraged investment strategy was **not suitable** for these four clients for the following reasons:

(a) The clients' age – DZ and EZ were in their seventies, and HN and MN were into their sixties;
(b) Employment status – DZ and EZ were retired, and HN and MN were near retirement;
(c) Ability of the clients to afford the costs associated with the investment loans, particularly on a monthly basis; and
(d) Ability to withstand investment losses.

38. Based upon the clear, convincing and cogent evidence that was submitted during the hearing, including the testimony of the Respondent, we find the Respondent breached the standard of conduct to be followed by all Approved Persons by:

Firstly, as admitted to in the Agreed Statement of Facts in regards to Allegation No. 1.

Secondly, in failing to report complaints by DZ and EZ after receiving three letters from their lawyer threatening to possibly pursue legal action against the Respondent regarding his recommendation of the leveraged investment strategy.

Thirdly, failing to report clients DZ and EZ demand for repayment of their initial investment capital of $116,000.00 due to his unsuitable investment recommendations.

Fourthly, by attempting to negotiate a settlement with clients DZ and EZ while failing to report the complaint, or the attempts to settle to PSC.

> Further, the Respondent breached PSC's policies and complaint handling in concealing DZ and EZ's complaint from the Member PSC thus circumventing the supervision process that protects investors and the public. There is no question that at all material times, PSC's Policies and Procedures required its Approved Persons, including the Respondent, to immediately report any client complaints to PSC. We have already referred to the definition of a "complaint", and the fact that PSC's policy required that a settlement may only be negotiated by the Chief Compliance Office.

39. We agree with the submission of MFDA staff that the obligation of Approved Persons to comply with the Policies and Procedures of the Members that they are registered with, is a cornerstone of the self-regulatory system.

40. Further, in previous MFDA cases, hearing panels have determined that a respondent's failure to comply with the Policies and Procedures of the Member constitutes a breach of the standard of conduct and MFDA Rules. See in the matter of *Tonnies* (2005), MFDA File No. 200503, Panel Decision dated June 27, 2005 at page 16 to 19 ("Tonnies"). We make that finding in respect of the Respondent's conduct as previously noted.

41. As can be seen from Section 4.1 of MFDA Policy No. 6, an Approved Person is required to report to the Member **within two business days** if the Approved Person is the subject of a client complaint in writing or is aware of a complaint from any person, whether in writing or in any other form with respect to him. Again the Respondent knowingly breached this policy.

42. At all material times the Respondent was a very knowledgeable, experienced investment advisor, who had been a branch manager. The e-mails sent by DZ and EZ, and KZ, clearly were a complaint. We reject Respondent's counsel's submissions with respect to a strict interpretation of the definition of "complaint". In our view there clearly was a complaint made to the Respondent from his clients which he failed to report to the Member.

43. The Respondent purposefully concealed DZ and EZ's complaint from PSC, and attempted to resolve their complaint without reporting the complaint to PSC. Obviously this interfered with PSC's ability fulfill its obligations as a Member, and protect DZ and EZ.

44. We agree with MFDA counsel's submission that the standard of conduct, the conflicts of interests rule, and the complaint handling obligations of registrants are cornerstones of investor protection in the securities industry. We find that all three of these rules were contravened when the Respondent attempted to negotiate a private settlement with the complainants DZ and EZ.

45. We note that as a result of the Respondent's conduct, the Zs were deprived of the proper complaint handling process for four months, before PSC became aware of the complaint. Once PSC became aware of the complaint it triggered the proper process, which resulted in the Zs' loan being collapsed, and the Zs receiving compensation from Investia.

46. We note that a contravention of MFDA Policy No. 3 has been found to be a contravention of the standard of conduct obligations set out in MFDA Rule 2.1.1: re: *Rempel, (2015)* MFDA File No. 201348, September 3, 2015.

47. On the whole of the evidence we find that Allegation #3 has been proved.

PENALTY

48. In Re: *Hill and Crawford Investment Management Group Ltd. and Albert Rodney Hill* (2009) MFDA Central Regional Council, MFDA File No. 200834, June 23, 2009, the panel stated:

> "**3.** The breaches of rules and regulations by HCIM and Mr. Hill indicate a certain irresponsibility and a lack of reasonable care in their attempts to meet the requirements and to obey the rules and regulations of the MFDA. Mutual fund dealers carry on a business which is based upon the trust of their clients. Their clients rely upon the dealer for care and maintenance of the funds that they invest with them and rely upon them to act in compliance with MFDA rules and regulations. The punishments that are

imposed must reflect the gravity of the breaches and the importance of the maintenance of the trust of clients and members of the public generally in the work of MFDA dealers.

4. A business which is of necessity based upon trust must always do its utmost to preserve that trust and when that trust is breached, to ensure that penalties which are imposed will help to reestablish the trust of the public in the dealers."

49. In *Tonnies, supra,* the panel stated:

"The Ontario Securities Commission has set out succinctly its role, not dissimilar to the role of this Panel, in determining penalty in Re: *Mithras Management Ltd. et al.* (1990) 13 OSCB 1600.

The Commission stated at 1610:

> …[T]he role of this Commission is to protect the public interest by removing from the capital markets – wholly or partially, permanently or temporarily as the circumstances may warrant – those whose conduct in the past leads us to conclude that their conduct in the future may well be detrimental to the integrity of those capital markets. We are not here to punish past conduct; that is the role of the courts, particularly under section 118 of the *Act*. We are here to restrain, as best we can, future conduct that is likely to be prejudicial to the public interest in having capital markets that are both fair and efficient.

Several previous decisions of industry tribunals, including an MFDA tribunal (*Re Parkinson* [2005] MFDA Case No. 200501), have found the following factors should be taken into account in determining the appropriate sanctions to impose:

(a) the protection of the investing public;
(b) the integrity of the securities market;
(c) specific and general deterrents;
(d) the protection of the governing body's membership; and
(e) the protection of the integrity of the governing body's enforcement processes.

Moreover, the Supreme Court of Canada in the *Cartaway* Decision, *supra*, has indicated that general deterrence is an appropriate consideration in making orders that are both protective and preventative. At para. 61 of that case, the Court stated:

> In a word, a general deterrent is preventative. It is therefore reasonable to consider general deterrents as a factor, albeit not the only one, in imposing a sanction under s. 162. The respective importance of general deterrents as a factor will vary according to the breach of the Act and the circumstances of the person charged with breaching the Act.
>
> Previous tribunals have set out a number of additional factors that should be considered in determining penalty. They include:
>
> - The seriousness of the allegations proved against the respondent;
> - The respondent's past conduct, including prior sanctions;
> - The respondent's experience in the capital markets;
> - The level of the respondent's activity in the capital markets;
> - Whether the respondent recognizes the seriousness of the improper activity;
> - The harm suffered by investors as a result of the respondent's activities;
> - The benefits received by the respondent as a result of the improper activity;
> - The risk to investors in the capital markets in the jurisdiction, were the respondent to continue to operate in capital markets in the jurisdiction;
> - The damage caused to the integrity of the capital markets in the jurisdiction by the respondent's improper activities;
> - 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;
> - The need to alert others to the consequences of inappropriate activities to those who are permitted to participate in the capital markets; and
> - Previous decisions made in some of the circumstances.
>
> See *Belteco Holdings Inc.* (1998) 21 O.S.C.B. 7743; *M.C.J.C. Holdings and Michael Cowpland* (2002), 25 O.S.C.B. 1133; and *Lamoureux (Re)*, (2002) A.S.C.D. No. 125."

50. MFDA staff proposed the following sanctions be imposed on the Respondent:

a) A fine of at least $50,000.00;
b) A suspension of at least three years on his authority to conduct securities related business in any capacity over which the MFDA has jurisdiction;

c) After the conclusion of this Suspension and upon becoming re-registered in the mutual fund industry:

i. A permanent prohibition on recommending new leveraged investments for clients;

d) Costs of at least $10,000.00.

Staff submitted the proposed penalties reflected 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.

51. Further, Staff submitted that the proposed penalties would foster an improved overall compliance by mutual fund industry participants, especially in relation to leveraged investing practices, and will additionally emphasize the importance of providing skilled and careful advice in dealing with vulnerable clients such as DZ and EZ, given their age. Staff submitted the penalties sought would not only discourage future misconduct by the Respondent, but more generally discourage other industry participants from failing to comply with their fundamental duty to know their clients, and encourage them to perform suitability assessments when recommending and implementing particular investments for them. We agree.

52. Counsel for the Respondent tendered an Affidavit of the Respondent sworn May 4, 2016 and he was cross-examined by counsel for the MFDA. In his Affidavit, the Respondent stated he has suffered both professional and personal reputational damage as a result of the allegations in the Notice of Hearing, and that his client referrals have declined. He also stated that if was prohibited from working as a financial planner for any length of time, he would have no way to meet his personal or business financial obligations, which included the employment of four fulltime administrative staff members in his business. Counsel for the MFDA objected to certain paragraphs in the Affidavit as being hearsay, and had the opportunity to cross-examine the Respondent on his Affidavit.

53. In his Affidavit the Respondent states he would face financial difficulties if a suspension or prohibition of any length of time were imposed. However, as counsel for staff pointed out, in

past cases MFDA Panels have considered the financial difficulty of the respondent as a mitigating factor in determining penalty. Despite the presence of financial difficulty MFDA Panels still ordered penalties with prohibitions and large fines.

54. Counsel for Staff referred us to several cases where the respondents made submissions that they faced financial difficulty. In *Re Gragasin* (2014) MFDA File No. 201249, July 9, 2014, the respondent admitted to submitting false information on a Client Account Application, a Loan Application and that the Leveraged Investment Strategy was unsuitable for the clients. The Panel ordered a three year prohibition, a fine of $30,000.00, and costs of $5,000.00.

55. In *Re Macareag (2014)* MFDA File No. 201142, June 24, 2014, the Respondent Macareag made penalty submissions regarding financial difficulty. He submitted his financial situation was such that he was living pay cheque to pay cheque, was living on debts, and was being garnished by other institutions. Notwithstanding these submissions, the Panel ordered a seven year prohibition, strict supervision for one year, a fine of $150,000.00, and costs of $10,000.00.

56. In *Re Popovich*, (2015) MFDA File No. 201240, May 27, 2015, the Panel stated:

> "18. A fine is also warranted and supported by existing jurisprudence. It is true that the imposition of a permanent prohibition may well make it less likely that a fine will ever be paid. (A suspension of fixed duration can be coupled with both a fine and conditions that require payment of the fine before re-registration is permitted). Nonetheless, the imposition of a fine signals our repudiation of the Respondent's conduct, and serves the objectives earlier described.
>
> 19. In our view, a fine of $100,000.00 takes into consideration the totality of circumstances, including an admittedly imprecise calculation of the Respondent's anticipated compensation, his personal and family circumstances, some evidence (albeit limited) of financial difficulties, and the fact that we are permanently prohibiting him from ever practicing in this industry."

57. We were also referred to the MFDA Penalty Guidelines including the paragraphs relating to Vulnerable Clients, Prior Warnings, Premeditation, And Harm suffered by investors as a result

of the Respondent's activities. We acknowledge the penalty types and ranges stated in the Guidelines are not mandatory; the Guidelines suggest the types and ranges of penalties that would be appropriate for particular case types. We have considered the penalty guideline recommendations in the appropriate categories.

58. After carefully considering the evidence, the submissions of counsel, and the authorities cited with respect to penalty, it is the unanimous view of this Panel that the following penalties be imposed on the Respondent, (which we ordered on May 5, 2016):

a) shall pay a fine in the amount of $100,000.00, pursuant to section 24.1.1(b) of MFDA By-law No. 1;
b) A ninety day suspension of the Respondent to conduct securities related business in any capacity, such suspension commencing May 9, 2016;
c) After completion of the aforesaid suspension, twelve months of strict supervision, followed by a further twelve months of close supervision;
d) A permanent prohibition of the Respondent from any leveraging with respect to clients/investors; and
e) Costs in the amount of $10,000.00.

DATED this 27th day of October, 2016.

"Stephen D. Gill"

Stephen D. Gill
Chair

"Holly Millar"

Holly Millar
Industry Representative

"Brian Cheung"

Brian Cheung
Industry Representative

DM 507668 v1