



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: IQON FINANCIAL INC.

SETTLEMENT HEARING

Hearing: May 24, 2007

Decision: May 24, 2007

DECISION AND REASONS

Hearing Panel of the Pacific Regional Council:

Hon. Roger Kerans FCI Arb, C Arb	Chair
David Webb	Industry Representative
Tina Coulson	Industry Representative

Appearances:

Jason D. Bennett, Esq.)	For the Mutual Fund Dealers Association of
)	Canada
Michael J. Roland, Esq.)	IQON Financial Inc

By Notice of Settlement Hearing, the Mutual Fund Dealers Association of Canada (“MFDA” or “the Association”), announced that it proposed to hold a hearing to consider whether, pursuant to section 24.4 of MFDA By-law No. 1, a Hearing Panel of the Pacific Regional Council should accept the Agreement entered into by MFDA staff and IQON Financial Inc (“the Respondent”). This hearing was held in Vancouver, B.C., on May 24, 2007, at the conclusion of which, the Panel accepted the Agreement, subject to the submissions made at the hearing. What follows are the Panel’s reasons.

The facts, as agreed by the parties, are as follows:

Registration History

6. The Respondent has been registered as a mutual fund dealer in the province of British Columbia since March 10, 1998. The Respondent is also registered as a mutual fund dealer in Alberta, Saskatchewan, Manitoba, Ontario, New Brunswick, Prince Edward Island, Nova Scotia, Newfoundland, Yukon, Northwest Territories and Nunavut. The Respondent has been a Member of the MFDA since May 10, 2002.

7. Between May 28, 1998 and October 16, 2006, Patrick Dennis Sullivan (“Sullivan”) was an Approved Person of the Respondent. Sullivan was first registered as a mutual fund salesperson in British Columbia on July 21, 1997.

All Island Equity Mortgage Investment Corp.

8. On or about February 27, 1997, Sullivan established All Island Equity Mortgage Investment Corp. (“AIEMIC”), a mortgage investment corporation registered with the Financial Institutions Commission of British Columbia. Sullivan and William Walker were the original Class A shareholders of AIEMIC.

9. In addition to the Class A shares, AIEMIC also issued Class B non-voting preferred shares (the “Shares”). By May 1998, AIEMIC had raised approximately \$1.1 million from 22 investors in the Shares. Investors in the Shares were entitled to receive a quarterly dividend based on the performance of AIEMIC.

10. On April 22, 1998, Sullivan entered into a Representative Commission Agreement with the Respondent, at which time he disclosed to the Respondent his interest and involvement in AIEMIC.

11. Following discussions between the Respondent and the British Columbia Securities Commission (the "BCSC") concerning Sullivan's involvement with AIEMIC, the BCSC allowed the transfer of Sullivan's registration as a mutual fund salesperson to the Respondent only after Sullivan agreed to restrict his involvement with AIEMIC to acting as a director and member of its management committee. On May 28, 1998, Sullivan was granted registration as a mutual fund salesperson with the Respondent on that basis. To give effect to this arrangement, on or about May 29, 1998, Sullivan signed an undertaking (the "Sullivan Undertaking") in which he stated that he "will not participate in or initiate any activities relative to the sale, promotion or solicitation of business or investments in or on behalf of [AIEMIC]."

12. In May 2002, the Respondent had an internal policy in place, section 8.4.2 of which stated that its Approved Persons in British Columbia were not authorized to trade in exempt securities, with the exception of British Columbia labour sponsored funds and certain government bonds and debentures (the "Internal Policy").

13. Outside of a routine audit, between May 1998 and February 2003, the Respondent did not take any additional steps to supervise Sullivan's compliance with the terms of the Sullivan Undertaking.

14. In or around February 2003, Sullivan asked the Respondent to approve certain radio advertisements relating to AIEMIC. As a result, the Respondent became aware that Sullivan may not have been complying with the terms of the Sullivan Undertaking and ought to have been aware that Sullivan may not have been complying with the Internal Policy.

15. Between February and July 2003, the Respondent conducted a review of Sullivan's activities involving AIEMIC (the "review"). Following the review, the Respondent concluded that Sullivan was not complying with the terms of the Sullivan Undertaking and was therefore engaging in activity that was contrary to the basis on which the BCSC had approved the transfer of his registration to the Respondent.

16. The Respondent notified Sullivan of the outcome of the review shortly after its completion. Between August 5, 2003 and October 21, 2003, Sullivan and senior staff of the Respondent entered into discussions on how to bring Sullivan into compliance with the Sullivan Undertaking and the Respondent into compliance with its obligations to the BCSC.

17. Between October 2003 and January 2006, despite having concluded that Sullivan was not in compliance with the terms of the Sullivan Undertaking, the Respondent did not take any action to ensure that Sullivan complied with the Sullivan Undertaking, the Internal Policy, MFDA Rule 1.1.1(a) or the requirements of the *Securities Act (British Columbia)*.

18. After being contacted by the MFDA in January 2006 about Sullivan's involvement with AIEMIC, the Respondent commenced another investigation of Sullivan's involvement with AIEMIC, which ultimately led to the Respondent placing Sullivan under close supervision in May 2006.

19. Sullivan resigned from the Respondent effective October 16, 2006.

20. By virtue of Sullivan's non-compliance with the Sullivan Undertaking, the Respondent was not in compliance with its obligations to the BCSC.

21. From inception to June 2006, AIEMIC represents that it raised approximately \$10,842,750 from over 120 investors. Of this amount, approximately \$5,527,362 was invested between May 28, 1998, when Sullivan joined the Respondent, and July 2003, when the Respondent concluded the review. An additional amount of approximately \$4,066,130 was raised between the conclusion of the review and June 2006.

22. Approximately 60% of the investors in AIEMIC were clients of the Respondent (the "clients"). Between 1997 and 2006, AIEMIC represents that the clients invested \$3,703,280, collectively, in AIEMIC. Of this amount, \$2,349,320 was invested after the Respondent joined the MFDA. Sullivan provided the clients with portfolio statements on the Respondent's letterhead which showed their investments in AIEMIC alongside other securities held with the Respondent. In total, the clients redeemed approximately \$547,440 of their mutual fund holdings with the Respondent to invest in AIEMIC.

23. To date, neither the Respondent nor the MFDA have received any complaints in respect of AIEMIC or Sullivan's involvement with AIEMIC. AIEMIC reports that between March 31, 1998 and December 31, 2005 the average annual yield paid to investors was 10%.

Breach of Agreement and Undertaking

(i) Compliance Deficiencies Detected

24. In March 2005, MFDA Compliance Staff conducted a routine compliance examination of the Respondent's sales policies, procedures and practices, the findings of which were reported to the Respondent on July 14, 2005. This was the first MFDA examination of the Respondent's sales policies, procedures and practices.

25. A number of deficiencies were identified, including in particular:

- (a) inadequate, incomplete or undocumented trade review and supervision at both the head office and branch office levels;
- (b) lack of evidence of client trading instructions; and
- (c) untimely or undocumented new account approval practices.

26. The deficiencies were of such a nature that MFDA Compliance Staff referred the results of the examination to MFDA Enforcement Staff for possible disciplinary action.

27. In December 2005, in consideration of the MFDA foregoing disciplinary proceedings in respect of the deficiencies, the Respondent signed an Agreement and Undertaking with the MFDA pursuant to which the Respondent agreed to resolve the deficiencies (the "Agreement and Undertaking"). Under the terms of the Agreement and Undertaking, the Respondent agreed to: (a) to develop and implement a plan to remedy the deficiencies; and (b) retain an independent consultant to determine whether the deficiencies had been rectified, identify any new or continuing deficiencies, and report its findings to the MFDA.

28. On August 21, 2006, MFDA Staff approved the plan developed by the Respondent to remedy the deficiencies.

29. In September 2006, the Respondent retained KPMG LLP ("KPMG") as an independent consultant to test the implementation of the Respondent's plan. KPMG completed its testing in February 2007 and reported its findings to MFDA Staff on March 30, 2007.

(ii) Repeat Compliance Deficiencies Identified

30. KPMG's testing confirmed that the Respondent had resolved a large number of the deficiencies in accordance with the terms of the Agreement and Undertaking. However, despite improvements having been made to the Respondent's sales policies,

procedures and practices, the testing also revealed that certain deficiencies remained unresolved, meaning that the Respondent had failed to fully carry out the terms of the Agreement and Undertaking.

31. KPMG's testing revealed, among other deficiencies, three principal ongoing deficiencies (the "Deficiencies"):

- (a) inadequate, untimely or undocumented trade review and supervision at the head office level and untimely trade review and supervision at the branch office level;
- (b) incomplete or untimely review of new accounts; and
- (c) inadequate controls to ensure the documenting of client trading instructions.

32. MFDA Compliance Staff referred the Respondent's failure to fully carry out the terms of the Agreement and Undertaking to MFDA Enforcement Staff for possible disciplinary action.

33. Since KPMG reported its findings on March 30, 2007, the Respondent has started to take steps to address the ongoing deficiencies identified by KPMG. The ongoing deficiencies, other than the Deficiencies, are to be resolved between MFDA Compliance Staff and the Respondent without the assistance of the monitor referred to in paragraph 37(c) below.

The Respondent also acknowledged and admitted guilt, in these words:

Conduct Contrary to the Public Interest

34. The Respondent admits that, contrary to MFDA Rule 2.5.1 and MFDA Policy No. 2, it failed to establish and maintain adequate and effective procedures for the supervision of Sullivan to ensure that:

- (a) Sullivan complied with the terms of the Sullivan Undertaking; and
- (b) the Respondent complied with its own obligations to the BCSC arising from Sullivan's registration with the Respondent.

35. The Respondent admits that, by virtue of its failure to ensure that Sullivan complied with the terms of the Sullivan Undertaking, the Respondent allowed Sullivan to engage in securities related business which was not carried on for the account of the Respondent or through the facilities of the Respondent, contrary to MFDA Rule 1.1.1(a).

36. The Respondent admits that it failed to fully carry out the terms of the Agreement and Undertaking, thereby engaging the authority of the Hearing Panel to impose a penalty on the Respondent pursuant to s. 24.1.2 of MFDA By-law No. 1.

Finally, the parties entered into this Agreement:

Terms of Settlement

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

- (a) the Respondent shall pay a fine in the amount of \$100,000 upon the acceptance of this Settlement Agreement;
- (b) the Respondent shall pay the costs of the MFDA's investigation and of this proceeding in the amount of \$7,500 upon the acceptance of this Settlement Agreement; and
- (c) the Respondent shall retain an independent monitor to address the Deficiencies in accordance with the terms set out in Schedule "B" to the Agreement upon the acceptance of this Settlement Agreement.

38. If this Settlement Agreement is accepted by the Hearing Panel, Staff will not initiate any proceeding under the By-laws of the MFDA against the Respondent or any of its officers or directors in respect of any conduct or alleged conduct of the Respondent in relation to the facts set out in Part IV of this Settlement Agreement, subject to the provisions of paragraph 43 below.

In answer to questions from the Panel, the parties at the hearing made these supplementary consensual submissions in explanation of the settlement agreement, which are also accepted by the Panel:

1. In response to a query what, if anything can be re-visited by MFDA in the event of a further breach by the Respondent in the future, it was said on behalf of MFDA “. . . there are really two halves to the facts. The first half dealing with Mr. Sullivan is a single issue and will be, if the agreement is accepted today, a finished aspect of this hearing. The second part concerns the monitor and compliance deficiencies as an ongoing concern, so to speak, and could be reopened somewhere down the road if there appears to be some type of non-compliance as far

as the action plan is concerned.” In other words, a distinction was being made between the Sullivan affair and other non-compliance irregularities that were discovered. Mr. Roland concurred that the matters described in paragraph 34 of the settlement agreement will be resolved finally by an approving order at hearing.

2. In response to a question whether the Panel should delay approval until the Action Plan is agreed upon, the joint submission is it would be better to approve what has been agreed to so far.

3. In response to a query whether KPMG would in fact act as suggested, the Panel was assured that it had agreed to act.

It is the finding of the Panel that the Respondent, contrary to MFDA Rule 2.5.1 and MFDA Policy No. 2, failed to establish and maintain adequate and effective procedures for the supervision of Sullivan to ensure that:

- (a) Sullivan complied with the terms of the Sullivan Undertaking; and
- (b) the Respondent complied with its own obligations to the BCSC arising from Sullivan’s registration with the Respondent;

and that, by virtue of its failure to ensure that Sullivan complied with the terms of the Sullivan Undertaking, the Respondent allowed Sullivan to engage in securities related business which was not carried on for the account of the Respondent or through the facilities of the Respondent, contrary to MFDA Rule 1.1.1(a).

As to disposition, the Panel affirms the agreed penalty:

- (a) the Respondent shall pay a fine in the amount of \$100,000 upon the acceptance of this Settlement Agreement;
- (b) the Respondent shall pay the costs of the MFDA’s investigation and of this proceeding in the amount of \$7,500 upon the acceptance of this Settlement Agreement; and

- (c) the Respondent shall retain an independent monitor to address the Deficiencies in accordance with the terms set out in Schedule “B” to the Agreement upon the acceptance of this Settlement Agreement.

In coming to this conclusion, the Panel considered and applied the observations made in *Re: Investors Group Financial Services Inc.*, MFDA Case # 200401, (December 16, 2004), and *Re: Joseph Zollo*, MFDA Case # 200610, (April 16, 2007), in determining whether the Settlement Agreement should be accepted, the Hearing Panel will consider a number of factors, including the following:

1. The public interest and whether the penalty imposed will protect investors.
2. Whether the Settlement Agreement is reasonable and proportionate, having regard to the conduct of the Respondent, as set out in the Agreement.
3. Whether the Settlement Agreement addresses the issues of both specific and general deterrence.
4. Whether the proposed settlement will prevent the type of conduct described in the Agreement from occurring again in the future.
5. Whether the Settlement Agreement will foster confidence in the integrity of the Canadian capital markets.
6. Whether the Settlement Agreement will foster confidence in the integrity of the MFDA.
7. Finally, whether the Settlement Agreement will foster confidence in the regulatory process itself.

The panel is of the view that these goals are met by the agreed disposition in this case. The fine is in the range. And particularly, we note that there have been no losses, no complaints, and that the Respondent has been very co-operative and has made admissions and has agreed to the actions as specified. That justifies the imposition of a minimum fine.

DATED at Vancouver, British Columbia, this 18th day of September, 2007.

“Roger P. Kerans”
The Hon. Roger P. Kerans, Chair

“Tina Coulson”
Tina Coulson, Panel Member

“David B. Webb”
David B. Webb, Panel Member

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