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: Keybase Financial Group Inc.

Heard: June 29, 2020 by electronic hearing in Toronto, Ontario
Decision: June 29, 2020
Reasons for Decision: July 24, 2020

REASONS FOR DECISION

Hearing Panel of the Central Regional Council:

Martin L. Friedland, CC, QC	Chair
Edward V. Jackson	Industry Representative
Guenther W. K. Kleberg	Industry Representative

Appearances:

Lyla Simon	)	Enforcement Counsel for the Mutual Fund Dealers Association of Canada
Michael Byers	)	Counsel for the Respondent
Howard Brand		Chief Compliance Officer of the Respondent

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"). A Notice of Settlement Hearing was issued on June 1, 2020. The hearing was held on Monday, June 29, 2020. The full Settlement Agreement, dated May 27, 2020, entered into between Staff of the MFDA and Keybase Financial Group Inc. ("Keybase" or the "Respondent") is available on the MFDA website. Keybase was represented by counsel at the Hearing and Keybase's chief compliance officer appeared by teleconference.

2. The Panel accepted the proposed Settlement Agreement at the conclusion of the June 29, 2020, hearing, with reasons to follow. These are our reasons for the decision.

3. Since May 2003, Keybase has been a Member of the MFDA. It is currently registered as a Mutual Fund and Exempt Product dealer in all provinces in Canada and the territory of Nunavut.

Respondent Failed to Respond Fairly and Promptly to Client Complaints

4. The proposed Settlement Agreement concerns allegations that between 2011 and 2019, the Respondent failed to handle 13 client complaints promptly and fairly, contrary to MFDA Rules 2.11 and 2.1.1, and the complaint handling duties and requirements under MFDA Policy No. 3.

5. MFDA Rule 2.11 states: "Every Member shall establish written policies and procedures for dealing with complaints which ensure that such complaints are dealt with promptly and fairly, and in accordance with the minimum standards prescribed by the Corporation from time to time."

6. Between 2011 and 2014 Keybase received a number of client complaints originating in Atlantic Canada, regarding a leveraged investment strategy that certain clients had implemented in their mutual fund accounts (the "Strategy").

7. The Strategy was that the clients borrowed monies and invested the borrowed monies in return of capital mutual funds ("ROC mutual funds"). With ROC mutual funds, typically investors receive monthly distribution amounts, a portion of which may be investors' original investment amount or capital. It normally occurs when the amount distributed by a fund exceeds the total net income and net capital gains earned by the fund. There are some tax advantages in using this strategy.

8. Between 2008 and 2009, as set out in paragraph 9 of the Settlement Agreement, in the context of the global financial crisis, the unit values of the ROC mutual funds declined, the distributions paid by the ROC mutual funds to investors were reduced and the clients were left with investment loans that required repayment. The clients experienced investment losses.

9. As set out in paragraph 10 of the Settlement Agreement, the client complaints to Keybase alleged the following concerns:

- the Approved Persons had failed to adequately explain the features of the Strategy to clients;
- the Approved Persons projected that the Strategy would generate sufficient returns to pay the clients' borrowing costs, and also allow them to pay down their mortgages more quickly and/or generate excess discretionary income, such that the clients would not have to incur any out-of-pocket expenses to sustain the Strategy;
- the Approved Persons had reported incorrect Know-Your-Client information on the clients' account opening and investment loan documents with respect to the clients' income and assets, risk tolerance and/or investment knowledge, and the liabilities.

10. A number of the clients who submitted complaints also commenced civil lawsuits seeking recovery of their monies.

11. The Respondent admits in paragraph 12 of the Settlement Agreement that it "failed to handle 13 client complaints it received in a fair and prompt manner in accordance with its obligations pursuant to MFDA Policy No. 3 and Rule 2.11."

12. Details about the handling of the client's complaints are set out in paragraphs 13 to 19 of the Settlement Agreement.

13. Paragraphs 13 to 15 describe the admitted fact that Keybase issued inadequate and unfair substantive responses. In spite of MFDA Policy No. 3 and Rule 2.11 that normally require a Member to provide its substantive response within three months of the receipt of the complaint, it took Keybase between seven months and three years to provide a substantive response to seven client complaints.

14. Paragraphs 16 and 17 describe Keybase's failure to investigate and assess the complaints fairly. Keybase, for example, did not treat the complaints as raising suitability issues, disregarded the clients' assertions that Approved Persons had not accurately represented the Strategy, and disregarded the clients' assertions that their Know-Your-Client information was recorded incorrectly on account and loan documents.

15. Paragraphs 18 and 19 describe Keybase's issuing of inadequate and unfair substantive responses. Its responses contained, for example, inadequate or inaccurate outlines of the complaint and did not include the basis for Keybase's conclusions on the suitability of the Approved Person's investment recommendations.

MFDA Rules and Policies Respecting Complaints

16. Rule 2.11, as stated above, provides that "Every Member shall establish written policies and procedures for dealing with complaints which ensure that such complaints are dealt with promptly and fairly, and in accordance with the minimum standards prescribed by the Corporation from time to time."

17. MFDA Policy No. 3 (Complaint Handling, Supervisory Investigations and Internal Discipline) details the requirements on Members to, among other things:

- engage in an adequate and reasonable assessment of all complaints;
- engage in a balanced approach to the gathering of facts that objectively considers the interests of the complainant; and
- ensure that complaints are handled and responded to within the time period expected of a Member acting diligently in the circumstances.

18. As counsel for the MFDA submitted, there is a direct link between client complaints being handled fairly and promptly and fostering continued investor confidence in the mutual fund industry. MFDA Hearing Panels have echoed this proposition.

19. The Hearing Panel in *Re Fundex Investments Inc.* 2019 LNCMFDA 147 stated at paragraph 28: "It is essential to both the success of the mutual fund industry and the protection of the investing public that Members view complaint handling as an integral part of their regular operations, and

prioritize this aspect of their business by handling all client complaints received in a competent and professional manner. As such, all MFDA Members are required to implement policies and procedures for handling client complaints (MFDA Rule 2.11) that address the minimum complaint handling requirements set out in MFDA Policy No. 3."

20. See also *Re Sterling Mutuals Inc.* 2016 LNCMFDA 77, which states at paragraph 16:

> "Prompt and fair complaint handling is a baseline expectation of Members in the industry that is essential for effective supervision and fairness to clients. If complaint handling is not conducted promptly, the potential for effective investigation may be undermined and a complainant may be unfairly deprived of a timely resolution to the complaint. If a complaint is not handled fairly, the process fails investors and is inconsistent with the public interest. Based on their knowledge of the industry and regulatory standards and requirements, their access to information on record about the accounts of clients and the activities of their Approved Persons and in many cases bearing in mind the size and financial resources of Members, Members are in the best position to evaluate the merits of a complaint and have an obligation to do so fairly."

Terms of Settlement

21. The Respondent agreed to the following Terms of Settlement (see paragraph 34 of the Settlement Agreement):

a) the Respondent shall pay a fine in the amount of $35,000;
b) the Respondent shall pay costs in the amount of $5,000;
c) the Respondent shall in the future comply with its complaint handling duties and requirements; and
d) a senior officer of the Respondent will attend in person on the date set for the Settlement Hearing.

Acceptance of Settlement Agreement

22. 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.

23. The conduct in the present case is very serious. Some might categorize it as egregious. This was not the Respondent's first breach of MFDA Rules. In 2009, Keybase was the subject of an

MFDA settlement hearing regarding compliance and supervision deficiencies. As part of the settlement in that matter, the Respondent paid a fine of $150,000 and agreed to retain a monitor to resolve compliance and other deficiencies. See *Re Keybase Financial Group Inc.* MFDA Case # 200823.

24. Some may consider that the penalty of $35,000 set out in the Settlement Agreement as inadequate. We have accepted the Settlement Agreement because of the positive steps that the Respondent has taken to correct its systems as well as the steps taken to compensate its clients.

25. The Sanction Guidelines (section 12) now specifically state that the steps taken by a Respondent are to be taken into account in assessing the penalty. The Sanction Guidelines state that Hearing Panels "should consider whether the Respondent voluntarily implemented corrective measures to avoid recurrence of the misconduct, for example, where a Member revises procedures or internal controls."

26. A number of MFDA Hearing Panels had – previous to the new Sanction Guidelines – held that taking corrective measures and the cost associated with doing so is an important mitigating factor in disciplinary cases. In *Re Equity Associates Inc.* 2015 LNCMFDA 56 at paragraph 18, for example, the Hearing Panel considered it an important factor that the Member had "put in place systems which will protect against the repetition of these contraventions." And in *Re Professional Investment Services (Canada) Inc*. MFDA Case No. 200928 at paragraph 12, the Hearing Panel stated: "We take into account the mitigating factors of the Respondent…and its acceptance of the extensive and expensive Independent Monitor."

27. In 2018, the Respondent appointed a consultant in order to resolve the Member's complaint handling deficiencies. The consultant's mandate included a review of complaints relating to the leveraged investment strategy and, where necessary, Keybase issued new substantive responses to clients. The consultant advised MFDA Staff that it trained Keybase staff regarding complaint handling. Keybase implemented the complaint handling recommendations. The consultant completed the mandate in 2019. The cost was about $90,000 for the consultant's services. The Respondent states that it will continue to utilize its revised complaint handling procedures to ensure that all client complaints are handled in accordance with MFDA Policy No. 3.

28. Counsel for the MFDA told the Hearing Panel that "Keybase now has adequate complaint handling procedures."

29. Some years earlier, in 2015, the Ontario Securities Commission had required Keybase and its IIROC affiliate, Argosy Securities Inc. to retain a consultant to recommend changes to the governance structure and compliance resources of Keybase and Argosy. In early 2016 Keybase retained the services of a consultant to complete a comprehensive review of Keybase's and Argosy's general compliance policies, procedures, and practices. Keybase paid approximately $200,000 for the compliance consultant's services. Paragraph 23 of the Settlement Agreement notes that "Keybase has taken steps to improve its general compliance, policies, procedures and practices."

30. The Respondent has also taken steps to compensate the clients who lost money through the scheme. At the date of the Settlement Agreement, Keybase had paid about $250,000 in compensation. There is also an offer to pay about $70,000 to another client.

31. The Panel believes that it is normally more desirable for a defendant to spend funds compensating clients who lost money and improving its systems than to pay a higher fine.

32. It should also be noted that Keybase has cooperated with Staff throughout the course of Staff's investigation and these proceedings.

33. By entering into a Settlement Agreement, the Respondent has accepted responsibility for its misconduct and saved the MFDA the time, resources and expenses associated with conducting a full hearing.

34. The penalty agreed upon is not out-of-line with the cases cited by counsel for the MFDA. See *Re Sterling Mutuals Inc.* 2016 LNCMFDA 77; *Re Equity Associates Inc.* 2015 LNCMFDA 56; *Re Partners in Planning Financial Services Ltd.* MFDA Case No. 201032; and *Re Worldsource Financial Management Inc.* MFDA Case No. 200929.

35. Settlements can be important and useful in achieving outcomes which further the goals of the securities regulatory context. The British Columbia Court of Appeal affirmed the British Columbia Supreme Court's statement with respect to a settlement by the British Columbia

Securities Commission (*British Columbia Securities Commission v. Seifert* [2007] B.C.C.A. 484, para. 31):

> "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."

36. 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."

37. 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. Respecting settlements is particularly desirable in cases, such as this one, where experienced counsel were involved and where there were, as stated by counsel, "significant and extensive negotiations."

38. The penalty agreed to in this case falls within "a reasonable range of appropriateness."

39. For the above reasons, the Panel accepted the Settlement Agreement.

DATED this 24th day of July, 2020.

"Martin L. Friedland"

Martin L. Friedland, CC, QC
Chair

"Edward V. Jackson"

Edward V. Jackson
Industry Representative

"Guenther W. K. Kleberg"

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