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: Professional Investments (Kingston) Inc.

REASONS FOR DECISION

HEARING PANEL:	Thomas J. Lockwood, Q.C., Chair Sandy Grant, Industry Representative Guenther Kleberg, Industry Representative
HEARD:	January 23, 2009
REPRESENTATION:	Shelly Feld for the MFDA Paul Fisher for the Respondent

1. By Notice of Settlement Hearing, dated December 22, 2008, a Hearing Panel of the Central Regional Council of the Mutual Fund Dealers Association of Canada ("MFDA") was convened on January 23, 2009, to consider whether, pursuant to Section 24.4 of By-law No. 1 of the MFDA, the Hearing Panel should accept a settlement agreement ("Settlement Agreement") entered into between Staff of the MFDA and Professional Investments (Kingston) Inc. ("the Respondent") on December 18, 2008.

2. At the outset of the proceedings, Staff advised that the Settlement Agreement had been prepared and publicized in accordance with Section 24.4 of By-law No. 1 and Rule 15.2(1) of the MFDA Rules of Procedure.

3. We also considered a joint Motion by Staff and the Respondent to move the proceedings "in-camera". This Motion was brought pursuant to Rule 15.2(2) of the MFDA Rules of Procedure, which provides as follows:

> "(2) A Hearing Panel may, on its own initiative or at the request of a party, order that all or part of the settlement hearing be held in the absence of the public, having regard to the principles set out in Rule 1.8."

4. Rule 1.8(2) provides as follows:

> "(2) A Panel may order that all or part of a hearing be heard in the absence of the public where the Panel is of the opinion that intimate financial or personal matters or other matters may be disclosed at the hearing which are of such a nature, having regard to the circumstances, that the desirability of avoiding disclosure thereof in the interests of any person affected or in the public interest outweighs the desirability of adhering to the principle that hearings be open to the public."

5. We granted the Motion on the condition, which was agreeable to both Staff and the Respondent, that, should the Hearing Panel accept the Settlement Agreement, we would provide Reasons for our Decision which, along with the Record of the Settlement Hearing, would be available to the public. This is consistent with Rule 15.2(3) of the MFDA Rules of Procedure.

6. The Hearing Panel then considered the provisions of the Settlement Agreement. After hearing submissions both as to the applicable law and as to why this particular Settlement Agreement met the appropriate criteria, the Hearing Panel retired to consider whether we were in a position to accept the Settlement Agreement on the basis of the material before us.

7. After consideration, we concluded that we required certain additional facts in order to appropriately assess the Settlement Agreement. We were aware of the provisions of Rule 15.3(1) of the Rules of Procedure, which provides as follows:

> "15.3 *Additional Facts Only to be Disclosed on Consent*
>
> (1) The Hearing Panel may advise the parties of any additional facts which it considers necessary to assess the settlement but unless the parties

consent, any facts which are not contained in the Settlement Agreement shall not be disclosed to the Hearing Panel."

8. We reconvened the Hearing, advised the parties of the additional facts which we considered necessary to assess the settlement, made reference to Rule 15.3(1), and then briefly adjourned the Hearing to provide the parties with an opportunity to consider their respective positions.

9. On reconvening, both Staff and the Respondent indicated a willingness to provide the additional information. However, they jointly requested that they have until February 6, 2009, to provide the answers. This request was granted. The additional information was, subsequently, jointly submitted to the Hearing Panel. The Hearing Panel is indebted to the parties for their co-operation and professionalism.

10. After considering the Settlement Agreement, along with the additional facts and submissions, the Hearing Panel unanimously accepted the Settlement Agreement and made an Order to this effect on February 17, 2009. At that time, we advised that written Reasons would follow. These are those Reasons.

11. The salient portions of the Settlement Agreement are as follows:

"II. JOINT SETTLEMENT RECOMMENDATION

2. Staff conducted an investigation of the Respondent's activities. The investigation disclosed that the Respondent had engaged in activity for which the Respondent could be penalized on the exercise of the discretion of the Hearing Panel pursuant to s. 24.1 of the By-law.

IV AGREED FACTS

Registration History

6. The Respondent has been registered as a mutual fund dealer in

Ontario since April 8, 1986 and has been a Member of the MFDA since March 8, 2002.

7. The Respondent has no previous disciplinary history.

Corporate Structure

8. The Respondent's head office is located in Kingston, Ontario. Presently, there are 3 sub-branches affiliated with head office which are located in Addison, Cornwall and Napanee. The Napanee sub-branch was registered after the completion of the MFDA sales compliance examination described below. The Respondent also has branch offices in Ottawa and Belleville, Ontario.

Failure To Conduct Adequate Trade Supervision

9. In March 2008, MFDA Staff completed a sales compliance examination of the Respondent covering the period from November 1, 2004 to January 31, 2008 (the "SCE") in order to assess the Respondent's compliance with MFDA By-laws, Rules and Policies. The results of the SCE were summarized in a report dated May 9, 2008 which was delivered to the Respondent.

10. The SCE identified a number of compliance deficiencies, the most serious of which concerned the failure of the Respondent to conduct adequate trade supervision.

11. At the time of the SCE:

a. 27 Approved Persons were affiliated with the Respondent's head office including 2 Approved Persons who worked at the Respondent's sub-branch in Addison and 2 Approved Persons who worked at the Respondent's sub-branch in Cornwall;

b. 24 Approved Persons were affiliated with the Respondent's Ottawa office; and

c. 3 Approved Persons were affiliated with the Respondent's Belleville office;

12. During the SCE, MFDA Staff discovered that the Respondent had not implemented an adequate two-tier supervision structure, contrary to MFDA Rule 2.5.1 and MFDA Policy No. 2, as the Respondent's policies and procedures were deficient in the following respects:

(i) *Inadequate Trade Supervision Conducted At Head Office*

13. The Compliance Officer responsible for supervising trading activity by Approved Persons at head office and the Belleville branch office reviewed their trading activity on-line but did not retain any records of his trade reviews, trade inquiries, responses received from Approved Persons and the resolutions achieved as a result of the trade reviews, if any, contrary to MFDA Rule 2.5.4 and MFDA Policy No. 2.

14. The Respondent did not have any procedures in place at its head office to detect unusual trading patterns such as excessive trading, excessive switching or market timing by Approved Persons, contrary to MFDA Policy No. 2 and Member Regulation Notice MR-0065.

(ii) *Inadequate Trade Supervision At The Belleville Branch*

15. The Branch Manager of the Belleville branch office did not conduct trade supervision in the branch in accordance with MFDA Rules 2.2.1, 2.5.3(b)(ii) and MFDA Policy No. 2.

(iii) *Inadequate Trade Supervision At The Ottawa Branch*

16. The Respondent did not conduct regular second-tier trade review to detect unusual trading patterns or ensure the suitability of client trading

activity at the Ottawa branch office, contrary to MFDA Rule 2.5 and MFDA Policy No. 2.

17. In light of the Respondent's failure to establish, implement and maintain an adequate two-tier supervision structure, the Respondent failed to meet the minimum standards of supervision required by MFDA Rule 2.5 and MFDA Policy No. 2.

CURRENT PRACTICES

18. Since the SCE Report was received by the Respondent, the Respondent has undertaken to revise its Policies and Procedures manual and implement an appropriate two-tier supervision structure in order to comply with MFDA Rules and Policies. The Respondent has commenced use of more extensive back-office computer software modules to facilitate improved trade supervision and other compliance functions. The Respondent has also provided training to branch managers and compliance staff to ensure that they understand their compliance responsibilities and know how to use the compliance functions of the back-office computer software so that appropriate and effective trade supervision will be conducted in the future.

V. CONTRAVENTIONS

19. The Respondent admits that prior to March 2008, the Respondent failed to establish, implement and maintain a two-tier compliance structure to:

a. properly supervise client account activity to:

(i) ensure that each order accepted and each recommendation made for any account of a client is suitable for the client and in keeping with that client's investment objectives; and

(ii) detect unusual trading patterns such as excessive trading, excessive switching and market timing;

(iii) ensure that the handling of the Respondent's business was in accordance with the By-laws, Rules and Policies of the MFDA and applicable securities legislation; and

b. maintain adequate records of trade supervision undertaken including inquiries made, responses received and follow-up action taken;

contrary to MFDA Rules 2.2.1, 2.5 and MFDA Policy No. 2.

VI. TERMS OF SETTLEMENT

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

a. the Respondent shall pay a fine in the amount of $10,000, pursuant to s. 24.1.2(b) of the By-law;

b. the Respondent shall pay costs of this proceeding in the amount $2,500, pursuant to s. 24.2 of the By-law;

c. the Respondent shall retain KPMG Inc. as an independent monitor to assist the Respondent to resolve the deficiencies in its trade supervision structure and review and test the Respondent's recently implemented trade supervision procedures to ensure that the Respondent is complying with its supervision obligations under MFDA By-laws, Rules and Policies, pursuant to s. 24.1.2(g) of the By-law; and

d. in accordance with s. 24.4.2 of the By-law, the Respondent agrees that in the future it will comply with all MFDA By-laws, Rules and Policies, and all applicable securities legislation and regulations made thereunder, including MFDA Rules 2.2.1 and 2.5 and MFDA Policy No. 2.

VII. STAFF COMMITMENT

21. 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 26 below.

26. If this Settlement Agreement is accepted by the Hearing Panel and, at any subsequent time, the Respondent fails to honour any of the Terms of Settlement set out herein, Staff reserves the right to bring proceedings under the By-laws of the MFDA against the Respondent based on, but not limited to, the facts set out in Part IV of the Settlement Agreement, as well as the breach of the Settlement Agreement."

12. We agree with the submission by Staff that the role of the Hearing Panel in a Settlement Hearing is not the same as its role in making a penalty determination after a contested Hearing.

13. In a contested Hearing, the Hearing Panel attempts to determine the correct penalty. In a Settlement Hearing, the Hearing Panel takes into account the settlement process itself and the fact that the parties have agreed to the penalties set out in the Settlement Agreement. In our view, a Hearing Panel should not interfere lightly in a negotiated settlement and should not reject a Settlement Agreement unless it views the penalty as clearly falling outside a reasonable range of appropriateness. As has been said: "The settlement process is one of negotiation and compromise and the penalty imposed following a settlement will often be less onerous than one imposed following a Hearing where similar findings are made."

Re: Clark (Re), [1999] I.D.A.C.D. No. 40 at page 3.

14. Previous MFDA Hearing Panels have determined the factors which should be considered in determining whether a Settlement Agreement should be accepted. These include the following:

(i) Whether acceptance of the Settlement Agreement would be in the public interest and whether the penalty imposed will protect investors;

(ii) Whether the Settlement Agreement is reasonable and proportionate, having regard to the conduct of the Respondent as set out in the Settlement Agreement;

(iii) Whether the Settlement Agreement addresses the issues of both specific and general deterrence;

(iv) Whether the proposed settlement will prevent the type of conduct described in the Settlement Agreement from occurring again in the future;

(v) Whether the Settlement Agreement will foster confidence in the integrity of the Canadian capital markets;

(vi) Whether the Settlement Agreement will foster confidence in the integrity of the MFDA;

(vii) Whether the Settlement Agreement will foster confidence in the regulatory process itself.

Re: Investors Group Financial Services (Re), [2005] MFDA Ontario Regional Council, File No. 200401, Hearing Panel Decision dated December 16, 2004 at pages 2-3.

Re: Evangeline Securities Limited (Re), [2008] MFDA Atlantic Regional Council, File No. 200816, Hearing Panel Decision dated September 21, 2008.

CONSIDERATIONS IN THE PRESENT CASE

15. It was submitted to us that we should accept the Settlement Agreement and the proposed penalties for, ***inter alia***, the following reasons:

(a) The Respondent has no past disciplinary history with the MFDA.

(b) The Respondent's misconduct has not resulted in any known client harm, client losses or client complaints.

(c) The Respondent has co-operated fully with the MFDA in the investigation and resolution of this matter.

(d) This was not a "repeat deficiency case". The "deficiencies" were first identified by the MFDA investigators in March of 2008. The Respondent was notified and immediately took steps to correct the deficiencies. Certain of these steps are set out in paragraph 18 of the Settlement Agreement (*supra*).

(e) The objective of protecting investors has been advanced by requiring the Respondent to address the compliance deficiencies.

(f) MFDA Staff is satisfied that the proposed penalties will be sufficient to deter the Respondent and other MFDA Members from engaging in similar conduct in the future.

(g) The fact that the Respondent will be required to retain KPMG Inc. to assist with the resolution of its compliance deficiencies gives Staff comfort that the changes that will be made by the Respondent to improve its trade supervision process will be effective.

(h) The Respondent admitted to its misconduct immediately and thereby:

  (i) accepted responsibility for its misconduct;

  (ii) demonstrated remorse; and

  (iii) avoided the need for a potentially lengthy investigation and hearing that would have entailed additional effort, time and expense to the MFDA to bring about the resolution of this matter.

(i) The Settlement Agreement and the proposed penalties are in keeping with the purpose of the MFDA to enhance investor protection and strengthen public confidence in the Canadian mutual fund industry by ensuring high standards of conduct by its Members and Approved Persons.

(j) The proposed penalties will deter misconduct by the Respondent, deter others from engaging in similar misconduct, improve overall compliance by mutual fund industry participants and foster public confidence in the mutual fund industry.

16. The Hearing Panel had initial concerns that the proposed fine was less than the minimum fine recommended by the MFDA Penalty Guidelines. These Guidelines recommend that where a fine is imposed in respect of a Member's supervisory deficiencies, including deficiencies with respect to policies, procedures and internal controls and the required two-tier supervisory process, the fine should be at least $25,000.00.

17. However, as Staff pointed out, these Guidelines recommend that a Hearing Panel take into account the following factors in a supervision case when determining the appropriate penalties to impose:

(a) The extent of inadequacy in the procedures for supervision or the actual supervision of employee(s).

(b) The extent of employee(s) misconduct.

(c) The amount of losses or compensation for which the Member is liable as a result of the employee(s) misconduct.

(d) "Red flag" warnings that should have been caught by a proper system of supervision or follow-up.

(e) Corrective measures taken since discovery of problem.

(f) Intentional or reckless disregard for requirements, or whether due to carelessness or inadvertence.

18. Staff submitted that in the present case:

(a) it was not alleged that the Respondent intentionally or recklessly disregarded its supervisory obligations or that the misconduct resulted in client harm or undetected misconduct of the Respondent's Approved Persons.

(b) the Respondent immediately took corrective measures.

(c) when the costs of retaining KPMG Inc. are taken into account, the total cost to the Respondent of resolving this matter will exceed the minimum recommended fine amount.

19. We have also considered the nature of these proceedings, the fact that they are public and the effect that this has had, and will have, on the Respondent.

20. We have also considered that this was a Settlement Agreement that was reached by the parties after significant discussion and negotiation. It represents what they feel, with their knowledge and experience, is an appropriate resolution.

21. Taking all of these factors into consideration, we unanimously concluded that this Settlement Agreement was reasonable and in the public interest and should be accepted by this Hearing Panel.

Dated at Toronto, Ontario this 24th day of March, 2009.

"Thomas J. Lockwood"
Thomas J. Lockwood, Q.C.
Chair

"Sandy Grant"
Sandy Grant
Industry Representative

"Guenther Kleberg"
Guenther Kleberg
Industry Representative

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