



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: Quadrus Investments Services Ltd.

Heard: November 23, 2021 by electronic hearing in Toronto, Ontario

Decision: November 23, 2021

Reasons for Decision: January 20, 2022

REASONS FOR DECISION

Hearing Panel of the Central Regional Council:

Thomas J. Lockwood, Q.C.
Patrick Galarneau
Jeff Page

Chair
Industry Representative
Industry Representative

Appearances:

Shelly Feld)	Director, Chief of Litigation for the Mutual
)	Fund Dealers Association of Canada
)	
Gillian Dingle)	Counsel for Respondent
)	
)	
Tim Prescott)	President and CEO
)	Quadrus Investments Services Ltd.
)	
Lesley Duffy)	Chief Compliance Officer
)	Quadrus Investments Services Ltd.
)	
Jennifer Stevenson)	AVP and Senior Counsel
)	Quadrus Investments Services Ltd.
)	

I. INTRODUCTION

1. By Notice of Settlement Hearing, dated November 15, 2021, the Mutual Fund Dealers Association of Canada (“MFDA”) gave notice that an electronic hearing would be held before a hearing panel of the Central Regional Council of the MFDA (“Hearing Panel”) on November 23, 2021, to consider whether, pursuant to Section 24.4 of MFDA By-law No. 1, the Hearing Panel should accept the settlement agreement (“Settlement Agreement”) entered into between Staff of the MFDA and Quadrus Investment Services Ltd. (“the Respondent”).
2. Due to the existence of COVID-19, and with the consent of the parties, the Settlement Hearing was conducted electronically by videoconference on November 23, 2021.
3. On November 18, 2021, the MFDA issued a News Release giving public notice of the Settlement Hearing scheduled for November 23, 2021.
4. On November 23, 2021, the Hearing Panel was formally presented with the executed Settlement Agreement. This Settlement Agreement had been prepared in accordance with Section 24.4 of MFDA By-law No. 1, with the exception that the Notice of Settlement Hearing did not comply with the time provisions set out in Rule 15.2(1) of the MFDA *Rules of Procedure*.
5. Rule 15.2(1) provides as follows:

“15.2 Notice and Public Access

(1) Except where a settlement is reached after the commencement of the hearing of a proceeding on its merits, a Hearing Panel shall not consider a Settlement Agreement unless at least 10 days’ notice of the settlement hearing has been given by the Corporation in the same manner as a notice of penalty pursuant to section 24.5 (Publication of Notice and Penalties) of MFDA By-law No. 1 specifying:

- (a) the date, time and place of the settlement hearing; and
- (b) the purpose of the settlement hearing with sufficient information to identify the Member or person involved and the general nature of the allegations which are the subject matter of the settlement.”

6. At the opening of the Settlement Hearing, MFDA Staff and the Respondent made a joint written and oral request that the Hearing Panel exercise its discretion pursuant to Rules 1.5 and 2.2(1)(a) of the MFDA *Rules of Procedure* to abridge the ordinary requirement set out in Rule

15.2 that a Settlement Hearing be heard only upon 10 days' notice to the public. We were also mindful of the General Principles set out in Rule 1.3 of the MFDA *Rules of Procedure*.

7. Rules 1.3(1), 1.5(1)(b) and 2.2(1)(a) of the *Rules of Procedure* provide as follows:

1.3 General Principles

(1) These Rules shall be liberally construed to secure the most expeditious and cost-effective determination of every proceeding on its merits consistent with the requirements of fairness.

1.5 General Powers of a Panel

(1) A Panel may:

(b) waive or vary any of these Rules at any time, on such terms as it considers appropriate.

2.2 Extension or Abridgment of Time

(1) The time for the performance of any obligation under these Rules may be extended or abridged:

(a) by a Panel, at any time on such terms as it considers appropriate;

8. The joint submission included that it is in the public interest that this Settlement Hearing be conducted in an expeditious manner and there would be no prejudice caused to members of the public if this request was granted because Settlement Hearings are held *in camera* and, therefore, even if the ordinary notice period was provided, members of the public would be excluded from the proceeding unless and until a Settlement Agreement is accepted by the Hearing Panel.

9. It was also submitted that once the Notice of Settlement Hearing became public there was speculation in the market place, which speculation could only be effectively quieted by the publication of an accepted Settlement Agreement.

10. It was also submitted that this type of relief has been granted in previous disciplinary proceedings. The cases to which we were referred included the following:

Sun Life Financial Services (Canada) Inc. (Re), 2018 LNCMFDA 3;

Mackenzie Financial Corp. (Re), 2018 LNONOSC 191;

Royal Mutual Funds Inc. (Re), 2018 LNONOSC 311; and

Steven Jules Rethy, Reasons for Decision, December 7, 2020, MFDA File No. 201965, paras 9-17.

11. After retiring to consider both the written and oral submissions, as well as the appropriate legislative provisions and the applicable case law, the Hearing Panel was unanimously of the view that this matter should proceed and that we would exercise our discretion to abridge the 10 day notice period in Rule 15.2 of the MFDA *Rules of Procedure*.

12. The Hearing Panel then granted the joint request of the parties to move the proceedings “in camera” so that the Settlement Agreement could be considered in the absence of the public. This procedure is consistent with Rule 15.2(2) of the MFDA *Rules of Procedure*.

13. 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.

14. After carefully considering the Settlement Agreement and the submissions of the parties, the Hearing Panel unanimously accepted the Settlement Agreement. We made an Order to this effect on November 23, 2021. At that time, we advised that written Reasons would follow. These are those Reasons.

II. SETTLEMENT AGREEMENT

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

“IV. AGREED FACTS

Registration History

6. The Respondent is registered in all provinces and territories in Canada as a mutual fund dealer and has been a Member of the MFDA since 2002.

7. The Respondent’s head office is located in London, Ontario.

Background

8. In 2016, the MFDA, in conjunction with the Ontario Securities Commission (“OSC”), other provincial securities regulators, and the Investment Industry Regulatory Organization of Canada, commenced a project known as the Targeted Review of Member Compensation and Incentive Programs (the “Review”). The Review was part of a larger

initiative to coordinate compliance efforts on common issues such as sales incentives and related conflicts of interest.

9. To obtain the necessary information for the Review, in March 2016, the MFDA required all Members to submit information respecting the compensation structure for their representatives, including all incentive and rewards programs.

10. Based on a review of the Respondent's submissions to the compensation/sales incentive questions and further investigation conducted by Staff in cooperation with the Respondent, Staff identified that some aspects of the compensation structure and sales incentive practices related to monetary and non-monetary incentives available to Approved Persons (as described in Issue #1 below) were not in compliance with Part 4 of National Instrument 81-105 and were a potential or actual conflict of interest contrary to MFDA Rule 2.1.4.

11. In addition, the Respondent identified the conduct described in Issue #2 below as a result of an investigation conducted by Staff in cooperation with the Respondent in response to a complaint received in late 2018. This investigation identified that some aspects of the Respondent's operations were not in compliance with an exemption order relating to National Instrument 81-105 granted to the Respondent.

Issue #1: Monetary and Non-Monetary Incentives to Sell Proprietary Mutual Funds

12. The Respondent is the exclusive distributor of certain proprietary mutual funds. The Respondent also distributes certain third party mutual funds.

13. At the material time (defined below), the Respondent had two general classes of Approved Persons ("APs"). First, those who are authorized to sell only proprietary mutual funds (known as "Category I Advisors"). Second, those who are authorized to sell proprietary mutual funds and third party mutual funds (known as "Category II Advisors").

14. Issue #1 relates to the Respondent's Category II Advisors.

15. The Respondent's APs were licensed to sell life insurance and contracted either with The Great-West Life Assurance Company ("GWL") or London Life Insurance Company ("LL") (collectively the "Insurers"). The Insurers administered mutual fund compensation payments to their respective dual licensees who were also APs on behalf of the Respondent.

The Respondent remained responsible for ensuring that compensation paid to its APs for business of the Member complied with all MFDA Rules and other applicable securities law requirements.

16. From 2002 to December 31, 2016 (the “material time”), the Respondent’s APs participated in three programs (described in greater detail below), each of which created incentives that may have encouraged APs to recommend proprietary mutual funds over mutual funds offered by third parties:

- i. the Gold Key Recognition Credits
- ii. the LL Recognition Program
- iii. the LL Sales Commission Bonus

Gold Key Recognition Credits

17. During the material time, the Respondent maintained the Gold Key Recognition Credits program for the Respondent’s APs associated with GWL, which consisted of approximately 530 APs (“GK APs”).

18. Gold Key Recognition Credits made GK APs eligible for non-monetary rewards such as performance recognition and business development meetings and conferences.

19. GK APs were able to recommend and sell propriety mutual funds (any load type) and segregated funds, and third party mutual funds (any load type).

20. Gold Key Recognition Credits were calculated only on the net sales and assets under administration of proprietary mutual funds and proprietary segregated funds, thereby creating an incentive for GK APs to favour the recommendation and sales of proprietary mutual funds over third party mutual funds.

The LL Recognition Program

21. During the material time, the Respondent maintained the LL Recognition Program for eligible LL APs, which consisted of approximately 307 APs or 10% of the total sales force (“Eligible LL APs”).

22. The LL Recognition Program made Eligible LL APs eligible for non-monetary rewards such as performance recognition and business development meetings and conferences.

23. Eligible LL APs were able to recommend and sell proprietary mutual funds (any load type) and segregated funds, and third party mutual funds (any load type).

24. LL Recognition Program credits were calculated only on the sale of LL segregated funds and proprietary mutual funds. Sales of third party funds (other than LSIF and Mackenzie RESP funds) did not generate LL Recognition Program credits, thereby creating an incentive for the Eligible LL APs to favour the recommendation and sales of proprietary mutual funds over third party mutual funds.

The LL Sales Commission Bonus

25. During the material time, the Respondent maintained the LL Sales Commission Bonus program for the Eligible LL APs.

26. The LL Sales Commission Bonus program for Eligible LL APs was structured as follows:

- Eligible LL APs were paid a sales bonus, which was determined based on sales commissions (for certain products) over a rolling 26 week pay sales commission period, multiplied by a bonus rate percentage.
- The bonus rate percentage was calculated based on sales commissions. Whereas deferred sales commission (“DSC”) mutual funds generate a sales commission for advisors, front-end load zero (“FEL-0”) mutual funds do not generate a sales commission for advisors. Therefore, when calculating the bonus rate percentage, a ‘notional commission’ was calculated on FEL-0 sales in order to match the commissions that would otherwise be earned on sales of DSC mutual funds.¹
- When calculating the bonus rate percentage, the ‘notional commission’ was applied to (and calculated on) FEL-0 sales of LL segregated funds and proprietary mutual funds, but was not applied to (and not calculated on)

¹ The Respondent adopted this element of its commission structure to avoid incentivizing the sale of DSC mutual funds versus the sale of FEL-0 mutual funds.

non-proprietary FEL-0 mutual funds.

- The 'notional commission' was used solely as a basis for calculating the bonus rate percentage. The bonus rate percentage was calculated using the rolling 26 week pay sales commission period (including any 'notional commission') on eligible funds, and ranged from 20% to 70% of all actual commission received by the Eligible LL APs during the year, including commissions from the sale of LL segregated funds, proprietary mutual funds, and third party mutual funds.

27. The exclusion of notional commission on third party FEL-0 mutual funds from the calculation of the bonus rate percentage allowed an Eligible LL AP to potentially increase their bonus rate percentage by selling proprietary FEL-0 mutual funds instead of third party FEL-0 mutual funds, thereby creating an incentive for Eligible LL APs to favour the recommendation and sales of proprietary FEL-0 mutual funds over third party FEL-0 mutual funds.²

Remediation

28. Beginning September 2016, after the impugned conduct had been identified by the MFDA (as described in paragraphs 16 to 27 above), the Respondent voluntarily and proactively commenced efforts requiring that the noted programs be appropriately amended or terminated. In particular, in January 2017, the programs were amended to include third party mutual funds in the recognition credits calculation, and to include notional commissions on third party mutual fund sales in the determination of the bonus rate.

29. In June 2017, the LL Sales Commission Bonus program was amended again to eliminate the sales bonus rate determination and replace it with the asset bonus rate which always included third party fund assets in its determination. The asset bonus rate is applied to all sales and trailer commissions earned on all segregated funds, proprietary mutual funds and third party mutual funds.

30. The Respondent took reasonable steps, in consultation with MFDA Staff, to investigate whether the programs described above in Issue #1 resulted in clients being

² This commission structure did not create an incentive to sell other categories of proprietary mutual funds sold on a DSC or low load basis.

advised to purchase proprietary mutual funds in circumstances where those funds were unsuitable for them or caused financial harm to them. No evidence was identified that proprietary mutual funds sold by GK APs or Eligible LL APs were unsuitable or caused financial harm. There is no evidence that any specific APs recommended specific trades based on the incentives that were available to them. In addition, the programs described above in Issue #1 were not paid for from monies that would have otherwise been payable to investors. The availability of the programs described in Issue #1 had no bearing on the fees charged to clients for any of the funds. As such, no evidence of direct financial harm to clients from any specific trades was identified.

31. Between 2008 and 2017, both GK APs and Eligible LL APs sold substantially more third party mutual funds than proprietary mutual funds. During this time, the sale of third party mutual funds by both GK APs and Eligible LL APs as a proportion of the Respondent's total mutual fund sales also significantly increased.

32. Certain APs who had already achieved the maximum bonus rate percentage would not have benefitted further by the inclusion of notional commissions on FEL-0 third party mutual fund sales, because once the maximum bonus rate percentage has been achieved, no further increase is possible. Also, certain APs who were already eligible to receive all benefits under the Gold Key Recognition Program or the LL Recognition Program would not have benefitted further from the inclusion of third party mutual fund sales in these calculations, because there are a finite number of benefits, and once eligibility for all benefits is achieved, no further benefits are available.

33. As of 2017, the Respondent discontinued its 'Gold Key' distribution channel, and thereby also discontinued the Gold Key Recognition Credits program.

Issue #2: Failure to Supervise Compliance with a Sales Incentives Exemption Order

34. Issue #2 described below relates to the Respondent's Category I Advisors. As stated above, Category I Advisors are authorized by the Respondent to sell only proprietary mutual funds.

35. On February 27, 2009, the Ontario Securities Commission granted the Respondent an exemption from the requirements in National Instrument 81-105 thereby allowing third party mutual funds to be held in accounts serviced by Category I Advisors on an

“accommodation” basis where no sales commission would be paid by the Respondent to Category I advisors in respect of the third party mutual funds (“Exemption”).³

36. The Respondent required an exemption from the requirements in National Instrument 81-105 because Category I Advisors may receive sales commissions at the time of the initial sale of proprietary mutual funds but may not receive sales commission in respect of third party funds sold on an accommodation basis; the Respondent would therefore have incentivized the sale of proprietary mutual funds.

37. The Respondent was granted the Exemption based on, among others, the following representations that it made regarding its structure and practices:

- third party funds are held in client accounts serviced by Category I Advisors only at the request of the investor, and on an “accommodation” basis only for clients who either already held them in their account moved to the Respondent or who wish to incorporate them into their financial plan;
- “accommodation” means that the Respondent does not promote or advertise the purchase of third party mutual funds through its Category I Advisors, or encourage Category I Advisors to promote or advertise the purchase of third party mutual funds;
- third party mutual funds may only be purchased in client accounts serviced by Category I Advisors on a “no load” basis or FEL basis where the FEL is reduced to nil (third party mutual funds may not be sold with a sales commission);
- Category I Advisors receive trailing commissions, but no sales commissions, in respect of third party mutual funds purchased by clients on an accommodation basis.

38. The Respondent was required by MFDA Rule 2.5.1 to establish, implement and maintain policies and procedures and have an adequate system of controls and supervision to ensure the handling of its Business was in accordance with the representations in the Exemption.

³ The Respondent is able to rely upon the Exemption in other provinces and territories pursuant to section 4.7(1) of the Multilateral Instrument 11-102 Passport System (MI 11-102).

39. To comply with the representations in the Exemption, the Respondent implemented a process to adjust trades involving the purchase of third party mutual funds in accounts serviced by Category I Advisors to ensure that clients purchased the third party mutual fund on a no load basis, or an FEL basis where the FEL is reduced to nil (the “Adjustments Process”).

40. The Adjustments Process generated a weekly report identifying trades of third party mutual funds submitted by Category I Advisors which required adjustments to comply with the Exemption. However, the Respondent’s staff were required to manually adjust the trades to ensure clients purchased third party mutual funds on a no load basis, or an FEL basis where the FEL is reduced to nil. This required the Respondent to reverse the purchase of any third party mutual fund with a sales commission (including remitting any sales commission received from the mutual fund company), and rebook the trade at FEL-0/no load (if a sales commission was received from the client, that sales commission amount would be added to the repurchase amount).

41. Commencing in about 2009 and continuing to late 2018, the Respondent failed to establish, implement and maintain policies and procedures, and have an adequate system of controls and supervision as required by MFDA Rule 2.5.1, necessary to ensure that it consistently complied with the representations in the Exemption. As a result, during this period:

- third party mutual fund trades in accounts of approximately 1,700 clients serviced by Category I Advisors were not adjusted as required;
- the Respondent received approximately \$219,000 in DSC or low load sales commissions in respect of third party mutual fund trades in accounts serviced by Category I Advisors that could not be reversed and rebooked in accordance with the Respondent’s process (and as a result was not remitted to the mutual fund companies);
- in approximately 525 instances a client incurred a DSC or low load charge in respect of a third party mutual fund trade in an account serviced by a Category I Advisor. The approximate remediation cost for these clients is \$43,000 and, in some instances, the Respondent will pay clients more than the DSC/low load charge that the client incurred in respect of third-party funds purchased while a client of the Respondent; and

- in approximately 31 instances a client paid a FEL charge (approximately \$4,300 in total FEL charges paid by clients) in respect of a third party mutual fund trade in an account serviced by a Category I Advisor that could not be reversed and rebooked in accordance with the Respondent's processes.

42. The Adjustments Process included a feature which automatically prevented any sales commission from being paid to a Category I Advisor in respect of the purchase of a third party mutual fund in an account serviced by the advisor. Accordingly, the Respondent did not pay any sales commission to Category I Advisors in respect of third party mutual funds sold on an accommodation basis.

43. Most of the third party mutual fund purchases processed in accounts serviced by Category I Advisors consisted of small value pre-authorized contributions. These trades represented a small proportion of the total dollar value of mutual fund trades processed for clients serviced by Category I Advisors during the relevant period.

Remediation

44. The Respondent voluntarily implemented a remediation plan to address the conduct described in Issue #2 above. This remediation plan included:

- a process to identify and contact current and former clients who were impacted;
- a compensation plan for current and former clients who paid sales charges or incurred DSCs or low load charges in respect of third party mutual funds in accounts serviced by Category I Advisors;
- a process to identify and take corrective action in respect of current or former clients who purchased third party mutual funds in accounts serviced by Category I Advisors where these funds may be subject to DSCs in the future, in accordance with the compensation plan;
- modifications to the Adjustments Process to ensure that trades involving the purchase of third party mutual funds in accounts serviced by Category I Advisors are identified and adjusted within a reasonable time period to prevent clients from incurring a sales charge or being subject to a DSC;
- additional record-keeping requirements with respect to trades involving the

purchase of third party mutual funds in accounts serviced by Category I Advisors;

- changes to its supervision structure to provide additional oversight and management of the modified Adjustments Process; and
- weekly random audits of trades identified and adjusted through the modified Adjustments Process to ensure that it is working properly.

45. Following the completion of the remediation measures, the Respondent had received a small net benefit on an aggregate basis, and the Respondent has made a charitable donation in an amount equal to this excess amount.

Additional Factors

46. The Respondent has fully cooperated with the MFDA's review of the issues that form the subject matter of this Settlement Agreement.

47. The Respondent has met with MFDA Staff and provided updates on remediation actions it has taken regarding the conduct described above.

48. As a result of the events described in this Settlement Agreement, the Respondent has reviewed all compensation structures relating to its APs and, where necessary, has taken steps to ensure that its compensation structures are compliant with regulatory requirements.

49. As of the date of this Settlement Agreement, the Respondent's compensation structures for Category II Advisors, including its standard sales and trailing commission rates payable in respect of mutual fund sales, do not differentiate between proprietary and third party mutual funds.

V. CONTRAVENTIONS

50. The Respondent admits that from 2002 to 2018, it failed to establish, implement and maintain adequate policies and procedures and an adequate system of controls and supervision to ensure that it complied with securities legislation including requirements relating to internal dealer incentive and sales practices, contrary to MFDA Rules 2.5.1 and 2.1.1.

VI. TERMS OF SETTLEMENT

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

- i. The Respondent will pay a fine in the amount of \$600,000 pursuant to Section 24.1.2 of MFDA By-law No. 1;
- ii. The Respondent will pay costs in the amount of \$25,000 pursuant to Section 24.2 of MFDA By-law No. 1;
- iii. The Respondent shall in the future comply with MFDA Rules 2.5.1. and 2.1.1.;
- iv. A senior officer of the Respondent shall attend on the date set for the Settlement Hearing.”

III. THE LAW

Failure to Have Adequate Systems to Ensure Compliance with Securities Legislation (Internal Dealer Incentives and Sales Practices)

16. MFDA Rule 2.5.1 states as follows:

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.

17. The Respondent’s admitted contravention of MFDA Rule 2.5.1 relates to its failure to ensure that it complied with the internal dealer incentive and sales practices requirements set out in National Instrument 81-105 (“NI 81-105”) and its failure to comply with the conditions of an exemption granted by the Ontario Securities Commission (“OSC”) relating to NI 81-105.

i) Background and Purpose of NI 81-105

18. The Companion Policy to NI 81-105 indicates that: [NI 81-105]

“has been adopted by the Canadian securities regulatory authorities as a response to the concern of many participants in the mutual fund industry that the pre-existing regulatory strategy of reliance on prospectus disclosure of sales practices, coupled with the discipline imposed by competitive market forces, were not sufficient to discourage sales practices and compensation arrangements that gave rise to questions as to whether participating dealers and their representatives were being induced to sell mutual fund securities on the basis of the incentives they were receiving as opposed to what was suitable for and in the best interests of their clients.”

19. The purpose of NI 81-105 is to ensure that the interests of investors remain uppermost in the actions of participants in the mutual fund industry by setting minimum standards of conduct to be followed by industry participants in distributing mutual funds that are designed to minimize the conflicts between the legitimate commercial goals of industry participants and the obligations that industry participants owe to investors.

20. Past decisions of Canadian security regulators addressing the failure of dealers to comply with NI 81-105 have determined that such contraventions are serious. See for example:

Sentry Investments Inc. (Re) 2017 LNONOSC 189 at para. 2.

Sentry Investments Inc. (Re) 2017 LNONOSC 192 at para. 2.

One Financial Corporation (Re), 2012 LNONOSC 197 at paras. 67-68.

ii) Internal Dealer Incentive Practices

21. The definitions section of National Instrument 81-102 (“NI 81-102”) concerning *Investment Funds* states that “principal distributor” means a person or company through whom securities of a mutual fund are distributed under an arrangement with the mutual fund or its manager that provides:

- a) An exclusive right to distribute the securities of the mutual fund in a particular area, or
- b) A feature that gives or is intended to give the person or company a material competitive advantage over others in the distribution of the securities of the mutual fund; and that “participating dealer” means a dealer other than the principal distributor that distributes securities of a mutual fund.

National Instrument 81-102, Excerpts – definitions of principal distributor and participating dealer at paras. 66-67.

22. Part 4 of NI 81-105 addresses internal dealer incentive practices. Sections 4.1 and 4.2 state that:

4.1 Participating Dealers’ Practices

No participating dealer shall provide an incentive to any of its representatives to recommend mutual funds of one mutual fund family over mutual funds of another mutual fund family.

4.2 Principal Distributors' Practices

(1) A principal distributor of a mutual fund that is also a participating dealer of another mutual fund shall not provide an incentive for any of its representatives to recommend a mutual fund of which it is a principal distributor over a mutual fund of which it is a participating dealer.

NI 81-105, *supra*, at section 4.1.

23. The Respondent is a principal distributor of proprietary mutual funds that its Approved Persons offer clients the opportunity to invest in and is a participating dealer with respect to third party mutual funds for which it is not a principal distributor.

24. NI 81-105 prohibits dealers and mutual fund companies from providing monetary or non-monetary incentives to Approved Persons that could induce the Approved Persons to recommend one mutual fund family (including a proprietary mutual fund family) over another mutual fund family in order to obtain the incentives being offered as opposed to basing recommendations solely upon that is suitable for and in the best interests of clients.

25. In the Settlement Agreement, the Respondent admitted that it failed to establish and maintain adequate systems of controls and supervision to ensure that it complied with Part 4 of NI 81-105.

IV. PRINCIPLES AND FACTORS REGARDING THE ACCEPTANCE OF SETTLEMENT AGREEMENTS

26. Investor protection is the primary goal of securities regulation. Settlements play an important and necessary role in meeting this objective.

Pezim v. British Columbia (Superintendent of Brokers), [1994] 2 S.C.R. 557 at para. 59.

27. In our view, the role of a Hearing Panel in a Settlement Hearing is not the same as its role in making a penalty determination after a contested Hearing. 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.

28. 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.

Jacobson (Re), [2007], Hearing Panel of the Prairie Regional Council, MFDA
File No. 200712, Reasons for Decision, dated July 13, 2007, at para. 70.

29. Previous Hearing Panels have also identified a number of additional factors which should be considered when determining whether the penalty sought to be imposed is appropriate. These include:

- a) The seriousness of the allegations proved against the Respondent;
- b) The Respondent's past conduct, including prior sanctions;
- c) The Respondent's experience in the capital markets;
- d) The level of the Respondent's activity in the capital markets;
- e) Whether the Respondent recognizes the seriousness of the improper activity;
- f) The harm suffered by investors as a result of the Respondent's activities;
- g) The benefits received by the Respondent as a result of the improper activity;
- h) The risk to investors and the capital markets in the jurisdiction, were the Respondent to continue to operate in capital markets in the jurisdiction;
- i) The damage caused to the integrity of the capital markets in the jurisdiction by the Respondent's improper activities;

- j) 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;
- k) The need to alert others to the consequences of inappropriate activities to those who are permitted to participate in capital markets; and
- l) Previous decisions made in similar circumstances.

Headley [Re], 2006, Hearing Panel of the Central Regional Council, MFDA File No. 200509, Reasons for Decision dated February 21, 2006 at para.85.

30. When determining whether a penalty agreed upon by the parties is appropriate, the Hearing Panel may also consider the MFDA's Sanction Guidelines ("Guidelines") which came in to effect on November 15, 2018. The Guidelines are not mandatory or binding on the Hearing Panel, but provide a summary of the key factors upon which discretion can be exercised consistently and fairly. Many of the same factors that are listed above, which have been considered in previous decisions of MFDA Hearing Panels, are also reflected and described in the Guidelines.

31. In the context of settlement agreements concerning contraventions of NI 81-105, the OSC has taken a deferential approach to determining whether a proposed settlement agreement should be accepted. For example, in the matter of *1832 Asset Management LP*, the OSC stated that:

"The role of the Panel is to decide whether the proposed settlement agreement as a whole, on the terms presented and agreed to, falls within an acceptable range and should be approved as being in the public interest. These sanctions are not necessarily the sanctions that might have been imposed by a panel, had this matter proceeded to a contested hearing. However, in our view, the sanctions and costs ordered will deter not only 1832, but also others in the industry from engaging in similar misconduct and will emphasize to industry participants that these types of practices are inconsistent with the obligations of registrants under NI 81-105, NI 31-103 and the provisions of the Act that have been referenced."

1832 Asset Management LP (Re), 2018 LNONOSC 212 ["1832"] at para. 9.

V. CONSIDERATIONS IN THE PRESENT CASE

32. Staff made very detailed written and oral submissions as to how these principles and factors applied to the case before us. These included the following:

- (a) Nature of the Misconduct

33. We agree with the submissions of Staff that the Respondent's failure to have an adequate system of controls and supervision to ensure compliance with mutual fund sales practices provided in NI 81-105 was serious. Adequate supervision in this area is required to promote investor protection by helping to ensure that an Approved Person's recommendations are provided in the best interests of clients on the basis of the clients' investment objectives and circumstances and the merits of the investments they recommend, without being influenced by conflicting monetary or other inducements.

See for example: *Sentry, supra* at para. 2.

34. An aggravating factor is that the misconduct occurred over an extended period of time.

(b) The Respondent's Past Conduct Including Prior Sanctions

35. In 2016, the Respondent entered into a settlement agreement with MFDA Staff in which it admitted that:

- a) between March 2009 and July 2015, the Respondent failed to employ adequate supervision to prevent Approved Person RM from engaging in discretionary trading, engaging in personal financial dealings with clients, and using pre-signed account forms, contrary to MFDA Rules 2.1.1, 2.1.4, 2.3.1 and 2.5.1; and
- b) the Respondent failed to report to the MFDA, within 5 business days or at all:
 - i. the Respondent's discoveries in March 2009 and September 2010, that Approved Person RM had, or may have, engaged in discretionary trading; and
 - ii. the Respondent's discovery in September 2010, that Approved Person RM had, or may have, engaged in personal financial dealings with clients; contrary to MFDA Policy No. 6, subsections 6.1(b)(i) and (v).

Quadrus Investment Services Ltd. (Re), 2017 LNCMFDA 20.

See also the Settlement Agreement at *Quadrus Investment Services Ltd. (Re)*, 2016 LNCMFDA 211.

36. In the previous proceeding, the Respondent paid a fine of \$75,000 and costs of \$20,000.

37. Although in both cases, the misconduct at issue concerned supervisory and compliance deficiencies, the misconduct being addressed in the present case is substantially different than the misconduct that gave rise to the Respondent's previous disciplinary proceeding. The previous

proceeding concerned the Respondent's failure to adequately supervise a specific Approved Person and to make a timely report to the MFDA when that individual's misconduct was discovered.

(c) The Respondent's Recognition of the Seriousness of the Misconduct

38. By entering into this Settlement Agreement, the Respondent has accepted responsibility for its misconduct and avoided the necessity of the MFDA incurring the time and expense of conducting a lengthy disciplinary hearing.

39. Staff advised the Hearing Panel that the Respondent has fully co-operated with the MFDA's investigation of the various issues that form the subject matter of the Settlement Agreement.

40. Staff detailed the proactive steps taken by the Respondent, as described in paragraphs 28-30, 33, 44 and 47-49 of the Settlement Agreement (*supra*), to address the deficiencies in its compliance with NI 81-105.

41. According to Staff, the Respondent has devoted substantial internal and external resources to implementing changes to its policies, procedures and internal controls and in designing and implementing the remediation plan. We agree with the submission of Staff that, in taking all of these steps, the Respondent has demonstrated a commitment to preventing or reducing the risk of future contraventions.

(d) Harm Suffered by Clients or Investors

42. With respect to Issue #1, there is no evidence that any Approved Person of the Respondent recommended funds that were unsuitable for clients or caused direct financial harm to them. Further, there is no evidence that any Approved Person recommended specific trades based on the incentives that were available to them. Finally, there is no evidence that the misconduct associated with Issue #1 had any bearing on the fees charged to clients for any funds that they purchased.

43. With respect to Issue #2, some clients were, admittedly, charged inappropriate fees. However, the Respondent did attempt to identify, contact and compensate the affected clients.

(e) Benefits Received by the Respondent

44. While the Respondent has admitted that it did realize a small net benefit, it made a charitable donation in an amount equal to the benefit.

(f) Deterrence

45. Deterrence is intended to capture both specific deterrence of the wrongdoer as well as general deterrence of other participants in the capital markets in order to protect investors.

46. General deterrence is particularly important in this case as this is a proceeding addressing a Member's failure to establish and maintain an adequate system of controls and supervision to ensure that it complied with securities legislation relating to internal dealer incentive and sales practices [NI 81-105]. The proposed penalties are necessary to: (1) convey the seriousness of this misconduct to the mutual fund industry; (2) ensure that other Members take all necessary steps to comply with all of their obligations to refrain from incentivizing Approved Persons to favour one fund family over another as a result of monetary or non-monetary inducements; and (3) to deter Members from offering incentives that may further the financial interests of the Member or its affiliates in contravention of NI 81-105 requirements.

(g) Previous Decisions Made in Similar Circumstances

47. Staff provided the Hearing Panel with a detailed chart seeking to show that the proposed resolution is within the reasonable range of appropriateness with regards to other decisions made by MFDA Hearing Panels in similar circumstances.

48. The following cases were discussed:

Sun Life Financial Services (Canada) Inc. (Re), 2018 LNCMFDA 3.

Sentry Investments Inc. (Re), 2017 LNONOSC 189 and 192.

Mackenzie Financial Corp. (Re), 2018 LNONOSC 191.

1832 Asset Management LP (Re), 2018 LNONOSC 212.

Royal Mutual Funds Inc. (Re), 2018 LNONOSC 311.

VI. DECISION

49. After a thorough review of the factors by which we should be guided, and the facts of this case, as reflected in the Settlement Agreement, we were, unanimously, of the view that this

Settlement Agreement was reasonable and in the public interest and should be accepted by the Hearing Panel. We so informed the parties at the conclusion of the Settlement Hearing.

VII. ORDER

50. After accepting the Settlement Agreement, we made the following Order:

- a) The Respondent will pay a fine of \$600,000 pursuant to Section 24.1.2 of MFDA By-law No. 1;
- b) The Respondent will pay costs of \$25,000 pursuant to Section 24.2 of MFDA By-law No. 1;
- c) The Respondent shall in the future comply with MFDA Rules 2.5.1 and 2.1.1; and
- d) If at any time a non-party to this proceeding, with the exception of the bodies set out in section 23 of MFDA By-law No. 1, requests production of or access to exhibits in this proceeding that contain personal information as defined by the MFDA Privacy Policy, or confidential financial information including in particular, any request for access to Exhibit #3 to the record which contains confidential financial information of the Respondent, then the MFDA Corporate Secretary shall not provide copies of or access to Exhibit #3 and shall not provide access to any other requested exhibits to the non-party without first redacting from them any and all personal information, pursuant to Rules 1.8(2) and (5) of the MFDA *Rules of Procedure*.

DATED this 20th day of January, 2022.

“Thomas J. Lockwood”

Thomas J. Lockwood, Q.C.
Chair

“Patrick Galarneau”

Patrick Galarneau
Industry Representative

“Jeff Page”

Jeff Page
Industry Representative