



Now New Self-Regulatory Organization of Canada, a consolidation of IIROC and the MFDA

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: Queen Financial Group Inc.

Heard: December 15, 2022 by electronic hearing in Toronto, Ontario

Decision: December 15, 2022

Reasons for Decision: February 7, 2023

REASONS FOR DECISION

Hearing Panel of the Central Regional Council:

Emily Cole
Edward Jackson
Joseph Yassi

Chair
Industry Representative
Industry Representative

Appearances:

Shelly Feld)	Director, Chief Litigation Counsel for the
)	Mutual Fund Dealers Association of Canada
)	
Anna Markiewicz)	Counsel for Respondent
)	
)	
Charles Jiang)	President, Queen Financial Group Inc.
)	
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)	

I. INTRODUCTION

1. This was a settlement hearing pursuant to sections 24.4 of By-Law No.1 of the Mutual Fund Dealers Association of Canada (the “MFDA”). The panel abridged the notice period at the joint request of the parties.

2. This proceeding arises from a sales compliance examination. At issue is the duty to know your product. There were no complaints against the Respondent and no financial harm to clients.

3. The President of the Respondent addressed the panel at the hearing and accepted full responsibility for the contravention. In July 2022, the Respondent hired a new compliance officer with specific experience with exempt market products to ensure that all new products are adequately vetted by the Respondent and that all the Respondent’s KYP obligations are complied with.

4. A settlement agreement signed by Staff and the Respondent on December 12, 2022 (the “Settlement Agreement”) was filed for our consideration. In the Settlement Agreement, the Respondent admitted to engaging in the following misconduct:

The Respondent admits that between January 1, 2017, and April 6, 2020, the Respondent approved and allowed the sale of seven exempt products (the “Products”) without using adequate due diligence to understand the material attributes, features and risks of the Products and ensuring that the Products offered to clients were suitable, contrary to MFDA Rules 2.2.1(c)1 and 2.1.1.

5. After hearing submissions from the parties, the Hearing Panel found the Respondent breached MFDA Rules 2.2.1(c) and 2.1.1, based on the facts set out in the Settlement Agreement and the admission above. We then considered the appropriate penalty.

6. We carefully reviewed the Settlement Agreement and considered the submissions made by the parties at the hearing and reached a decision regarding penalty. We advised the parties of our decision.

7. In the circumstances of this case, we decided the appropriate penalty is:

¹ On December 31, 2021, MFDA Rule 2.2 was amended to conform with client focused reforms to National Instrument 31-103. As the conduct addressed in this Settlement Agreement pre-dated the amendment to the Rules, all references in the Settlement Agreement to MFDA Rule 2.2 concern the version of the Rule that pre-dated the December 31, 2021, amendments.

- a) the Respondent shall pay a fine in the amount of \$30,000, payable in certified funds on the date that this Settlement Agreement is accepted by a Hearing Panel, pursuant to s. 24.1.2(b) of MFDA By-law No. 1;
- b) the Respondent shall pay costs in the amount of \$7,500, payable in certified funds on the date that this Settlement Agreement is accepted by a Hearing Panel, pursuant to s. 24.2 of MFDA By-law No. 1;
- c) the Respondent shall in the future comply with MFDA Rules 2.2.1(c) and 2.1.1.

8. These are the reasons for our decision:

II. AGREED FACTS

i. Registration History

9. The Respondent has been registered as a mutual fund dealer in Ontario and has been a Member of the MFDA since October 2006. The Respondent has been registered as a mutual fund dealer in British Columbia from February 5, 2008, to January 1, 2013, and since August 30, 2017.

10. The Respondent has been registered as a limited market dealer or exempt market dealer in Ontario, British Columbia and Quebec during the periods listed below:

- a) in Ontario since March 6, 2008;
- b) in British Columbia from October 18, 2010, to December 31, 2013, and since August 30, 2017; and
- c) in Quebec since December 3, 2014.

Corporate Structure

11. The Respondent's head office is in Markham, Ontario (the "Head Office"). As of November 1, 2022, 59 Approved Persons were registered with the Respondent and conduct business from head office, from 2 additional branch offices located in Richmond, British Columbia and from a sub-branch office in St. Laurent, Quebec. Based on the amount of assets under its administration, the Respondent is a small mutual fund dealer compared to other Members of the MFDA.

III. BACKGROUND

12. On October 31, 2005, the MFDA issued MFDA Staff Notice MSN-0048 “Know-Your-Product” the purpose of which was to clarify the obligations of Members and Approved Persons with respect to the approval and sale of investment products. The Notice states, among other things, that:

Know-your-client requirements are a fundamental part of meeting basic suitability obligations. However, these obligations can only be properly discharged if Approved Persons and supervisory staff of the Member also fully understand the products that are being recommended to clients. . . A basic level of due diligence must be completed on all products being considered for sale by the Member before the products are approved. Member procedures should provide for different levels of analysis for different types of products. For example, an extensive formal review may not be required for many conventional mutual funds. However, a more comprehensive review should be performed on products that are novel or more complex in structure. . . In determining whether to approve a product for sale, Member should not merely rely on the representations of the issuer, or on the fact that the product appears to be similar to others, or that other firms are already offering the product. In all cases, the approval process must be independent and objective. Members are advised that simply making inquiries will not be sufficient to discharge their responsibility to conduct due diligence. Members must properly follow up on any questions they have raised until they have been satisfied that they have a complete understanding of the products they propose to sell. . . It is critical that the Member develops an understanding of all features of the product. Issues such as liquidity of the product and the nature of any underlying investments and their inherent risks must be examined before assigning a risk ranking to the product. The Member should develop guidelines or an investor profile for which the product would be generally suitable, including risk levels, time horizon, income, and net worth. The Member should also clearly identify investors for whom the product is not suitable. Concentration limits should be assigned to products and/or general classes of products where appropriate. . . As a best practice, a committee involving senior management of the Member should be empowered with ultimate authority in the product approval process, to ensure that all business units of the Member have signed off on the product prior to sale.

13. MSN-0048 also stated that “Members should be particularly careful when examining suitability issues in relation to exempt securities” and set out additional guidance applicable to the approval and sale of exempt products.

The 2019 Sales Compliance Examinations

14. In 2019, MFDA Compliance Staff (“MFDA Compliance”) conducted a sales compliance examination of the Respondent in order to assess compliance by the Respondent with the By-laws, Rules and Policies of the MFDA (the “2019 Sales Compliance Examination”) and issued a report to the Respondent dated April 6, 2020, at the conclusion of the 2019 Compliance Examination summarizing a list of compliance deficiencies that were identified during the compliance examination (the “2020 Sales Compliance Report”).

15. The 2019 Sales Compliance Examination of the Respondent’s operations covered the review period between January 1, 2017, and August 31, 2019.

16. During the 2019 Sales Compliance Examination, MFDA Compliance identified deficiencies with respect to the Respondent's new product approval due diligence process. Specifically, the Respondent did not complete adequate due diligence and did not record adequate information to demonstrate its understanding of all material information relevant to the suitability of the Products that it approved for sale by Approved Persons to its clients. Therefore, the Respondent did not fulfill its "Know-Your-Product" ("KYP") obligations with respect to these Products.

17. After receiving the 2020 Sales Compliance Report, the Respondent proposed actions that the Respondent agreed to take to address the compliance deficiencies that had been identified in the report including the deficiencies in its KYP process (the "KYP Deficiencies").

The Know-Your-Product Compliance Deficiencies Of The Respondent

18. MFDA Compliance had identified various KYP Deficiencies of the Respondent during previous MFDA sales compliance examinations of the Respondent dating back to 2013.

19. In some cases, the Respondent did not acquire important information necessary to evaluate the exempt products that it intended to allow its Approved Persons to sell. In other cases, the Respondent claimed that it had obtained the relevant information but did not appropriately document the due diligence that it had completed before approving the exempt products for sale by its Approved Persons. KYP Deficiencies limited the Respondent's ability to provide the necessary direction and supervision to Approved Persons to ensure that it was fulfilling its suitability obligations with respect to the exempt products that it approved for sale to clients.

20. After being informed about KYP Deficiencies during sales compliance examinations prior to the 2019 Sales Compliance Examination, the Respondent prepared a template document that set out a list of information that should be obtained, reviewed, and analyzed with respect to each exempt product that the Respondent was considering approving for sale by its Approved Persons (the "KYP Template") in order to bring its KYP process for potential new products to an adequate standard. However, even after this KYP Template was prepared, the Respondent did not complete the KYP Template to the extent required to address the KYP Deficiencies.

21. During the 2019 Sales Compliance Examination, MFDA Compliance found that the Respondent had not completed adequate due diligence during the process of approving seven Products for sale to its clients. Among the Products were two products that had a unique and

complex structure that promised investors an indirect interest in certain high-profile companies that were not publicly traded at the time when the products were approved for sale. Although the Respondent had obtained a copy of a slide presentation from the issuer that summarized some of the features of the two exempt products, the Respondent did not acquire sufficient documentation from the issuers or document adequate information in the KYP Template prepared in respect of any of the Products to fulfill its KYP obligations with respect to the approval of the Products for sale to its clients.

22. The number of investors who purchased the Products and the timing of those transactions is summarized as follows:

- Product 1 – Limited Partnership Purchased by 4 clients in November 2017.
- Product 2 – Limited Partnership Purchased by 4 clients between October and December 2018
- Product 3 – Limited Partnership Purchased by 1 client in November 2018
- Product 4 – Preferred Shares In A Mortgage Investment Corporation
Purchased by 34 clients between January 2018 and September 2019 and 2 additional clients between September 2019 and March 2021.
- Product 5 – Mortgage Investment Corporation Bond Purchased by 3 clients in July 2019 prior to the MFDA Sales Compliance Examination and 1 additional client in September 2019.
- Product 6 – Mortgage Investment Corporation Purchased by 10 clients who between October 2018 and April 2019 prior to the MFDA Sales Compliance Examination and 1 additional client in September 2019.
- Product 7 – Trust Units Purchased by 4 clients between December 2017 and January 2018

23. The Respondent admits that prior to the issuance of the 2020 Sales Compliance Report on April 6, 2020, it failed to adequately resolve its KYP Deficiencies to an extent necessary to ensure that the Products that Approved Persons of the Respondent were authorized to sell to clients were suitable for such clients.

24. The KYP Deficiencies that were identified in the 2020 Sales Compliance Report included the following:

- a) the Respondent had not ensured that in all cases it obtained all the critical documents necessary to understand and evaluate the Products that it approved for sale by its Approved Persons, such as offering documents, term sheets and financial statements;

- b) the Respondent had not documented the precise investment structure of the Products;
- c) the Respondent had not obtained sufficient information about the Products to properly assess, determine and document:
 - i. the investment objectives of some of the Products;
 - ii. the amount of compensation that an Approved Person was eligible to receive for selling some of the Products;
 - iii. the nature and extent of potential conflicts of interest associated with some of the Products;
 - iv. the costs to investors of holding some of the Products;
 - v. the projected returns that investors could reasonably expect to receive on some of the Products;
 - vi. a methodology for determining a valuation of the investment interest that clients would be acquiring or holding after the date of purchase of the Products for two of the Products;
 - vii. an assessment of the financial position and management experience of the issuers of some of the Products; and
 - viii. the extent of limitations on the liquidity of investments in some of the Products and a determination of what assets (e.g.; cash or shares) investors would be eligible to receive if they wished to redeem their investments in those Products.

25. The KYP Deficiencies of the Respondent limited the ability of its Approved Persons and compliance staff responsible for conducting trade supervision to ensure that the Products were suitable for the clients to whom the products were offered, contrary to MFDA Rules 2.2.1 and 2.1.1.

26. After receiving the 2020 Sales Compliance Report, the Respondent contacted the issuer of the two unique products that it had approved for sale (as described in paragraph 19 above) and obtained the documentation and information that should have been reviewed and analyzed prior to the approval of those products for sale.

27. The Respondent states that it reviewed the sales of each of the Products to its clients by examining the KYC documents of each client to whom the Products were sold and any relevant accredited investor information in respect of those clients to ensure that each of the transactions was suitable.

Additional Factors

- a) The Respondent has no previous MFDA disciplinary history.
- b) The Respondent cooperated with the MFDA during the investigation process.
- c) There is no evidence that the Respondent's misconduct resulted in financial harm to clients. However, the financial position of the Products is not publicly reported.
- d) No clients have submitted complaints to the Respondent or to the MFDA concerning exempt products that they purchased in investment accounts held with the Respondent. The Respondent acknowledges that if it receives any client complaints in the future, it will comply with its complaint handling obligations.
- e) Investors who purchased the Products received documentation that warned them of certain risks associated with the products including general notes of caution that investments in the Products were risky and that investors could lose money and might not be able to sell their investments quickly, or at all. Investors in six of the seven products received documentation that explicitly stated that they could lose their entire investment in those products.
- f) In July 2022, the Respondent engaged the services of a new compliance officer with specific experience with exempt market products to ensure that all new products are adequately vetted by the Respondent and that all of the Respondent's KYP obligations are complied with.

IV. ANALYSIS

28. At the time of the misconduct admitted in this case the obligation to know your product was incorporated in MFDA Rule 2.2.1(c) "Know Your Client" which then stated"

2.2.1 "**Know-Your-Client**". Each Member and Approved Person shall use due diligence:

(c) to ensure that each order accepted, or recommendation made for any account of a client is suitable for the client and in keeping with the client's investment objectives.

MFDA Rule 2.2.1(c).

29. In 2005, the MFDA provided guidance about the duty to know your product in Member Staff Notice 0048 "Know Your Product".

Know-your-client requirements are a fundamental part of meeting basic suitability obligations. However, these obligations can only be properly discharged if Approved Persons and supervisory staff of the Member also fully understand the products that are being recommended to clients.... A basic level of due diligence

must be completed on all products being considered for sale by the Member before the products are approved. Member procedures should provide for different levels of analysis for different types of products. For example, an extensive formal review may not be required for many conventional mutual funds. However, a more comprehensive review should be performed on products that are novel or more complex in structure.... In determining whether to approve a product for sale, Member should not merely rely on the representations of the issuer, or on the fact that the product appears to be similar to others, or that other firms are already offering the product. In all cases, the approval process must be independent and objective. Members are advised that simply making inquiries will not be sufficient to discharge their responsibility to conduct due diligence. Members must properly follow up on any questions they have raised until they have been satisfied that they have a complete understanding of the products they propose to sell. ...It is critical that the Member develops an understanding of all features of the product. Issues such as liquidity of the product and the nature of any underlying investments and their inherent risks must be examined before assigning a risk ranking to the product. The Member should develop guidelines or an investor profile for which the product would be generally suitable, including risk levels, time horizon, income, and net worth. The Member should also clearly identify investors for whom the product is not suitable. Concentration limits should be assigned to products and/or general classes of products where appropriate.... As a best practice, a committee involving senior management of the Member should be empowered with ultimate authority in the product approval process, to ensure that all business units of the Member have signed off on the product prior to sale.

MSN-0048 Know-Your-Product, October 31, 2005.

30. MSN-0048 imposed a heightened obligation to carefully examine exempt securities and provided additional guidance applicable to the approval and sale of exempt products.

MSN-0048 Know-Your-Product, October 31, 2005.

31. Understanding the products being recommended for sale is a fundamental component of complying with the suitability obligation then set out in Rule 2.2.1:

...to properly discharge this [suitability] obligation, a Member, including its supervisory staff and Approved Persons, must also understand the product being recommended to clients. In our view, this is a fundamental component of complying with [MFDA] Rule 2.1.1 and discharging the obligation imposed by [MFDA] Rule 2.2.1(c).

Farm Mutual Financial Services Inc. (Re), 2009 LNCMFDA 12 at para. 56.

32. The KYP obligation includes obtaining the necessary information to perform adequate due diligence and documenting the steps taken to understand the products to ensure they are suitable for sale by Approved Persons.

33. The Respondent failed to meet its KYP obligation. The KYP deficiencies identified in the 2020 Sales Compliance report included:

- a) the Respondent had not ensured that in all cases it obtained all the critical documents necessary to understand and evaluate the Products that it approved for sale by its Approved Persons, such as offering documents, term sheets and financial statements;

- b) the Respondent had not documented the precise investment structure² of the Products;
- c) the Respondent had not obtained sufficient information about the Products to properly assess, determine and document:
 - i. the investment objectives of some of the Products;
 - ii. the amount of compensation that an Approved Person was eligible to receive for selling some of the Products;
 - iii. the nature and extent of potential conflicts of interest associated with some of the Products;
 - iv. the costs to investors of holding some of the Products;
 - v. the projected returns that investors could reasonably expect to receive on some of the Products;
 - vi. a methodology for determining a valuation of the investment interest that clients would be acquiring or holding after the date of purchase of the Products for two of the Products;
 - vii. an assessment of the financial position and management experience of the issuers of some of the Products; and
 - viii. the extent of limitations on the liquidity of investments in some of the Products and a determination of what assets (e.g.; cash or shares) investors would be eligible to receive if they wished to redeem their investments in those Products.

Settlement Agreement, paras. 19 and 22.

² For example, clients were offered an opportunity to purchase units in two limited partnerships (“LPs”) that were investing in well known non-public companies, but the Respondent had not documented in its due diligence files whether the LP’s interest in the target companies were acquired by means of direct share ownership or through some other financial instrument. The Respondent also did not document the extent of the LP’s interests in the target companies or the proportionate interest that investors in the LP would acquire by means of their investments.

Potential harm

34. These KYP deficiencies hindered the Respondents ability to properly determine suitability thus putting their clients at risk. The KYP and KYC obligations work in tandem to enable Approved Persons to determine suitability.

35. In *Popovich* the MFDA Hearing Panel stated:

The "suitability" obligation requires that the advisor determine whether an investment is appropriate for his or her client. Of course, suitability can only be properly ascertained if the advisor "understands the investment product and knows enough about the client to assess whether the product and client are a match."

Popovich (Re), 2015 LNCMFDA 48 (Misconduct) at para. 155, citing *Lamoureux (Re)*, [2001] A.S.C.D. No. 613.

36. It was clear that Members and Approved Persons could not fulfill their obligation to match investment products to the needs of their clients unless they had an adequate understanding of the product to make such an assessment. As MSN-0069 stated:

Members and APs must understand the salient facts about the products they offer to their clients in order to fulfill their suitability obligation. MFDA Member Regulation Notice MR-0048 – Know-Your-Product provides further guidance to Members on their due diligence obligations when approving and offering a product for sale.

MSN-0069, Know-Your-Client (KYC) and Suitability, April 14, 2008.

37. The failure to meet the KYP obligation limited the Respondent's ability to provide the necessary direction and supervision to Approved Persons to ensure that it was fulfilling its suitability obligations with respect to the exempt products that it approved for sale to clients.

Factors considered.

38. The panel considered the following factors in deciding to accept the proposed penalty:

- a) The contravention did not result in any financial harm to clients.
- b) There were no complaints against the Respondent.
- c) Investors who purchased the products received documentation that warned them of certain risks associated with the products.
- d) The contravention was detected during a routine Compliance examination of the Dealer.
- e) The Respondent was proactive and proposed the corrective action.
- f) The Respondent has engaged a new compliance officer with specific experience with exempt market products to ensure that all new products are adequately vetted

by the Respondent and that all of the Respondent's KYP obligations are complied with.

- g) The Respondent has no previous MFDA disciplinary history.
- h) The Respondent cooperated with the MFDA during the investigation process.
- i) The President of the Respondent appeared at the hearing and addressed the panel on behalf of the Respondent. The President of the Respondent took full responsibility for the contravention and apologized on behalf of the dealer. The President of the Respondent expressed his commitment to correct the issue and ensure it did not occur again in the future.

39. The Panel agrees with Staff that the proposed penalties strike an appropriate balance that reinforces the Member's obligations to take its KYP obligations seriously without being excessively punitive having regard to the small size of the dealer and the lack of evidence of client harm resulting from the misconduct. The proposed penalties reflect 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 Members and improving overall compliance by mutual fund industry participants.

V. COSTS

40. An award of costs of \$7,500 is appropriate and consistent with previous decisions.

DATED this 7th day of February, 2023.

"Emily Cole"

Emily Cole

Chair

"Edward Jackson"

Edward Jackson

Industry Representative

"Joseph Yassi"

Joseph Yassi

Industry Representative