



Mutual Fund Dealers Association of Canada
Association canadienne des courtiers de fonds mutuels

FILE NO. 200820

MUTUAL FUND DEALERS ASSOCIATION OF CANADA

**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: Sterling Mutuals Inc.

Present: The Honourable Fred Kaufman, C.M., Q.C., Chair
 Linda J. Anderson, Panel Member
 Robert C. White, Panel Member

Date heard: August 21, 2008

Date decided: August 21, 2008

Counsel: Jason D. Bennett, Enforcement Counsel
 Melissa J. Mackewn, for the Respondent

DECISION and REASONS

On August 21, 2008, after hearing representations from counsel, we approved a Settlement Agreement reached between the Mutual Fund Dealers Association of Canada (“MFDA” or “the Association”) and Sterling Mutuals Inc. (“Sterling” or “the Respondent”). At the conclusion of the hearing, we signed an Order to that effect, with written reasons to follow. Put briefly, the Agreement provides that Sterling pay a fine in the amount of \$50,000, that it retain an independent monitor to resolve certain compliance deficiencies, and that it pay costs in the amount of \$5,000.

The Facts

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

Registration History

1. The Respondent became a member of the MFDA on March 8, 2002.
2. The Respondent is registered as a mutual fund dealer in Alberta, British Columbia, Manitoba, New Brunswick, Nova Scotia and Saskatchewan. The Respondent is registered as a mutual fund dealer and limited market dealer in Ontario.

Repeat Compliance Deficiencies

3. In December 2002, Staff conducted a first round compliance examination of the Respondent covering the period April 2002 to November 2002 in order to assess the Respondent's compliance with MFDA Rules, By-laws and Policies (the "First Examination"), the results of which were summarized and delivered to the Respondent in a report dated July 10, 2003.
4. The First Examination identified numerous compliance deficiencies which required immediate corrective action by the Respondent. Staff required the Respondent to describe in writing by no later than July 31, 2003 the steps it had taken, or intended to take, to resolve each of the deficiencies.
5. By letter dated August 7, 2003, the Respondent provided Staff with a summary of the steps it had taken, or intended to take, to resolve the deficiencies.
6. By letter dated September 5, 2003, Staff asked the Respondent to clarify portions of its August 7, 2003 response and take further action to correct the deficiencies by no later than September 19, 2003.

7. By letter dated October 6, 2003, the Respondent provided the clarifications requested by Staff and outlined the further steps it intended to take to resolve the deficiencies.

8. By letter dated October 9, 2003, Staff advised the Respondent that, based on the Respondent's actions to date, and provided that the Respondent proceeded to take certain other corrective measures to resolve the deficiencies, Staff was satisfied that the deficiencies identified during the First Examination either had been, or would be, resolved.

9. In April 2006, Staff conducted a second round compliance examination of the Respondent covering the period January 2003 to February 2006 (the "Second Examination"), the results of which were summarized and delivered to the Respondent in a report dated September 22, 2006.

10. The Second Examination revealed that several deficiencies found during the First Examination had not been resolved. The Respondent either had not taken the corrective measures which it undertook to implement or the corrective measures it took were inadequate to resolve the deficiencies.

(i) Repeat Deficiency – Evidence of Trade Supervision

11. Between January 2003 and February 2006, the Respondent failed to establish, implement and maintain policies and procedures which ensured adequate head office account supervision in accordance with MFDA Policy 2, including policies and procedures which ensured that evidence of trade reviews was maintained in accordance with MFDA Rule 2.5.4, contrary to MFDA Rule 2.5.1 and MFDA Policy 2.

12. In particular, the First Examination revealed that the head office Compliance Officer did not consistently initial and date the Respondent's daily trade blotter. In addition, the Compliance Officer was reviewing and approving his own trading activity. Staff asked the Respondent to state what action it intended to take to resolve this deficiency.

13. In its August 7, 2003 letter, the Respondent advised Staff that it had changed its procedures to improve the recording and approval of trading activity. The Respondent also advised that trades made, reviewed and approved by the Compliance Officer in question were on behalf of self-serve clients using the Respondent's "discount service" who initiate all trades and do not seek the advice of the representative. The Respondent added that in such cases the Compliance Officer was "simply executing the clients [sic] instructions."

14. In its September 5, 2003 letter, Staff replied that an alternate Compliance Officer should review all transactions placed under the principal Compliance Officer's representative code. Staff also reminded the Respondent that MFDA Rule 2.2.1(c) requires that *all trades* accepted by the Member for any account of a client must be suitable for the client, emphasizing that Rule 2.2.1(c) does not differentiate between unsolicited trades and those placed on the advice of an Approved Person. Staff asked the Respondent to confirm that the alternate Compliance Officer would perform suitability reviews of all trades placed under the principal Compliance Officer's "rep code" and that all trades would be subject to review going forward.

15. In its October 6, 2003 letter, the Respondent confirmed to Staff that "An alternate compliance officer will review the transactions placed under the compliance officers [sic] 'rep. code' for suitability."

16. The Second Examination revealed that of 37 trades sampled by Staff, the head office Compliance Officer had failed to evidence the date of his trade review in 32 instances.

(ii) Repeat Deficiency – Approval & Use of Trade Names

17. Between January 2003 and February 2006, the Respondent failed to establish, implement and maintain policies and procedures adequately governing the use of business, trade or style names by its Approved Persons and failed to ensure that any such names were approved by the Respondent and used in accordance with MFDA Rule 1.1.7, contrary to MFDA Rule 2.5.1.

18. In particular, during the First Examination Staff obtained copies of business cards being used by several Approved Persons of the Respondent. Staff notified the Respondent that the legal name of the Respondent did not appear on the business cards in at least equal size to that of the Approved Person's trade or business name. Staff reminded the Respondent that MFDA Rule 1.1.7 requires that the legal name of the Member must appear in at least equal size to that of the Approved Person's trade or business name. Staff asked the Respondent to state what action it intended to take to resolve this deficiency.

19. In its August 7, 2003 letter, the Respondent advised Staff that it was "currently reviewing the business cards of all representatives who use a different trade name. They will conform to the MFDA standards." The Respondent also advised Staff that all such Approved Persons "were notified of the MFDA rules but were given a reasonable period to deplete old stocks of printed materials."

20. In its September 5, 2003 letter, Staff stated that "a reasonable period of time has passed with respect to this issue. The MFDA expects Sterling and its Approved Persons to be in compliance with Rule 1.1.7(b)(ii) immediately."

21. In its October 6, 2003 letter, the Respondent advised Staff that its "Approved Persons have been notified that trade names must be registered and the Sterling Mutuals name/logo must be displayed in equal prominence to the trade name."

22. The Second Examination revealed that many of the Respondent's Approved Persons used trade names, however Staff found no evidence of the Respondent's written authorization for such use. Furthermore, MFDA records indicated that the Respondent had failed to notify the MFDA of the use of these trade names, as required by MFDA Rule 1.1.7.

(iii) Repeat Deficiency – Content of Client Name Statements

23. Between January 2003 and February 2006, the Respondent failed to establish, implement and maintain policies and procedures which ensured that client name account statements which it produced and delivered to clients contained the information required by MFDA Rule 5.3.3(b) and (c), contrary to MFDA Rule 2.5.1.

24. In particular, the First Examination revealed that the Respondent's client name account statements for the period ending September 30, 2002 did not contain all of the account and transaction information required by MFDA Rule 5.3.3(b) and (c), in particular:

- (a) all debits and credits;
- (b) the quantity and description of each security purchased, sold, transferred and the dates of each transaction;
- (c) for automatic payment plan transactions, the date the plan was initiated, a description of the security and the initial payment made under the plan;
- (d) the date the statement was issued; and
- (e) the period covered by the statement.

Staff asked the Respondent to state what action it intended to take to resolve this deficiency.

25. In its August 7, 2003 letter, the Respondent advised Staff that it was "currently working with our programmers to produce a statement that better reflects the MFDA standards...All statements will be fully compliant for the required annual statement. Sterling will also be moving to electronic delivery of statements as outlined in MR-0016."

26. In its September 5, 2003 letter, Staff asked the Respondent to provide an implementation plan that includes timelines and dates for completing the programming required to bring the Respondent's statements into conformity with MFDA Rule 5.3.3.

27. In its October 6, 2003 letter, the Respondent advised Staff the “development of an ‘add-on’ piece of software for Winfund is currently under development. The programmer estimates 6 weeks until the role [sic] out of the software and some additional time for testing. In the interim we are using Winfund’s statements for the quarterly statements and the fund companies are continuing to send trade confirmations.”

28. The Second Examination revealed that client name account statements for the period ending December 31, 2005 still failed to meet all of the content requirements of MFDA Rule 5.3.3(b) and (c).

Inadequate Compliance Structure

29. The Second Examination revealed that the Respondent did not require its branch managers to supervise client account activity at the branch office level, meaning that:

- (i) the Respondent had failed to establish, implement and maintain a two-tier compliance structure to supervise client account activity, contrary to MFDA Rule 2.5.1 and MFDA Policy 2; and
- (ii) by virtue of the misconduct described in (i) above, the Respondent had prevented its branch managers from discharging their supervisory responsibilities as required by MFDA Rule 2.5.3(b)(ii), contrary to MFDA Rule 2.5.1 and MFDA Policy 2.

30. By virtue of the Respondent maintaining a single-tier compliance structure, trading activity at the branch office level was not being supervised by the Respondent’s branch managers, being the individuals with the greatest knowledge of and familiarity with the clients and client accounts serviced by the Approved Persons under their supervision.

The Contraventions

Based on the facts set out above, the Respondent admitted that, between January 2003 and February 2006, “it failed to establish, implement and maintain policies and procedures to ensure that the handling of its business was in accordance with MFDA Rules 1.1.7, 2.5.4. and 5.3.3 and MFDA Policy 2, contrary to MFDA Rule 2.5.1 and MFDA Policy 2.”

The Respondent furthermore admitted that, between the same dates, “it (i) failed to establish, implement and maintain a two-tier compliance structure to supervise client account activity, contrary to MFDA Rule 2.5.1 and MFDA Policy 2; and (ii) prevented its branch managers from discharging their supervisory responsibilities under Rule 2.5.3(b)(ii) by failing to establish, implement and maintain a two-tier compliance structure, contrary to MFDA Rule 2.5.1 and MFDA Policy 2.”

Discussion

It is trite to say that the Rules, Regulations and Policies of the MFDA are designed to preserve the integrity of its members and to protect the public with whom they deal. It is, therefore, of the utmost importance that they be followed, and that deficiencies identified as a result of MFDA audits not only be implemented, but that this be done in a timely fashion. As the facts set out above demonstrate, this is not what happened here, and hence the actions brought by MFDA Enforcement counsel.

We subscribe to the views expressed by past hearing panels that, in general, settlement agreements should be accepted, bearing in mind the following criteria:

1. That it is in the public interest to do so and that the penalties proposed will be sufficient to protect investors;
2. That the agreement is reasonable and proportionate, having regard to the conduct of the Respondent;

3. That the agreement addresses the issues of both specific and general deterrence;
4. That the agreement is likely to prevent the type of conduct set out in the facts;
5. That the agreement will foster confidence in the integrity of the Canadian capital markets;
6. That the agreement will foster confidence in the integrity of the MFDA; and
7. That the agreement will foster confidence in the regulatory process itself.

(See, for instance, *In re Leer*, [2007] MFDA Pacific Regional Council, File 200710, *In re Zollo*, [2007] MFDA Ontario Regional Council, File 200610, and *In re Investors Group Financial Services*, [2005] MFDA Ontario Regional Council, File 200401.)

We also note that while in a contested hearing the Panel attempts to determine the correct penalty, in a settlement hearing the Panel “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.” (*In re Milewski*, [1999] I.D.A.C.D. No. 17.)

In the present case, corrective measures are now being taken by the Respondent and the appointment of an independent monitor will be of value in ensuring that all of the deficiencies will be corrected in an appropriate manner. By admitting the violations, the Respondent has avoided the necessity of a protracted investigation and a lengthy hearing at considerable additional expense to the MFDA, and ultimately the membership. Also, the amount of the fine falls well within the Association’s Penalty Guidelines.

Having considered the facts of this case, and bearing in mind the criteria set out above, all members of the Hearing Panel were of the opinion that the Settlement Agreement reached between the parties should be approved,

and so it was.

Dated at Toronto, Ontario, this 3rd day of September, 2008

“Hon. Fred Kaufman”
Hon. Fred Kaufman, Chair

“Linda J. Anderson”
Linda J. Anderson, Member

“Robert C. White”
Robert C. White, Member

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