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

IN THE MATTER OF A DISCIPLINARY HEARING
PURSUANT TO SECTIONS 20 AND 24 OF BY-LAW NO. 1 OF
THE MUTUAL FUND DEALERS ASSOCIATION OF CANADA

Re: Tolu Adeola
(May also be known as Adeola Tolu)

Heard: January 28, 2015, in Toronto, Ontario
Reasons for Decision: February 20, 2015

REASONS FOR DECISION

Hearing Panel of the Central Regional Council:

Paul M. Moore Q.C.	Chair
David W. Kerr	Industry Representative
Matthew Onyeaju	Industry Representative

Appearances:

David Halasz	)	For the Mutual Fund Dealers Association of Canada
Tolu Adeola	)	Not in attendance nor represented by Counsel

PART I – OVERVIEW

1. On June 25, 2014, the Mutual Fund Dealers Association of Canada (the "MFDA") issued a Notice of Hearing in respect of a former Approved Person, Tolu Adeola (may also be known as Adeola Tolu) (the "Respondent"), which alleges the following:

> **Allegation #1**: Between December 4, 2007 and July 5, 2008, the Respondent prepared and submitted new client account forms and loan applications for seven clients which the Respondent knew or ought to have known contained false, incorrect or misleading information, thereby failing to observe high standards of ethics and conduct in the transaction of business and engaging in conduct unbecoming an Approved Person, contrary to MFDA Rule 2.1.1.
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> **Allegation #2**: Between December 4, 2007 and July 5, 2008, the Respondent misrepresented, failed to fully and adequately explain, or omitted to explain the risks, benefits, material assumptions, features and costs of a leveraged investment strategy that he recommended and implemented in the accounts of seven clients, thereby failing to ensure that the leveraged investment strategy was suitable for the clients and in keeping with the clients' investment objectives, contrary to MFDA Rules 2.2.1 and 2.1.1.
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> **Allegation #3**: Between December 4, 2007 and July 5, 2008, the Respondent failed to ensure that the leveraged investment strategy that he recommended and implemented in the accounts of seven clients was suitable for the clients and in keeping with their investment objectives, having regard to the clients' relevant "Know-Your-Client" information and financial circumstances, including but not limited to the clients' ability to afford the costs associated with the investment loans and withstand investment losses, contrary to MFDA Rules 2.2.1 and 2.1.1.
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> **Allegation #4**: On or about April 4, 2012, the Respondent engaged in business conduct which was unbecoming and detrimental to the public interest by abandoning his business as an Approved Person without notice to his clients or to the Member, thereby frustrating the ability of the Member and MFDA Staff to investigate his conduct, contrary to MFDA Rule 2.1.1.
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> **Allegation #5:** Since December 8, 2011, the Respondent failed to cooperate with the Member's investigation arising out of a client complaint, contrary to the Member's policies and procedures pursuant to MFDA Rules 1.1.2, 2.5.1, 2.11 and MFDA Rule 2.1.1.

2. Staff of the MFDA ("Staff") relied upon the affidavit of Stephen Davis, Investigator with the MFDA, sworn January 26, 2015 (the "Davis Affidavit").

3. Staff also relied upon section 20.4 of MFDA By-law No. 1, and Rules 7.3 and 8 of the MFDA Rules of Procedure, which empower a Hearing Panel to accept the facts alleged and conclusions contained in a Notice of Hearing as proven, where a Respondent does not file a Reply or participate in the hearing.

PART II – FACTS

The proceeding

4. By news release issued by the MFDA on July 18, 2014, the MFDA gave notice that the first appearance on this matter would be held on August 20, 2014. The Respondent did not participate in the first appearance, and Staff brought a motion at the first appearance for an order for substituted service of the Notice of Hearing on the Respondent.

5. By order dated August 20, 2014, the Hearing Panel ordered that the Respondent had been served with the Notice of Hearing, and had been given notice of the first appearance in accordance with the MFDA Rules of Procedure.

6. By news release issued by the MFDA on October 9, 2014, the MFDA gave notice that the hearing on the merits, originally scheduled to take place October 23, 2014, would take place on January 28, 2015, at 10:00 a.m. The MFDA's website is accessible by any member of the public. The Notice of Hearing has remained on the MFDA's website since that time.

7. The Respondent has not contacted Staff since this proceeding was commenced.

Registration History

8. From December 4, 2007 to August 28, 2012, the Respondent was registered in Ontario as mutual fund salesperson (now referred to as a dealing representative) with WFG Securities of Canada Inc. ("WFG"). The Respondent is not currently registered in the securities industry in any capacity.

Leveraged investment loans

9. The events at issue in this proceeding involved Clients AO#1, KA, DS, IS, AO#2, HK, JBS, and OI, ("the Clients") who complained to WFG about the conduct of the Respondent. The Clients stated that the Respondent engaged in the same, or substantially similar, conduct, whereby the Respondent had the Clients obtain investment loans and used the proceeds of the investment loans to purchase mutual funds, including return of capital ("ROC") mutual funds as a part of a leveraged investment strategy. In some cases, the Respondent represented to certain Clients that proceeds of the loan could be put towards their own private businesses, and it was only subsequently that the Respondent told these Clients that the monies they borrowed would instead be invested in mutual funds.

10. In the course of obtaining the leveraged loans, the Respondent prepared and submitted new client account forms ("NCAFs") and loan applications on behalf of the Clients. These documents contained false and misleading information about the assets and liabilities of the Clients, and their Know-Your-Client ("KYC") information.

11. The Respondent also misrepresented features of the leveraged investment strategy, including that the monies invested in the mutual funds would generate distributions each month which would pay the costs associated with the investment loans, so no out-of-pocket expenses would be incurred by the Clients.

12. The total amount of the investment loans obtained by the Clients was $700,000.

Allegation #1: False and misleading loan applications and New Client Account Forms

13. The Respondent prepared and submitted NCAFs and loan applications for the Clients, which contained false, incorrect and misleading information. In particular, the Respondent:

(a) reported on the Clients' loan applications and/or NCAFs that they each owned cash or liquid assets which they did not in fact own, or which the Respondent inflated in value;

(b) reported on the loan applications for clients AO#1, KA, DS, IS, AO#2, HK, and JBS that these clients owned Registered Retirement Savings Plans and other investments which they did not in fact own, or which the Respondent inflated in value;

(c) reported on the Clients' loan applications that the Clients owned residences and other assets which the clients did not in fact own, or which the Respondent inflated in value;

(d) inflated the net worth, mischaracterized the client's investment knowledge, or inflated the risk tolerance on the NCAFs for clients AO#1, KA, DS, IS, OI and AO#2;

(e) reported on the Clients' loan applications income information that was incorrect or inflated; and

(f) reported on loan applications incorrect occupation information for clients AO#1 and IS.

14. Further, the Respondent had Clients AO#1, KA, DS, and AO#2 sign the loan applications or NCAFs when the documents were blank or only partially complete, or asked them to sign the documents without giving them the opportunity to fully review the documents.

15. The policies and procedures of WFG at the material time provide:

> **General**: It must be kept in mind at all times that leveraging (borrowing for securities purchases), as with any investment strategy, is not suitable for all clients. Before leveraging is used, it is important that you carefully review the matter for suitability based on the specific client's investment objectives, needs, investing experience, financial position and their capacity to service debt load.
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> You should carefully review with each client, the risks inherent to leveraging. In particular, the client must be advised that changes in interest rates and/or value of funds can result in the client having to make payments for the loans from other resources.
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Leveraging Parameters

Clients must have the following as a minimum:

- Clients must have a risk tolerance of medium or higher;
- The total borrowed funds to invest must not exceed 40% of the clients' verifiable total net worth;
- Client investment knowledge must be good or above;
- Minimum income must be $25,000 or more;
- Client investment horizon must be long term; and
- Clients must be able to afford to service their debt load using their own demonstrated personal income. The following methods to fund a loan will not be included as income when applying for approval: systematic withdrawal plans (SWPs) and cash distributions from underlying funds …

Allegation #2: Misrepresentations and failure to adequately explain features and risks of leveraged investment strategy

16. In the case of Clients IS, DS, HK, AO#1, and OI, the Respondent induced them to take out their investment loans by leading them to believe that they could use the borrowed monies personally, or towards their personal business. The Respondent only explained to these clients that the borrowed monies were required to be invested in mutual funds (and not for their personal use) after their investment loans were approved.

17. The Respondent made one or more of the following representations to Clients AO#1, DS, KA, AO#2, and JBS:

(a) they would not be required to incur any out-of-pocket expenses to cover the costs of the investment loans;
(b) the investment would generate distributions each month which would pay the costs associated with the investment loans and provide additional amounts of money that could be used for personal uses; and
(c) the value of the investments purchased with the borrowed monies would not decline.

18. The Respondent misrepresented, failed to fully and adequately explain, or omitted to explain to the Clients the nature of the leveraged investment strategy, and in particular the unique factors of ROC mutual funds.

19. The ROC mutual funds purchased by the Clients were structured to pay monthly proceeds to investors which could include a return of the capital originally invested by the investors.

20. In the event that the value of the underlying investments declined due to deteriorating market conditions, poor investment performance or other factors such that the amount of the monthly proceeds paid to investors exceeded the increase in the value of underlying investments, there was a real and substantial risk that the ROC mutual funds would be required to reduce, suspend or cancel altogether the monthly proceeds paid to investors.

21. Initially, the ROC mutual funds generated proceeds each month which were sufficient to pay the costs associated with the investment loans. Thereafter, during the 2008 to 2010 period, the distributions paid to the Clients by the ROC mutual funds declined.

22. For clients KA, DS, and HK the reduced distributions paid by the ROC mutual funds were insufficient to pay the costs of servicing their investment loans. Clients KA, DS, and HK were eventually put in the position where they were required to incur out-of-pocket expenses, which they had difficulty affording or were unable to reasonably afford, in order to service their investment loans.

23. The proceeds paid by the ROC mutual funds to investors could include a return of the capital originally invested by the investor. If the returns generated by the underlying investments held by the ROC mutual fund were not sufficient to cover the proceeds paid to investors, then the shortfall would, over time, reduce the value of the ROC mutual funds purchased by the Clients. This potential problem would be compounded where, as here, for the most part, the Clients did not reinvest the proceeds paid to them back into the ROC mutual funds and instead took the proceeds in cash and used them for other purposes.

24. As a result of the decline in value of the ROC mutual funds, the total value of the Clients' investment declined below the outstanding principal amount of their investment loans. As a consequence, the Clients were not in a position to sell their ROC mutual funds and use the sale proceeds to pay down their investment loans without incurring a shortfall for which they would be responsible.

25. The Clients indicated that they had limited to no investment knowledge, had limited to no prior investing experience, and had never previously borrowed monies to invest. The Clients were, for the most part, also relatively new to Canada, and some indicated that they trusted the Respondent because of their common background.

Allegation #3: Unsuitable leveraging recommendations

26. As a result of the Respondent implementing the leveraged investment strategy, the Clients incurred losses of approximately $181,057.

27. The leverage strategy implemented by the Respondent for each Client raised concerns about suitability, as it triggered Red Flags based on the factors required or suggested in WFG's policies and procedures, and/or the industry guidelines (MSN 0069 – Suitability).

28. Further, there is no evidence to suggest that the Clients:

a) could reasonably afford to service their investment loans using their own personal income and without relying upon the distributions generated by their investment; or
b) could withstand investment losses arising from the strategy.

29. As well, the Clients provided information about their inability to maintain their investment loans or afford any investment losses. For example:

a) Client KA could not afford the interest payments and had to take cash advances from her credit card, and she defaulted on the payments which led to AGF Trust to commence collection steps against her;
b) Client DS was a defendant in a small claims court action brought by AGF Trust in order to recover payment of the outstanding investment loan (plus interest) due to his defaulting on the required monthly payments;
c) Client HK could not afford the interest payments and had to use cash advances from his credit card;
d) Client AO#2 could not afford to pay any extra money if the distributions did not cover the cost of maintaining the loan as she was earning $11 per hour; and
e) none of the Clients had sufficient assets with which to pay a shortfall arising from the leverage strategy.

30. The Clients complained to WFG and sought compensation. WFG conducted a review and investigation of the Clients' complaints, and paid compensation to the Clients.

Allegations #4 and #5: The Respondent abandoned his business and failed to cooperate with the Member's investigation

31. WFG's policies and procedures provided, in part, as follows:

Complaint Definition

A complaint is any written or verbal statement (including email audio recordings) made or submitted by a client or any person acting on behalf of a client alleging a grievance in connection with the conduct, business or affairs of WFGS, an AP…

Cooperation

You are expected to cooperate with the Company's … Compliance Department … in any investigations, examinations or assignment on behalf of the Company. You are expected to provide all information, records and documents in your possession or control, to the extent required to allow these Company representatives to meet their assigned obligations…

32. On or about December 6, 2011, AO#1 filed a written complaint to WFG against the Respondent concerning leverage suitability and falsification of her financial information on account forms and loan documentation. WFG commenced an investigation of the complaint, and sought information from the Respondent on a number of occasions about the complaint. The Respondent indicated to WFG that he would respond to the client's allegations, but never did.

33. By about April 2012, and in some cases approximately two years earlier, Clients KA, AO#1, DS, AO#2, and IS advised that the Respondent had also ceased communicating with them.

34. WFG continued to receive client complaints against the Respondent as described above. On or about June 19, 2012, WFG advised the Respondent that WFG had made a number of unsuccessful attempts to contact him with respect to the client complaints. WFG advised the Respondent that it was suspending him effective immediately for 30 days, and that his agreements with WFG would be terminated if he did not respond to WFG within 30 days. The Respondent did not respond, and WFG terminated the Respondent's associate agreement with WFG.

35. WFG has advised the following with respect to the Respondent:

i. the last trade he initiated was on or about March 7, 2010;
ii. he logged onto WFG's back-office system on March 22, 2012;
iii. WFG received no correspondence from him after April 10, 2012;
iv. WFG has been unsuccessful in their attempts to speak with him;
v. to the best of WFG's knowledge he did not notify anyone at WFG that he was no longer going to service his mutual fund clients;
vi. to the best of WFG's knowledge he did not notify his clients that he was no longer going to service their accounts;
vii. the clients serviced by him were reassigned to another Approved Person on September 12, 2012, who has been in contact with the clients about the change of advisor; and

viii. as of March 26, 2013, WFG was not aware of any additional complaints against him.

36. The Respondent has not communicated with WFG or Staff despite repeated attempts to obtain a statement from him. He has not explained or accounted for his whereabouts or his failure to respond to the requests for comment concerning the complaints against him.

37. As a result of the Respondent's failure to cooperate with WFG's investigation, neither WFG nor Staff have been able to obtain any information or documents from him with respect to the subject matter of Allegations #1 to #3 or to fully investigate the allegations made against him. Accordingly, WFG and Staff have been unable to determine the full nature and extent of the Respondent's misconduct.

PART III – SERVICE OF THE NOTICE OF HEARING AND THE EFFECT OF FAILING TO RESPOND TO THE PROCEEDING

Service of the Notice of Hearing

38. Pursuant to the Hearing Panel's Order dated August 20, 2014, the Respondent was served with the Notice of Hearing, and had notice of the first appearance. The October 9, 2014 news release by the MFDA gave notice that the hearing on the merits would occur on January 28, 2015. The Respondent has not filed a Reply, and thus far has not participated in this proceeding.

Effect of a failure to respond to the proceeding

39. Section 20.4 of MFDA By-law No. 1 states:

> If a Member or person summoned before a hearing of a Hearing Panel by way of Notice of Hearing fails to:
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> (a) serve a reply in accordance with s. 20.2; or
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> (b) attend at the hearing specified in the Notice of Hearing, notwithstanding that a reply may have been served;

> the Hearing Panel may proceed with the hearing of the matter on the date and at the time and place set out in the Notice of Hearing (or any subsequent date, at any time and place), without further notice to and in the absence of the Member or person, and the Hearing Panel may accept the facts alleged by the Corporation in the Notice of Hearing as having been proven by the Corporation and may impose any of the penalties described in Section 24.1.

40. Rules 7.3 and 8 of the MFDA Rules of Procedures similarly empower a Hearing Panel, where a Respondent does not file a Reply or attend the hearing, to proceed with the hearing in the absence of a Respondent and accept the facts alleged and conclusions in the Notice of Hearing as proven.

41. The Hearing Panel proceeded with the hearing in the absence of the Respondent. In addition, the Hearing Panel, having regard to the Respondent's failure to respond to this proceeding, accepted the facts alleged and conclusions drawn in the Notice of Hearing as proven notwithstanding that Staff has adduced evidence to prove its case.

PART IV – MISCONDUCT: LAW AND FINDING

Relevant Rules

42. The relevant rules with respect to misconduct are:

(a) MFDA Rule 2.1.1 (*Standard of Conduct*);
(b) MFDA Rule 2.2.1 ("*Know-Your-Client*" and *suitability*);
(c) MFDA Rule 1.1.2 (*"Compliance by Approved Person"*);
(d) MFDA Rule 2.5.1. (*"Member Responsibilities"*); and
(e) MFDA Rule 2.11 (*"Complaints"*).

Allegation #1 – False and misleading loan applications and NCAFs

43. MFDA Rule 2.1.1 prescribes the standard of conduct applicable to Members and Approved Persons. It states that each Member and Approved Person shall:

(a) deal fairly, honestly and in good faith with its clients;

(b) observe high standards of ethics and conduct in the transaction of business;

(c) not engage in any business conduct or practice which is unbecoming or detrimental to the public interest; and

(d) be of such character and business repute and have such experience and training as is consistent with the standards described in Rule 2.1.1, or as may be prescribed by the Corporation.

44. MFDA Rule 2.1.1 is designed to protect the public interest by requiring Approved Persons to adhere to a high standard of ethical conduct. The Rule articulates the most fundamental obligations of all registrants in the securities industry.

45. MFDA Hearing Panels have consistently held that an Approved Person contravenes the standard of conduct set out in MFDA Rule 2.1.1 when he or she completes account forms and loan applications with information which he or she knows, or ought to know, is false.

> *Villarin (Re)*, [2014] MFDA Prairie Regional Council, File No. 201352, Hearing Panel decision dated July 9, 2014, at para. 25 ("*Villarin")*
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> *Sulkers (Re)*, [2014] MFDA Prairie Regional Council, File No. 201318, Hearing Panel decision dated July 9, 2014, at para 6 ("*Sulkers*")
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> *Sobrevilla (Re)*, [2014] MFDA Prairie Regional Council, MFDA File No. 201351, Hearing Panel Decision dated July 9, 2014, at paras. 5-6 ("*Sobrevilla*")
>
> *Gragasin (Re)*, [2014] MFDA Prairie Regional Council, File No. 201249, Hearing Panel decision dated July 9, 2014, at paras. 7-10 ("*Gragasin*")
>
> *Sarker (Re)*, [2014] MFDA Central Regional Council, File No. 201327, Hearing Panel decision dated February 28, 2014, at paras. 13-14, and 26-27, ("*Sarker*")
>
> *McAuley (Re)*, [2011] MFDA Central Regional Council, File No. 201018, Hearing Panel Decision dated April 11, 2011 ("*McAuley*")
>
> *Lipski (Re)*, [2010] MFDA Pacific Regional Council, File No. 201012, Hearing Panel Decision dated November 3, 2010, at page 5-6 ("*Lipski*")

Satti (Re), 2012 LNCMFDA 70, at para 23-24 ("*Satti*").

46. In the present case, the Respondent prepared and submitted NCAFs and loan applications for 8 clients of WFG, which contained false, incorrect and misleading information, as described above at paragraph 13.

47. Further, certain Clients (AO#1, KA and DS, and AO#2) reported that the Respondent had them sign the loan applications or NCAFs when the documents were blank or only partially complete, or the Clients did not fully review the documents before the clients signed them.

48. The evidence shows a repeated pattern engaged in by the Respondent in regard to the contents of the Clients' loan application documents and NCAFs. The Clients reported that they had very limited assets and earnings, and limited to no investment experience or knowledge. This is in stark contrast to the profile shown on the loan application and NCAF documents prepared and submitted by the Respondent to enable the investment loans to occur.

49. By engaging in the conduct described above, the Respondent increased the likelihood that the lender would approve the investment loans for the Clients. As the investment loans were used to purchase mutual funds, this conduct increased the amount of business that the Respondent was able to process through WFG, which in turn increased the Respondent's compensation.

50. In addition, the Respondent's conduct made it appear to WFG's supervisory and compliance staff as though the Clients satisfied WFG's requirements regarding the use of leveraging. This conduct inhibited WFG's ability to fulfill its supervisory obligations with respect to the suitability of investment loans.

51. The Respondent's conduct was fundamentally inconsistent with the ethical obligations of Approved Persons as set out in MFDA Rule 2.1.1.

Overview of the suitability obligation

52. The Respondent's conduct described involved a failure by the Respondent to fulfill his suitability obligation described below.

53. MFDA Rule 2.2.1 states:

> 2.2.1 **"Know-Your-Client".** Each Member and Approved Person shall use due diligence:
>
> (a) to learn the essential facts relative to each client and to each order or account accepted;
> (b) to ensure that the acceptance of any order for any account is within the bounds of good business practice; and
> (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; and
> (d) to ensure that, notwithstanding the provisions of paragraph (c), where a transaction proposed by a client is not suitable for the client and in keeping with the client's investment objectives, the Member has so advised the client before execution thereof.

54. This MFDA Rule codified the "Know-Your-Client" and "suitability" obligations recognized by securities regulators. Securities regulators have held that these obligations are "an essential component of the consumer protection scheme of [securities legislation] and a basic obligation of a registrant, and a course of conduct by a registrant involving a failure to comply with them is an extremely serious matter". *E. A. Manning Ltd. et al (Re)*, 1995 LNONOSC 377 (OSC) ("*E.A. Manning*") at p. 34; *Daubney (Re)*, 2008 LNONOSC 338 (OSC) ("*Daubney*") at para. 15; *DeVuono (Re)*, [2012] MFDA Pacific Regional Council, MFDA File No. 201102, Hearing Panel Decision dated November 22, 2012 (Misconduct) ("*DeVuono*") at para. 52,; and *Pretty (Re)*, [2014] MFDA Atlantic Regional Council, Hearing Panel decision dated January 30, 2014 ("*Pretty*") at para. 89.

55. In *Lamoureux*, a hearing panel of the Alberta Securities Commission described the relationship between the "Know-Your-Client" and "suitability" obligations. The hearing panel stated that:

The "know your client" and "suitability" obligations are conceptually distinct but, in practice, they are so closely connected and interwoven that the terms are sometimes used interchangeably.

The "know your client" obligation is the obligation to learn about the client, their personal financial situation, financial sophistication and investment experience, investment objectives and risk tolerance.

The "suitability" obligation is the obligation of a registrant to determine whether an investment is appropriate for a particular client. Assessment of suitability requires both that the registrant understands the investment product and knows enough about the client to assess whether the product and client are a match.

Lamoureux (Re), [2001] A.S.C.D. No. 613 (ASC) ("*Lamoureux*") at pp. 11-12.

DeVuono, *supra* at para. 53.

Pretty, *supra* at para. 89.

The Three Stage Analysis of Suitability

56. Securities authorities have adopted a three-stage analysis of suitability, according to which a registrant is obliged to:

(a) use due diligence to know the product and know the client;
(b) apply sound professional judgment in establishing the suitability of the product for the client; and
(c) disclose the negative as well as the positive aspects of the proposed investment.

Daubney, *supra* at para. 17.

DeVuono, *supra* at para. 52.

Pretty, *supra* at para. 89.

57. In *Lamoureux*, the hearing panel explained the three stage process that an advisor must follow to fulfill their suitability obligations, stating that:

> Knowing the product involves carefully reviewing and understanding the attributes, including associated risks, of the securities that they are considering recommending to their clients. Knowing the client was discussed above.
>
> Only after the "due diligence" of the first stage is completed, can the registrant move to the second stage in which they fulfil their obligation to determine whether specific trades or investments, solicited or unsolicited, are suitable for the client.
>
> Suitability determinations…will always be fact specific. A proper assessment of suitability will generally require consideration of such factors as a client's income, net worth, risk tolerance, liquid assets and investment objectives, as well as an understanding of particular investment products. The registrant must apply sound professional judgement to the information elicited from "know your client" inquiries. If, based on the due diligence and professional assessment the registrant reasonably concludes that an investment in a particular security in a particular amount would be suitable for a particular client, it is then appropriate for the registrant to recommend the investment to that client.
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> By recommending a securities transaction to a client, a registrant enters the third stage of the process… At this stage, when making the client aware of a potential investment, the registrant is obligated to make the client aware of the negative material factors involved in the transaction, as well as positive factors.
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> The disclosure of material negative factors in the third stage of the process is intended to assist the client in making an informed investment decision.
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> *Lamoureux*, *supra* at pp. 16-17.

Allegation #2: Misrepresentations and failure to adequately explain features and risks of leveraged investment strategy

58. A registrant has an obligation to couple the recommendation to a client to invest in a certain product or strategy with disclosure to the client of all salient material relevant to the product or strategy including negative factors involved in the transaction, prior to executing a trade on the client's behalf. A balanced presentation must be offered to the client in the interest of complete disclosure and relative objectivity.

> *Lamoureux*, *supra* at p. 19.
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> *Abrams in trust for Transpacific Sales Ltd.* v. *Sprott Securities Ltd. and*

Spork, [2003] O.J. No. 3900 (C.A.) at pp. 7-8 and 10.

59. The registrant is obliged to properly explain all of the material risks of the leveraging strategy and the leveraging recommendation should not be supported by inaccurate or misleading representations.

Mytting (Re), 2012 LNIIROC 45 ("*Mytting*") at pages 17-18.

60. It is particularly important that the registrant ensure the client understands the risks of borrowing monies to invest because leveraging can magnify the losses suffered by the client.

Daubney, *supra* at paras 24-25.

61. In addition, a registrant's description of the risks of leveraging must take into the account the possibility of a market downturn and the impact such a downturn would have on the leverage strategy. It ought to be reasonably foreseeable to any investment advisor that there might, at almost any time, be a market downturn that might prove to be of minor or major proportion and would impact, potentially substantially, the performance of a mutual fund.

Pretty, *supra* at para. 103.

Rhoads v. *Prudential-Bache Securities Canada Ltd.*, [1992] B.C.J. No. 153 at pp. 7-8.

62. In the present case, the Clients had limited to no investment knowledge or experience, and had never previously borrowed monies to invest.

63. In the case of Clients IS, DS, HK, AO#1, and OI, the Respondent induced them to take out their investment loans by leading them to believe that they could use the borrowed monies towards their personal businesses. For these clients, the fact that the borrowed monies were going to be invested in mutual funds was only explained to them by the Respondent after their investment loans were approved.

64. The Respondent made a number of representations to Clients (as described at paragraphs 17 and 18 above) that were inadequate, or omitted to explain the risks, benefits, and features of a leveraged investment, particularly the unique factors associated with ROC mutual funds.

65. The Respondent's conduct as described above is fundamentally at odds with an Approved Person's obligations to determine the suitability of the product sold to the Clients, and the obligation to disclose all salient material relevant to the investment loans entered into by the Clients. For some of the Clients, the loans were entered into by them based on false pretenses, and for others based on an unbalanced explanation lacking any real disclosure of the nature of the investment, its features and risks.

66. MFDA cases have held that ignoring the obligation to disclose relevant information, including negative aspects of the transaction is a contravention of an Approved Person's suitability and Know-Your-Client obligations pursuant to MFDA Rules 2.2.1 and 2.1.1

> *Villarin, Supra,* at para. 27.
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> *Arseneau (Re)*, [2012] MFDA Atlantic Regional Council, MFDA File No. 201115, Hearing Panel Decision dated September 28, 2012 at paras. 39-46.

Allegation #3 – Unsuitable leveraging recommendations

67. Special considerations apply where a registrant recommends the use of leveraging. In circumstances where a registrant is evaluating the suitability of a leveraging strategy for a client, the registrant is required to consider whether the client has sufficient income or unencumbered liquid assets to be able to, among other things:

> (a) withstand a market downturn without jeopardizing their financial security; and
> (b) satisfy all loan obligations (both principal-and-interest) associated with the strategy;

regardless of the performance of the investments purchased as a result of the strategy and without relying on anticipated income from the investments.

Daubney, supra at paras 199-205.

Pretty, *supra* at para. 105.

68. In *Sarker*, the Hearing Panel found that the Respondent had contravened his suitability and Know-Your-Client obligations when he failed to assess whether the clients could afford to service their investment loans without relying upon the distributions generated by the ROC mutual funds and withstand investment losses in the event the leveraged investment strategy did not perform as the Respondent represented it would.

Sarker, *supra* at para. 15.

69. In the present case, the leveraged investment strategy implemented by the Respondent led to losses of approximately $181,057.

70. The Know-Your-Client and asset/liability information of the Clients triggered suitability concerns/red flags.

71. Further, Clients could not reasonably afford to service their investment loans using their own personal income and without relying upon the distributions generated by their investment, or they could not withstand investment losses arising from the strategy.

72. For example, the leverage loans implemented by the Respondent led to: the need for some Clients to pay the maintenance interest payments using credit; interest payment defaults; collection procedures; and the commencement of court action by the lender to recover monies owed.

73. Importantly, none of the Clients had sufficient assets with which to pay a shortfall arising from the leverage strategy.

74. The Clients complained to WFG and sought compensation. WFG paid compensation to the Clients.

75. By engaging in the conduct described above, the Respondent acted contrary to MFDA Rules 2.2.1 and 2.1.1. The investment loan strategy implemented by the Respondent for the Clients was not suitable or in keeping with their investment objectives, having regard to their Know-Your-Client information and financial circumstances.

Allegation #4 – Abandoning mutual fund business

76. MFDA Hearing Panels have held that an Approved Person contravenes the standard of conduct set out in MFDA Rule 2.1.1 when he or she abandons their business as an Approved Person without notice to his clients or to the Member. This conduct is, among other things, detrimental to the public interest, and frustrates the ability of the Member and the MFDA to investigate the Approved Person's conduct.

> *Parkinson (Re)* [2005], Hearing Panel of the Ontario Regional Council, MFDA File No. 200501, Decision and Reasons dated April 29, 2005, at pp. 19-20 ("Parkinson").

77. The Respondent did not notify anyone at WFG that he was no longer going to service his mutual fund clients. Also, the Respondent did not notify his clients that he was no longer going to service their accounts. Clients tried to reach the Respondent who ceased communicating.

78. Despite repeated attempts to contact him, the Respondent has not contacted WFG or the MFDA. The Respondent's whereabouts remain unknown.

79. By abandoning his practice without notice to WFG or the clients, the Respondent engaged in business conduct which is unbecoming or detrimental to the public interest, and is contrary to MFDA Rule 2.1.1.

Allegation #5 – Failure to cooperate with the Member's investigation of client complaints

80. The Respondent, as an Approved Person at WFG, had an obligation pursuant to the Member's policies and procedures to cooperate with the Member's investigation of client complaints.

81. WFG received clients' complaints and sought information from the Respondent. The Respondent did not respond to WFG's request for information.

82. Members are responsible for establishing, implementing and maintaining policies and procedures to ensure the handling of its business is in accordance with MFDA By-laws, Rules and Policies and with applicable securities legislation.

83. An Approved Person is required to comply with the supervisory policies and procedures established, implemented and maintained by a Member under Rule 2.5.1, and the Respondent's failure to do so in this case was a breach of his obligations under MFDA Rule 1.1.2.

84. Additionally, where an Approved Person fails to comply with the Member's policies and procedures, he engages in conduct which falls below the acceptable standard of conduct expected of Approved Persons as prescribed by MFDA Rule 2.1.1(b).

85. In *Tonnies*, the MFDA Hearing Panel held that the direction in the Member's policies and procedures manual ("PPM") can be used as a standard of ethics and conduct against which they can measure the activities of Tonnies and it was clear that Tonnies breached the internal standards of the Member when he failed to abide by the policies and procedures set out by the Member.

> *In The Matter of Arnold Tonnies*, [2005] Hearing of the Prairie Regional Council, MFDA File No. 200503, Hearing Panel Decision dated June 27, 2005 ("*Tonnies*"), at pp.10, 16 to 19.

86. The Respondent breached WFG's internal standards and fell short of the standards expected of Approved Persons in the Canadian mutual fund industry.

87. By engaging in the conduct set out above, the Respondent failed to comply with the Member's policies and procedures in respect of cooperating with the Member's investigation

arising out of a client complaint, contrary to MFDA Rules 1.1.2 and 2.5.1, as well as MFDA 2.1.1.

PART V – PENALTY: LAW AND FINDING

Proposed penalty

88. Staff submitted that the appropriate penalty to impose on the Respondent was:

(a) a permanent prohibition on the Respondent's authority to conduct securities related business while in the employ of or associated with any MFDA Member, pursuant to s. 24.1.1(e) of MFDA By-law No. 1;
(b) a fine of $250,000, pursuant to s. 24.1.1(b) of MFDA By-law No. 1; and
(c) costs of $10,000, pursuant to s. 24.2 of MFDA By-law No. 1.

Factors concerning the appropriateness of the penalty

89. The primary goal of securities regulation is the protection of the investor.

Pezim v. *British Columbia (Superintendent of Brokers)*, [1994] 2 S.C.R. 557 (S.C.C.) at paras. 59, 68.

90. Factors Hearing Panels frequently consider when determining whether a penalty is appropriate include the following:

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

(h) the damage caused to the integrity of the capital markets in the jurisdiction by the Respondent's improper activities;
(i) 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;
(j) the need to alert others to the consequences of inappropriate activities to those who are permitted to participate in the capital markets; and
(k) previous decisions made in similar circumstances.

Headley (Re) [2006] MFDA Ontario Regional Council, File No. 200509, Hearing Panel Decision dated February 21, 2006.

Considerations in the present case

(a) Nature of the misconduct

91. The nature of the misconduct is an aggravating factor in the present case.

92. MFDA Hearing Panels have held that providing false information in NCAFs and loan applications is serious misconduct, which is inconsistent with the duties of registrants in the securities industry.

Villarin, *supra* at para. 19.

93. In addition, the Know-Your-Client and suitability obligations are "essential" to protecting the public and any failure to comply with these obligations is "an extremely serious matter".

E. A. Manning, *supra* at p. 34.

Daubney, *supra* at para. 15.

DeVuono, *supra* at para. 52.

Pretty, *supra* at para. 89.

94. The Respondent's leveraging activities at issue in this disciplinary proceeding involved at least 8 clients and more than $700,000 in investment monies.

95. Moreover, the Respondent's misconduct is aggravated by his failure to cooperate with the Member's investigation into his conduct, and by his abandoning of his mutual fund business. This conduct shows a serious disregard for his duties and obligations as an Approved Person.

(b) Client harm

96. The Respondent's conduct caused harm to clients who relied upon him for advice. The Clients incurred investment losses of approximately $181,057. The Member paid compensation to the Clients.

(c) Benefits received by the Respondent

97. The Respondent benefitted from this misconduct through the receipt of commissions and fees generated by the purchase of at least $700,000 worth of mutual funds with the monies borrowed by the Clients.

(d) Risk to investors

98. By failing to cooperate with the Member's investigation and abandoning his business, the Respondent has demonstrated that he is not governable within the self-regulatory regime. In addition, the Respondent's falsification and exaggeration of the Client's assets, and his leveraging practices demonstrate that he ignored his obligations as a registrant to ensure that his leveraging recommendations were suitable for clients. The Respondent would continue to pose a risk to investors were he permitted to be registered in the mutual fund industry. A permanent prohibition is appropriate and necessary to protect investors.

(e) The Respondent's past conduct including prior sanctions

99. The Respondent has not previously been the subject of MFDA disciplinary proceedings. However, this factor should be given very little weight in light of his serious misconduct and all the aggravating factors.

(f) The Respondent's recognition of the seriousness of his misconduct

100. As the Respondent did not respond to the disciplinary proceeding, the Respondent either does not recognize the seriousness of his misconduct, or is unwilling to take responsibility for it. This is an aggravating factor with respect to penalty.

(g) Deterrence

101. Staff submitted that the penalties requested are sufficient to deter not only the Respondent, but also any others who participate in the capital markets, from engaging in similar improper activity. We agree.

102. A permanent prohibition on the authority of an Approved Person to conduct securities related business with an MFDA Member is the most serious penalty available to the Hearing Panel.

103. In addition, a fine in the amount of $250,000 is significant and could not reasonably be viewed as a license fee or cost of doing business.

(h) Previous decisions made in similar circumstances

104. The proposed penalties are consistent with previous decisions made in similar circumstances.

105. Having regard to all of the foregoing considerations, we determined that the proposed penalties are reasonable and proportionate having regard to the conduct of the Respondent and the circumstances of this case. We imposed the requested penalties.

Costs

106. MFDA Staff also requested that an order for costs be made against the Respondent in the amount of $10,000. This amount will permit the MFDA to recover from the Respondent a portion of the costs attributable to conducting the investigation and this hearing, such that these costs do not have to be borne by the MFDA or subsidized by those Members and Approved Persons of the MFDA who do not engage in this type of activity. This amount of costs is also within the range of amounts awarded by MFDA Hearing Panels in the decisions listed above. We granted the cost order requested.

Written Submission of Staff

107. In preparing these reasons we relied extensively on the excellent and well researched written Submission of Staff and adopted as our own much of his reasoning and analysis as well as much of his text.

DATED this 20th day of February, 2015.

"Paul M. Moore"

Paul M. Moore Q.C.
Chair

"David W. Kerr"

David W. Kerr
Industry Representative

"Matthew Onyeaju"

Matthew Onyeaju
Industry Representative

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