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: Sean Preston Davidson

Heard: June 21, 2021 by electronic hearing in Toronto, Ontario
Decision (Penalty) and Reasons: June 29, 2021

DECISION (PENALTY) AND REASONS

Hearing Panel of the Central Regional Council:

Martin L. Friedland, C.C., Q.C.	Chair
Matthew Prew	Industry Representative
Timothy J. Pryor	Industry Representative

Appearances:

Alan Melamud	)	Enforcement Counsel for the Mutual Fund Dealers Association of Canada
Sean Preston Davidson	)	Respondent, not in attendance or represented by counsel

Background

1. This is an electronic Hearing under Sections 20 and 24 of By-law No. 1 of the Mutual Fund Dealers Association of Canada ("MFDA"). The Hearing was held by way of a videoconference on June 21, 2021. Sean Preston Davidson (the "Respondent") did not appear at the Hearing in-person or by video or teleconference. Nor was he represented by counsel. He filed a Reply to the alleged misconduct on January 8, 2021, but did not participate further in the proceedings. Counsel for the MFDA ("Staff") informed us at the hearing that several weeks earlier the Respondent informed Staff that he did not plan to attend the Hearing on June 21, 2021.

2. From November 13, 2002 to October 31, 2018, when he was terminated in connection with the matters that are the subject of the present hearing, the Respondent was registered in Ontario as a dealing representative (formerly a mutual fund salesperson) with Sterling Mutuals Inc. (the "Member"), a Member of the MFDA. At all material times, the Respondent carried on business in the Windsor, Ontario area. The Respondent is not currently registered in the securities industry in any capacity.

3. The rules provide that because the Respondent did not appear at the Hearing, the Panel is entitled to accept as proven the facts alleged and conclusions drawn by the Staff in the Notice of Hearing (see Rule 7.3 of the MFDA *Rules of Procedure*). Nevertheless, Staff presented sworn evidence, concerning the allegations. There were three detailed sworn affidavits with numbered exhibits from MFDA staff, from Ms. Tania Czajkiwsky, the Chief Compliance Officer of the Member at the material time, and one from Mr. Nelson Cheng, the Ultimate Designated Person ("UDP") of the Member. At the conclusion of that phase of the Hearing, the Panel adjourned and then announced that we were satisfied that the facts alleged by MFDA are correct and that the Respondent had failed to comply with the By-laws, Rules or Policies as alleged in the three allegations.

4. Staff then made submissions as to penalty. The Panel reserved its decision on the penalty and stated that we would issue our decision on the appropriate penalty in due course as well as our reasons for both the misconduct and the penalty. This is our decision on the penalty and the reasons for our decisions for the finding of misconduct and the penalty.

Alleged Misconduct

5. Proceedings against the Respondent were commenced by a Notice of Hearing, dated November 11, 2020.

6. The MFDA alleged the following violations of the By-Laws, Rules or Policies of the MFDA:

> **Allegation #1**: In or about February 2014, the Respondent engaged in personal financial dealings with a client when he borrowed or otherwise accepted approximately $18,000 from one or more clients, which gave rise to a conflict or potential conflict of interest which he failed to disclose to the Member or otherwise address by the exercise of responsible business judgment influenced only by the best interests of the client, contrary to the policies and procedures of the Member, and MFDA Rules 2.1.4, 2.1.1, 2.5.1 and 1.1.2.
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> **Allegation #2**: Between 2014 and 2017, the Respondent submitted three annual compliance questionnaires to the Member that contained false or misleading responses, thereby interfering with the ability of the Member to supervise the Respondent's activities, engaging in conduct detrimental to the public interest, and failing to observe high standards of ethics and conduct in the transaction of business, contrary to MFDA Rule 2.1.1.
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> **Allegation #3**: Between January 2015 and January 2017, the Respondent failed to disclose to the Member that he had filed a consumer proposal in January 2015, contrary to the Member's policies and procedures, and MFDA Rules 2.1.1, 1.2.2(b) (now 1.4(b), 2.5.1 and 1.1.2, and s. 4.1(g) of MFDA Policy No. 6.

Borrowing from Clients

7. On or about March 2004, the Respondent began servicing the accounts of both MC and KC. They were old friends of the Respondent.

8. On or about February 2014, the Respondent borrowed $18,000 from one or both of MC and KC. It is not entirely clear who actually provided the funds. The Respondent did not document the loan in writing, specify a repayment schedule, promise to pay any interest, or provide any collateral.

9. Borrowing money from a client has consistently been held by other panels to be a conflict of interest under Rules 2.1.1 and 2.1.4. Member Regulation Notice 0047, dated October 3, 2005, takes a hard line on borrowing from clients, stating under the heading "Borrowing from Clients:"

> "Borrowing from a client by either the Member or Approved Person raises a significant and direct conflict that in almost all cases will be impossible to resolve in favour of the client. While such activity is not explicitly prohibited under MFDA rules, MFDA staff are unaware of any circumstances where Members or Approved Persons proposing to enter into any such arrangements would be able to demonstrate that the conflict has been properly dealt with."

10. As the Hearing Panel stated in *Re Gaunt* (2013 LNCMFDA 63 at para. 47):

> "A conflict of interest occurs when one party to a matter advances, uses or pursues his own interests in dealing with another person, to whom he has an obligation of dealing fairly, to the detriment of that other person or to his own advantage rather than the person to whom he owes the duty of fairness."

There are many similar MFDA cases: see, e.g., *Re Elwood* (2020) MFDA File No. 201940; *Re Piper* 2018 LNCMFDA 31); and *Re Bott* 2017 LNCMFDA 95.

11. MFDA Rule 2.1.4 provides:

a) Each Member and Approved Person shall be aware of the possibility of conflicts of interest arising between the interests of the Member or Approved Person and the interests of the client. Where an Approved Person becomes aware of any conflict or potential conflict of interest the Approved person shall immediately disclose such conflict or potential conflict of interest to the Member.

d) Each Member shall develop and maintain written policies and procedures to ensure compliance with Rules 2.1.4(a), (b) and (c).

12. The Member also prohibited its Approved Persons from borrowing funds from clients. Approved Persons have an obligation to comply with the Member's policies and procedures: see *Re Franco* (2011 LNCMFDA 55) at para. 38.

13. At no time did the Respondent disclose to the Member his borrowing from either MC or KC. Section 4.1(g) of MFDA Policy No. 6 ("Information Reporting Requirements") requires that an Approved Person report to the Member within two business days, if "the Approved Person becomes bankrupt or suspends payment of debts generally or makes an arrangement with creditors or makes an assignment or is deemed insolvent." The failure to report a consumer proposal has previously been found to be a contravention of section 4.1 (g). See *Re Piper* (2018 LNCMFDA 31) at paras. 14-15.

14. The fact that MC and KC were old friends does not affect the legality of the borrowing. As the court stated in *Re Elwood* (2020) MFDA File No. 201940) at para. 12.2: "the fact that the borrowing was from a friend does not avoid the conflict of interest. Previous MFDA Hearing Panels have determined that borrowing money from a 'friend' gives rise to a conflict of interest which must be disclosed to the Member and must be resolved in the best interests of the client."

15. The Respondent did not dispute the loan in his Reply. He claimed that it was not the business of the Member or the MFDA to know what he did in his personal life with a close friend.

16. We therefore concluded that the Respondent breached Allegation #1.

False or Misleading Compliance Questionnaires

17. On each of the three annual compliance questionnaires in May 2014, December 2016 and December 2017, the Respondent was asked whether he had ever lent or borrowed money from a Member client. In each case, the respondent answered in the negative.

18. The Respondent breached Allegation #2 by deceiving the Member in three annual compliance questionnaires after the loan was made by stating that he had not borrowed funds from clients.

Failure to Report a Consumer Proposal to the Member

19. It is clear that the Respondent needed the funds because he was in financial difficulty. He was heading towards bankruptcy or an arrangement with creditors.

20. At all material times, the Member's policies and procedures required its Approved Persons to report any material changes to the Member within at most five business days. The Member's policies and procedures further required that certain events be reported within two business days, including where an Approved Person had suspended payments of debts or made an arrangement with creditors.

21. On or about January 26, 2015, the Respondent filed a consumer proposal, which showed the Respondent's total debts to unsecured creditors were about $75,000. The Respondent satisfied the consumer proposal on or about September 19, 2018.

22. The consumer proposal was not disclosed to the Member until January 3, 2017 – almost two years after he filed the proposal. As with the loan from MC and KC, he did not disclose the consumer proposal in the annual compliance questionnaires, which specifically asked Approved Persons to "confirm that you have reported all of your financial disclosure, including, but not limited to, garnishments, directions to pay, bankruptcies, and or consumer proposals to Head Office within 5 business days of the event."

23. It was through the consumer proposal that the MFDA and the Member discovered the loan to MC and KC. The name C appeared on the consumer proposal – the Respondent still owed MC $15,290 – and the MFDA asked the Member whether they were clients.

24. In his Reply, the Respondent stated that he had told the Member's UDP, Nelson Cheng, about a potential bankruptcy in January 2015 and about the consumer proposal in March 2015, but the Respondent provided no record of his doing so and there is a sworn affidavit from the UDP that he was not told about the proposal. The Panel believes that such disclosure did not take place. Had it taken place, the UDP stated in his affidavit, he would have dealt with it at the time. In any event, such disclosure would have been later than the disclosure required in such a case.

25. It is important that Members know immediately if an Approved Person is not financially solvent. Only with such knowledge can Members take the necessary steps to guard against the very real risks to clients, the commercial risks and liabilities to the Member, and risks to the public interest.

26. The Respondent thus breached all three allegations.

Penalty

27. What penalty should be imposed? The conduct is serious, consisting of obtaining a substantial loan from a client, misleading the Member as to the loan, and also by not disclosing the consumer arrangement. By failing to properly disclose both the client borrowing and consumer proposal to his Member, the Respondent undermined the Member's ability to perform its role in the regulatory scheme and ensure client protection.

28. MC and KC were repaid part of the loan through the consumer arrangement and otherwise, making a total amount repaid of $5,729. MC therefore suffered a loss of over $12,000. The Respondent profited by receiving $18,000, without interest.

29. In his favour, the Respondent has not been the subject of previous disciplinary action by the MFDA.

30. Further, the Member communicated with the Respondent's other former clients and no similar conduct was disclosed.

31. Deterrence of such conduct is an important consideration. The penalty has to be a significant amount to discourage such conduct.

32. Misleading the Member and not participating in the disciplinary proceedings is a particularly serious matter. Although it appears likely that the Respondent is not interested in getting back in the industry, this is a case, as argued by Staff, where the Respondent should be prohibited from returning to the industry.

33. We believe that a fine of $25,000, as suggested as a minimum by Staff, is the appropriate fine. It is higher than the sum borrowed or owing, but this is often the case. Moreover, this is not just a simple case of borrowing funds.

34. Coupled with the prohibition against rejoining the industry, the fine is a significant deterrent to others.

35. The fine is not out-of-line with the many cases cited to us by Staff. See, in particular: *Re Elwood* 2020 MFDA File No. 201940; *Re Piper* 2018 LNCMFDA 31; *Re Bott* 2017 LNCMFDA 95; and *Re Gaunt* 2013 LNCMFDA 63.

36. The suggestion by Staff of an order for costs of $7,500 is reasonable, considering that the actual costs shown to us were about double that sum.

37. We therefore order that:

a) the Respondent be permanently prohibited from conducting securities related business in any capacity while in the employ of, or in association with, any MFDA Member pursuant to section 24.1.1 (e) of MFDA By-law No. 1;
b) the Respondent pay a fine in the amount of $25,000, pursuant to section 24.1.2 (b) of MFDA By-law No. 1; and
c) the Respondent pay costs in the amount of $7,500, pursuant to section 24.2 of MFDA By-law No. 1.

DATED this 29th day of June, 2021.

"Martin L. Friedland"
Martin L. Friedland, C.C., Q.C.
Chair

"Matthew Prew"
Matthew Prew
Industry Representative

"Timothy J. Pryor"
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Industry Representative

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