



Ontario
Securities
Commission

Commission des
valeurs mobilières
de l'Ontario

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IN THE MATTER OF CLAYTON SMITH

STATEMENT OF ALLEGATIONS

(Subsections 127(1) and 127.1(1) of the *Securities Act*, RSO 1990, c S.5)

A. ORDER SOUGHT:

Staff of the Enforcement Branch ("**Enforcement Staff**") of the Ontario Securities Commission (the "**Commission**") request that the Commission make an order pursuant to subsections 127(1) and 127.1(1) of the *Securities Act*, RSO 1990, c S.5 (the "**Act**") to approve the settlement agreement dated as of May 28, 2018 between Clayton Smith ("**Smith**" or the "**Respondent**") and Enforcement Staff.

B. FACTS:

Enforcement Staff make the following allegations of fact:

I. OVERVIEW

1. For there to be fairness and confidence in Ontario's capital markets, it is critical that investment fund managers ("**IFMs**") and the individuals who control them faithfully and diligently fulfill their fiduciary duty to act in the best interests of their funds and the investors in those funds. Investors must be in a position to believe that their investments will be treated with the utmost care by those in whose trust they are placed. This matter concerns the conduct of Smith who engaged in fraud, and breached his duty to act fairly, honestly and in good faith with clients, while directing the affairs, and being the registered Ultimate

Designated Person (“**UDP**”) and Chief Compliance Officer (“**CCO**”), of a registered firm, Crystal Wealth Management System Limited (“**Crystal Wealth**”).

2. The conduct at issue occurred during the period April 2012 to April 2017 (the “**Material Time**”).

3. Smith was an experienced market participant and registered with the Commission during the Material Time. Crystal Wealth was the IFM, portfolio manager (“**PM**”) and trustee for a suite of 15 proprietary investment funds (“**Crystal Wealth Funds**”). Smith was the directing mind of Crystal Wealth, its sole officer and director as well as the firm’s UDP and CCO.

4. Smith, Crystal Wealth and Smith’s holding companies engaged in fraud involving two Crystal Wealth Funds – Crystal Wealth Mortgage Strategy (formerly, Crystal Enhanced Mortgage Fund, the “**Mortgage Fund**”) and Crystal Wealth Media Strategy (formerly, Crystal Wealth Strategic Yield Media Fund, the “**Media Fund**”). Smith caused monies to be advanced from the Mortgage and Media Funds, purportedly in connection with the purchase of investments for the funds. In fact, at Smith’s direction, certain of the monies were transferred directly to Smith’s holding company, as described in paragraph 20. With respect to other monies, Smith instructed the third-party recipients to transfer the funds to Smith, his holding company or a related company.

5. Smith also arranged to personally receive payments from an entity that sold investments to the Media Fund, creating a material conflict of interest that Crystal Wealth neither responded to nor disclosed.

6. By engaging in fraud and failing to respond to or disclose a material conflict, Crystal Wealth breached its obligation to discharge its duties honestly, in good faith and in the best interests of the Mortgage and Media Funds. Smith and Crystal Wealth continued to cause Crystal Wealth clients to be invested in the Mortgage and Media Funds and in so doing, they failed to deal fairly, honestly and in good faith with clients.

7. As Crystal Wealth's CCO and UDP, Smith failed to discharge his obligations to ensure, promote and monitor compliance with securities legislation by Crystal Wealth and individuals acting on its behalf. He also misled Enforcement Staff during his examination under oath about his relationship to one of the corporate entities involved in the fraud.

II. DETAILED FACTS

(1) Crystal Wealth, Clayton Smith and Smith's Holding Companies

8. Crystal Wealth is a Burlington-based Ontario corporation that was registered with the Commission in several categories, including as an IFM and PM.

9. Crystal Wealth created and managed the Crystal Wealth Funds, which were structured as open-ended mutual fund trusts and distributed on a prospectus-exempt basis, pursuant to offering memoranda ("**OMs**").

10. Crystal Wealth performed the roles of trustee, IFM, PM and promoter for the Crystal Wealth Funds. As the IFM, Crystal Wealth managed the day-to-day business of the Crystal Wealth Funds and oversaw the PM function. As PM, Crystal Wealth was required to make suitable investment decisions for the Crystal Wealth Funds' portfolios consistent with the respective fund's investment objectives.

11. As at April 20, 2017, Crystal Wealth recorded a value for the assets under management ("**AUM**") of all of the Crystal Wealth Funds of approximately \$193,198,912.

12. There were approximately 1,250 Crystal Wealth clients that had discretionary managed accounts for which Crystal Wealth was the PM. Many of these clients were invested in various of the Crystal Wealth Funds. Smith was the advising representative for a number of clients with managed accounts.

13. Smith, an Ontario resident, founded Crystal Wealth in 1998 and was the firm's directing mind. From 1998 onward, Smith was Crystal Wealth's President, Chief Executive Officer and Chief Financial Officer. During the Material Time, Smith

beneficially owned a controlling interest in Crystal Wealth and was its sole officer and director.

14. Smith was registered with the Commission in a number of capacities, including as an advising representative in the category of PM, and as Crystal Wealth's CCO and UDP. As CCO and UDP, Smith bore responsibility for supervising, promoting and monitoring Crystal Wealth's compliance with Ontario securities law.

15. Smith was also the directing mind of CLJ Everest Ltd. ("**CLJ Everest**") and 1150752 Ontario Limited ("**115 Limited**"), Ontario holding companies for which Smith was the sole officer and director. Smith owned 100% of CLJ Everest which, in turn, owned 100% of 115 Limited's voting shares. 115 Limited owned the majority of Crystal Wealth's outstanding shares. 115 Limited's registered business name was MBS Partners.

16. Crystal Wealth Marketing Inc. ("**CWMI**") is an Ontario company that was owned by Smith and Scott Whale ("**Whale**"), a shareholder and advising representative of Crystal Wealth. Smith acted as a director and officer of CWMI between August 2014 and February 2015, when the conduct described in section (5) below occurred.

17. Chrysalis Yoga Inc. ("**Chrysalis**") is a yoga studio owned by Smith's former common law wife, at which Smith taught yoga and meditation part-time. Smith was initially a 50% owner and a director and officer of Chrysalis. During much of the Material Time, Smith dealt with Chrysalis' finances and bookkeeping and had signing authority over its bank account.

18. On April 26, 2017, on application by the Commission under subsection 129(1) of the Act, the Ontario Superior Court of Justice made an order appointing Grant Thornton Limited receiver and manager of the assets of Smith, personally, and the assets of Crystal Wealth, the Crystal Wealth Funds, CLJ Everest, 115 Limited and receiver of a bank account owned by Chrysalis.

(2) Misappropriation of Investor Monies from the Mortgage Fund involving 115 Limited

19. The April 12, 2007 and August 31, 2012 Offering Memoranda for the Mortgage Fund (the "**Mortgage Fund OMs**") stated that the Mortgage Fund's investment objective was to "generate a consistently high level of interest income while focusing on preservation of capital by investing primarily in residential mortgages in Canada." The Mortgage Fund OMs also stated that Crystal Wealth would enter into agreements with independent companies to procure and service mortgage loans and that Crystal Wealth would rely on the expertise of licensed mortgage brokers to service and monitor the mortgages in which the Mortgage Fund invested.

20. Despite these representations, during the period of April 2012 to September 2013, Smith caused the Mortgage Fund to make six payments, totaling approximately \$894,932, to his holding company, 115 Limited. 115 Limited was neither independent nor a registered mortgage broker and the six payments were not used to acquire mortgages from 115 Limited. Instead, shortly after each payment from the Mortgage Fund, Smith caused 115 Limited to pay all, or a significant portion, of the funds to Chrysalis, CLJ Everest (Smith's holding company), or himself. In total, Smith caused 115 Limited to pay \$511,000 to Chrysalis, \$389,000 to CLJ Everest and \$10,000 to himself, substantially with funds received from the Mortgage Fund.

21. Subsequently, in respect of these transactions, Smith advised the Mortgage Fund's auditors, BDO Canada LLP ("**BDO**") that the Mortgage Fund held interests in mortgages obtained through an entity known as MBS Partners (the "**Purported Mortgage Investments**"). The amounts of the advances from the Mortgage Fund to 115 Limited correspond approximately to the principal amounts for six Purported Mortgage Investments reflected in the correspondence provided to BDO.

(3) Misappropriation of Investor Monies from the Media and Mortgage Funds

22. The Media Fund was the largest of the Crystal Wealth Funds, with a recorded AUM of approximately \$54,466,843 as at April 20, 2017. The April 30, 2013 and August 30, 2014 Offering Memoranda for the Media Fund (the "**Media Fund OMs**") stated that the Media Fund's investment objective was "to generate a high level of interest income with minimum volatility and low correlation to most traditional asset classes by investing in asset-backed debt obligations of motion pictures and series television productions."

23. According to the Media Fund OMs, Media House Capital (Canada) Corp. ("**Media House**") was to source, advise in connection with the procurement of and service investments in film loans for the Media Fund. On behalf of the Media Fund, Smith dealt principally with Aaron Gilbert ("**Gilbert**"), Media House's majority shareholder and sole director, and Steven Thibault ("**Thibault**"), Media House's Vice President, Finance. After the purchase of a film loan by the Media Fund, Media House was to monitor and report on the performance of the investment, including the actual sales performance of the related production compared with target projections on an ongoing basis.

24. The Media Fund OMs described the film loans it intended to purchase as short to medium term loans of 12 to 30 months that have been made "to independent producers used to fund a portion of the production costs to complete motion pictures and series television productions." Once a potential debt investment was sourced for the Media Fund by Media House, which was to have evaluated it and reported on whether it complied with due diligence guidelines, Crystal Wealth was to perform its due diligence and examine how the new debt investment fit into the overall investment portfolio from a diversification point of view.

25. Among the film loans recorded in the Media Fund's financial statements were six film loans acquired from Media House during the period October 2013 to July 2015 (the "**Bron Film Loans**") that were for film productions produced by Gilbert's company, Bron Studios Inc. Gilbert and Thibault had a role with the borrower film

production companies on the Bron Film Loans, and signed loan documents on behalf of both Media House as lender, and the production companies as borrower. The Media Fund acquired four of the Bron Film Loans from Media House. Two of the Bron Film Loans were initially purchased by the Mortgage Fund and subsequently sold to the Media Fund. The monies for the Bron Film Loans flowed largely from the Media Fund or the Mortgage Fund to Media House, Bron Animation Inc. ("**Bron Animation**") or BSI Developments Inc. ("**BSI Developments**"), other companies related to Gilbert.

26. With respect to three of the Bron Film Loans (*Henchmen*, *Mercy* and *Kingdom*), Smith caused the Media Fund to advance investor monies to Media House or Bron Animation in tranches, and then directed Gilbert and/or Thibault to:

- (a) transfer a portion of the funds advanced from the Media Fund to Smith, CLJ Everest and Chrysalis, which resulted in transfers totaling approximately \$465,000 to Smith, \$2.3 million to CLJ Everest and \$125,000 to Chrysalis; and
- (b) transfer approximately \$4.1 million of the funds advanced from the Media Fund to Spectrum-Canada Mortgage Services Inc. ("**Spectrum**"), a service provider for the Mortgage Fund, to buy from the Mortgage Fund:
 - (i) certain mortgages in arrears involving third parties; and
 - (ii) the Purported Mortgage Investments;

on behalf of Media House or BSI Developments, removing these mortgages and the Purported Mortgage Investments from the Mortgage Fund's books.

27. With respect to the purchase of another Bron Film Loan (*A Good Day's Work*) by the Mortgage Fund, Smith directed Spectrum to advance \$1.25 million from funds held in trust for the Mortgage Fund to BSI Developments. Smith then directed Gilbert and Thibault to, on receiving the funds advanced, transfer approximately \$1

million of the funds to a law firm representing Smith, which funds were then used for the purchase of a residential property for Smith in Burlington, Ontario, and approximately \$200,000 to CLJ Everest. Smith later caused the Mortgage Fund to advance additional monies to BSI Developments as additional loan advances for *A Good Day's Work*. These monies were substantially used by Gilbert and/or Thibault to transfer \$375,000 to CLJ Everest.

28. Smith used the monies that had been transferred to him and to CLJ Everest, as described in subparagraph 26(a) and paragraph 27, substantially for personal purposes, including the purchase of another residential property at which Smith resided in Burlington, Ontario. Some of the funds were transferred to Crystal Wealth.

(4) Misappropriation of Investor Monies from the Mortgage Fund involving CLJ Everest

29. Smith caused Crystal Wealth to enter into an agreement (the "**Master Financing Agreement**") dated July 6, 2016 with Magnitude CS Energy Inc. ("**MCS**"), which was described as being in the business of installing power and heat co-generating equipment for large energy users ("**MCS Energy Projects**"). Craig Clydesdale ("**Clydesdale**"), an Ontario resident, is a director and officer of MCS. The Master Financing Agreement contemplated that the Crystal Wealth Funds could provide financing for MCS Energy Projects, and that separate project specific financing agreements would be entered into. In addition, CLJ Everest entered into an agreement dated July 6, 2016 with MCS, pursuant to which CLJ Everest would be paid a monthly consulting fee of "15% of the Net Free Cash Flow from all Energy Projects" for its assistance with any aspect of MCS's business operations.

30. Smith also caused Crystal Wealth and CLJ Everest to enter into a share purchase agreement (the "**Share Purchase Agreement**") dated October 21, 2016 with Whale. The Share Purchase Agreement provided that CLJ Everest would acquire all of Whale's shares in Crystal Wealth for a purchase price of \$1,586,277, with a closing date of November 7, 2016.

31. On November 2, 2016, Smith caused the Mortgage Fund to advance \$2 million to MCSNoxrecovery ("**MCSNox**"), another Clydesdale company, which was recorded as a loan in the Mortgage Fund's financial statements. On November 7, 2016, MCSNox advanced \$1.75 million to CLJ Everest, substantially funded with the monies received from the Mortgage Fund. The day after MCSNox advanced the \$1.75 million to CLJ Everest, Smith caused CLJ Everest to use \$1,586,277 of it to buy the Crystal Wealth shares held by Whale.

32. The course of conduct Smith and Crystal Wealth engaged in with respect to the Mortgage and Media Funds as described in sections (2) and (3) above and this section (4), was deceptive and placed the pecuniary interests of Mortgage and Media Funds' investors at risk. By engaging in this conduct, Smith, Crystal Wealth, CLJ Everest and 115 Limited engaged or participated in acts, practices or courses of conduct relating to the Mortgage and Media Funds that Smith, Crystal Wealth, CLJ Everest and 115 Limited, knew or reasonably ought to have known perpetrated a fraud on investors, in breach of subsection 126.1(1)(b) of the Act.

(5) Failure to Respond to or Disclose Material Conflict of Interest

33. Between August 2014 and February 2015, Smith received a substantial financial benefit from the purchase of certain film loans by the Media Fund from Media House. At the time, Smith was the directing mind of Crystal Wealth, and on behalf of Crystal Wealth, served as the lead PM for the Media Fund. The benefit obtained by Smith created a material conflict of interest that Crystal Wealth neither responded to nor disclosed to investors.

34. According to the Media Fund OMs, Media House was to receive compensation for sourcing and administering the film loans in the form of a loan facilitation fee of up to 10% of the face value of any loans the Media Fund purchased from Media House (the "**Loan Facilitation Fee**"). Crystal Wealth was to receive a management fee at an annual rate of 2% of the AUM of the Media Fund.

35. The Media Fund OMs did not disclose that for several of the film loans, a portion of the Loan Facilitation Fee was paid to CWMI, a company for which Smith

was a 50% shareholder, and an officer and director. From August 2014 to February 2015, Media House and Bron Management Ltd., another company associated with Gilbert, paid CWMI approximately 30% of the Loan Facilitation Fee on film loans acquired by the Media Fund during that period. The Loan Facilitation Fee payments to CWMI totaled approximately \$622,780. CWMI used substantially all of the monies to make payments to its two shareholders, Whale and Smith. Smith received \$323,000, funded substantially from those Loan Facilitation Fee payments.

36. Causing the Media Fund to purchase film loans for which Smith received a substantial personal payment created a material conflict of interest that Crystal Wealth had an obligation to respond to and that reasonable investors would be expected to be informed about. Crystal Wealth failed to respond to or disclose the conflict to investors, contrary to subsections 13.4(2) and (3) of National Instrument 31-103 – *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (“**NI 31-103**”).

(6) Failure to Deal Fairly, Honestly, and in Good Faith with Clients

37. As registered advisers, Crystal Wealth and Smith had an obligation to deal honestly, fairly and in good faith with their clients. While Smith and Crystal Wealth engaged in the conduct described in sections (2) to (5) above, Smith and Crystal Wealth caused clients to be invested in the Mortgage and Media Funds. In so doing, Smith and Crystal Wealth breached their obligation to deal fairly, honestly and in good faith with clients, contrary to section 2.1 of OSC Rule 31-505 – *Conditions of Registration* (“**OSC Rule 31-505**”).

(7) Failure to Discharge Duties as an IFM Honestly, in Good Faith, and in the Best Interests of the Investment Fund

38. Crystal Wealth was the IFM for the Mortgage and Media Funds, and as such, had the obligation to discharge its duties honestly, in good faith, and in the best interests of the Mortgage and Media Funds. Crystal Wealth, as trustee for the Crystal Wealth Funds, had an express fiduciary obligation under the master declaration of trust for the funds, to act in good faith and in the best interests of

the unitholders or investors, who were the beneficiaries of the trusts and whose monies were entrusted to Crystal Wealth.

39. By engaging in the conduct described in sections (2) to (5) above, Crystal Wealth breached its fiduciary duty and failed to discharge its duties honestly, in good faith and in the best interests of the Mortgage and Media Funds, contrary to subsection 116(a) of the Act.

(8) Failure to Discharge Duties of CCO and UDP

40. As Crystal Wealth's CCO, Smith had an obligation pursuant to section 5.2 of NI 31-103 to establish policies and procedures directed towards assessing compliance by Crystal Wealth with securities legislation and to monitor and assess compliance with securities legislation by Crystal Wealth and individuals acting on its behalf.

41. As Crystal Wealth's UDP, Smith had an obligation pursuant to section 5.1 of NI 31-103 to supervise the activities of Crystal Wealth that were directed towards ensuring compliance with securities legislation and to promote compliance with securities legislation by Crystal Wealth and the individuals acting on its behalf.

42. In light of the conduct that Smith and Crystal Wealth engaged in described in sections (2) to (7) above, Smith failed to fulfil his obligation as CCO and UDP of Crystal Wealth to ensure, promote and monitor compliance with securities legislation by Crystal Wealth and individuals acting on its behalf, contrary to sections 5.1 and 5.2 of NI 31-103.

(9) Misleading Enforcement Staff

43. Smith was examined under oath by Enforcement Staff on September 26 and 27, 2017 pursuant to subsection 13(1) of the Act. During this examination, Enforcement Staff asked questions about various entities Smith dealt with on behalf of the Mortgage Fund, including MBS Partners, the entity through which Smith and Crystal Wealth perpetrated a fraud as described in section (2), above. During the examination, Smith misled Enforcement Staff by:

- (a) falsely stating that neither he nor Crystal Wealth had an interest in MBS Partners, when in fact Smith beneficially owned 100% of the voting shares of MBS Partners, which was the business name that was registered for Smith's company, 115 Limited, and Smith was the director, officer and directing mind of 115 Limited; and
- (b) falsely stating that MBS Partners had no interest in Crystal Wealth, when in fact 115 Limited owned the majority of Crystal Wealth's outstanding shares throughout the Material Time.

44. Smith thereby breached subsection 122(1)(a) of the Act because he made statements that, in a material respect, and at the time and in the light of the circumstances under which they were made, were misleading or untrue or did not state a fact that was required to be stated or that was necessary to make the statements not misleading.

C. BREACHES AND CONDUCT CONTRARY TO THE PUBLIC INTEREST

Enforcement Staff allege the following breaches of Ontario securities law and conduct contrary to the public interest:

- (a) the Respondent engaged in or participated in acts, practices and courses of conduct relating to securities that the Respondent knew or reasonably ought to have known perpetrated a fraud on the Mortgage and Media Funds and their investors, contrary to subsection 126.1(1)(b) of the Act;
- (b) the Respondent did not deal fairly, honestly and in good faith with the Respondent's clients, contrary to subsection 2.1(2) of OSC Rule 31-505;
- (c) the Respondent did not comply with the Respondent's obligations as the UDP and CCO of Crystal Wealth, contrary to sections 5.1 and 5.2 of NI 31-103;

- (d) the Respondent made statements in evidence submitted to Enforcement Staff that, in a material respect and at the time and in the light of the circumstances under which they were made, were misleading or untrue or did not state facts that were required to be stated or that were necessary to make the statements not misleading, contrary to subsection 122(1)(a) of the Act;
- (e) the Respondent, a director and officer of Crystal Wealth, CLJ Everest and 115 Limited, authorized, permitted or acquiesced in each company's non-compliance with Ontario securities law, and is deemed not to have complied with Ontario securities law under section 129.2 of the Act; and
- (f) as set out in subparagraphs (a) through (e) above, the Respondent engaged in conduct contrary to the public interest.

DATED this 8th day of June, 2018.