

# Registrant Outreach : Interesting Conduct Files

## Presenters:

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## Why Should I Be Interested in Registrant Conduct Files?

- Serious misconduct can lead to regulatory action brought by the Registrant Conduct Team in the Registration, Inspections and Examinations Division;
- The nature and versatility of the tools available to the Registrant Conduct Team might not be commonly understood; and
- The takeaways from these files provide guidance about how to avoid and mitigate the risks of non-compliance with Ontario securities law.

## Why Does the OSC Take Registrant Conduct Seriously?

- Confidence in capital markets is predicated on an assumption of a level playing field - misconduct threatens the balance of fairness.
- We can prevent future harm proactively, not just reactively, when we act as effective gatekeepers based on past experience.
- We want to respect the efforts of good actors who put in the necessary time and resources to comply with Ontario securities law.

## **ST&T Capital Management Ltd. and Ning Wang**

Director's Decision d. April 10, 2024

*Conflicts of Interest, KYC and Suitability Obligations*

## ST&T Capital Management

- Registered as Investment Fund Manager (**IFM**), Portfolio Manager (**PM**), Exempt Market Dealer (**EMD**).
- The firm managed portfolios for separately managed account clients; although registered as an IFM, no investment funds launched yet.
- The firm showcased its investment strategy in its proprietary account, with the view of marketing the proprietary account to institutional investors.

## Improper borrowing from clients

- Total of \$1.3 mm USD borrowed from three separately managed account clients to fund the firm's investments through proprietary accounts.
- Clients were issued promissory notes.
- The purpose of the promissory notes was to increase the amount of the proprietary account to be able to attract additional investors to grow ST&T.
- Interactive Brokers (the custodian) closed all of ST&T's custody accounts and filed a gatekeeper report.
- No conflicts of interest (**COIs**) assessment.
- Prohibited under s. 13.12(2) of NI 31-103.

## Improper Sales of Shares in Registered Firm

- ST&T raised \$1.9 mm in capital from 8 investors.
- Class B non-voting shares of ST&T.
- The purpose of the capital raised was to fund ST&T's operating expenses, such as renting office space, paying salaries, and legal and compliance consulting.
- No KYC or suitability assessment.
- No COIs assessment.
- No disclosure of risk or financial condition of ST&T.



## Director's Decision of April 10, 2024

- ST&T's and Wang's registrations to be suspended.
- Suspension made effective in 30 days (to facilitate an orderly transfer of client accounts to a different registered firm).
- There was a clear material COIs between the Registrants and clients when the Registrants sold the Class B shares of ST&T and issued the promissory notes.
- Client loans and capital raising did not comply with:
  - COIs requirements,
  - the KYC and suitability requirements, and
  - the requirement to deal fairly, honestly and in good faith with clients (section 2.1 of the OSC Rule 31-505 *Conditions of Registration*).

## Takeaways

- Serious regulatory consequences for COIs and suitability failures, even if the aggregate amount of money at issue was modest.
- Client Focused Reforms (**CFRs**) enhanced protections around COIs.
- Registrant obligations apply and cannot be turned “on” and “off” depending on the purpose of the capital raising.
- Gatekeeping reports provide timely alerts to the regulators.

## THE REGISTRANT CONDUCT TIPS

- Avoid material COIs when they cannot be addressed in the best interest of the client – which is not a term to be defined narrowly.

Material COIs must be resolved in the best interest of clients.

- To the extent that firms are expected to meaningfully consider COIs in their business, they should take steps to document these COIs and the associated controls (including pre-trade controls, post-trade reviews etc.) as well as consider the ongoing effectiveness of these controls through regular testing.
- Such controls must be used in conjunction with adequate disclosure.
- We expect firms to take the lead in addressing material COIs, including those related to the firm's product shelf and compensation structures.

## **Florence Wealth Management Inc. et al.**

Director's Decision d. December 3, 2024

*Misleading Staff, Misleading Investors or the Public, Conflicts of Interest*

## Background

- Toronto-based EMD since September 1, 2020.
- Unbeknownst to RIE Staff at the time of registration, Florence was founded and financed by business partners Vishy Karamadam and Max Guo, who ran a commercial real estate issuer (**ForeGrowth**).
- Karamadam and Guo had tried to get a new firm registered as a captive EMD to distribute ForeGrowth, but failed to obtain registration in light of significant compliance deficiencies with a prior firm and concerns with their marketing practices.
- The sole shareholder of Florence was Yu Pan, who the firm's ultimate designated person (**UDP**) said was an independent investor found through his network but who was, in fact, Guo's mother.

## Florence's Application for Registration

- Identified the source of the firm's capital as being a holding company whose shares were owned by Ms. Yu Pan.
- In the written business plan, advised that the firm would not be trading in or advising in securities issued by a related or connected issuer.
- Represented that the firm did not expect to have any relationships that could reasonably result in any significant conflicts of interest.
- Made no reference to Karamadam or Guo.
- Registration granted, as the OSC was unaware of the connections between Ms. Pan and Messrs. Karamadam and Guo.

## Florence's Application for Registration (continued)

- Unbeknownst to RIE Staff
  - Pan was Guo's mother,
  - Guo was a beneficial shareholder of the holding company and therefore an indirect beneficial shareholder of Florence,
  - The firm's capital had been provided to Pan by Karamadam through a loan guaranteed by Guo,
  - Florence sold securities of ForeGrowth to the public using its registration as EMD, making Florence and ForeGrowth "related" and "connected," contrary to the business plan.

## Florence's Distribution of ForeGrowth Issuers

- Florence began distributing ForeGrowth Issuers in November 2020, approximately two months after it became registered.
- Form 45-106F1 *Reports of Exempt Distribution* did not disclose that Florence and ForeGrowth were connected.
- The relationship between Florence and ForeGrowth was not disclosed until June 2022 in Florence's RAQ.
- Karamadam and Guo participated in the day-to-day operations of Florence.



## 2023 Compliance Review of Florence

- RIE discovered the relationship between Pan and Guo.
- False consulting agreement documentation created for Pan and other false investor communications presented to RIE Division.
- Significant compliance deficiencies.

## Settlement Agreement

- Admissions made by Florence:
  - Florence's application for registration was inaccurate.
  - Florence sold ForeGrowth Issuer securities without disclosing that it was related and connected to the issuer.
  - Failed to demonstrate the integrity and proficiency required for ongoing registration.
  - UDP and Chief Compliance Officer (**CCO**) did not discharge their respective obligations.

## Settlement Agreement (continued)

- Joint Recommendation to the Director:
  - Florence's registration shall be suspended, and UDP and CCO were given bans of 5 and 3 years respectively.

## THE REGISTRANT CONDUCT TIPS

- Be truthful in disclosures to the public and the regulator.
- The business plan is a key component of a registration application and should be complete, detailed and correct; and amendments via the Form F6 must be filed promptly when aspects of the business plan change.
- UDPs and CCOs need to discharge their obligations even if majority shareholders recommend non-compliance.
- NI 31-103 requires the CCO to submit an annual report to the board of directors. CCO must also report to the UDP any instances of non-compliance with securities legislation that create a reasonable risk of harm to a client or to the market, or are part of a pattern of non-compliance.

## **The remaining slides relate to unpublished matters**

These files will be anonymized but will otherwise be described correctly for guidance purposes.

## **A firm registered as an Investment Fund Manager**

Repeated Marketing Deficiencies

## A History of Improper Marketing

- The Investment Management Division had identified numerous marketing deficiencies over time
  - Selective performance data (irregular start and end points)
  - Ratings and rankings from agencies not designated as rating agencies
  - Inadequate disclosure around performance-based marketing.
- The firm typically responded to the OSC by agreeing to take down any marketing materials with which the OSC didn't agree.
- The firm's marketing department was not well-versed in securities law – strictly marketing expertise.

## Staff's Recommended Terms and Conditions

- Meaningful changes were required with the firm's marketing practices – the process of Staff identifying problematic sales materials and the firm withdrawing at Staff's request was neither appropriate nor sustainable.
- The firm was required to hire a marketing monitor to oversee and review the marketing activities of the Firm, through whatever medium, before those activities occur.
- The monitor's mandate included overseeing and reviewing the Firm's compliance with Part 15 of National Instrument 81-102 *Investment Funds*.
- The firm was also placed on the Refilings and Errors List.



## THE REGISTRANT CONDUCT TIPS

- A registered firm's marketing efforts must be reviewed for compliance before going live.
- Registered firms need to take care to ensure marketing materials do not contain false, misleading, exaggerated or unsubstantiated representations.
- A firm referring to itself as "best" or "#1" needs to be careful about how this messaging might be interpreted – and must avoid material omissions of facts or necessary context.
- Registered firms should also ensure that they have adequate policies and procedures related to the use and monitoring of social media, and that training is provided to employees where necessary.

## **A firm applying for Exempt Market Dealer registration**

Engaging in Registerable Activities without registration

## Holding Out Without Registration

- The firm seeking registration made inconsistent public statements about its relationship with an issuer, including on YouTube and other social media.
- At a major tech conference, the firm included a slide in its presentation that it had obtained EMD registration
  - Section 25(1) of the Act prohibits holding out without registration
  - Section 44(1) of the Act prohibits untrue representations about registration.
- The firm's argument was that it submitted the slides months in advance and anticipated obtaining registration before then – but their proposed CCO lacked the necessary experience to satisfy the proficiency requirements.

## Registrant Conduct's Recommendation

- Firm should withdraw application, reapplying in the future with a qualified CCO candidate.
- Consultant could be valuable in formulating a specific plan to address the issues that have been identified.
- No refusal on record if withdrawal happens in good faith.
- Firm withdrew application.

## THE REGISTRANT CONDUCT TIPS

- Never represent that you are or will be registered until the application is granted.
- Before filing a registration application, consider obtaining high-quality professional support to determine whether the CCO candidate is likely to qualify and whether appropriate compliance supports are in place.
- We encourage firms to review CSA Staff Notice 31-356, which provides guidance on compliance consultants.
- Firms are welcome to contact us regarding CCO eligibility and we will share any non-confidential concerns that we can.

## **An individual application as a dealing representative – Exempt Market Dealer**

Solvency concerns and failure to provide true and complete information

## Solvency and Proficiency Concerns

- The applicant reapplied for registration after being terminated for cause by their previous employer for personal financial dealings with their colleagues and non-compliance with certain financial transaction procedures.
- The applicant did not disclose the prior termination for cause in the application.
- During our interview with the applicant, they represented that their financial condition was improving.
- Through our due diligence efforts, we were able to determine that in reality, the individual had severe financial challenges and would likely be shortly filing a consumer proposal (which subsequently happened).

## Solvency and Proficiency Concerns

- The applicant had a number of significant debts arising from gambling losses and poor financial decisions.
- In light of the applicant's active consumer proposal which required a substantial payment to creditors, and the circumstances surrounding the significant debt that gave rise to the consumer proposal, the RIE Division had concerns with the applicant's solvency and the associated risk that the applicant would engage in self-interested activities at the expense of the clients.



## Integrity Concerns - Failure to provide True and Complete Information

- Applicant did not provide an accurate description of the extent of their indebtedness and withheld that they were considering making a consumer proposal (which they ultimately did make).
- The applicant also acknowledged that they knowingly failed to disclose their termination for cause to their new proposed sponsoring firm and in their registration application. As a result, the RIE Division was of the view that the applicant had not demonstrated the requisite integrity, proficiency or solvency for registration.

## THE REGISTRANT CONDUCT TIPS

- Carefully review questions on the registration application with applicants.
- As part of due diligence where financial concerns have been flagged, inquire as to whether a near-term insolvency event is a possibility.
- Registered firms are the first line of defence as gatekeepers. Consider withdrawing the application when you learn of detrimental information that was not disclosed by the individual up front.
- Provide information promptly when asked by regulatory staff about formerly sponsored individuals – your firm might benefit in the future from prompt cooperation by a former sponsoring firm of your applicant.

## Resources

- [Opportunity to be heard and Director's decisions](#)
- [OSC Staff Notice 34-701](#): Publication of Decisions of the Director on Registration Matters Under Part XI of the *Securities Act* (Ontario) ("Opportunities to be Heard")
- [CSA Staff Notice 33-320](#) The Requirement for True and Complete Applications for Registration
- [CSA Staff Notice 31-356](#) Guidance on Compliance Consultants Engaged by Firms Following a Regulatory Decision

# Questions?



# Thank you

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