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Securities  
Commission

Commission des  
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de l'Ontario

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**IN THE MATTER OF THE *SECURITIES ACT*,  
R.S.O. 1990, c. S.5, AS AMENDED**

**- AND -**

**IN THE MATTER OF  
AN APPLICATION FOR A HEARING AND REVIEW OF  
THE DECISION OF DIRECTOR BRIDGE OF THE ONTARIO SECURITIES  
COMMISSION, PURSUANT TO SUBSECTION 8(2) OF THE *SECURITIES ACT*,  
R.S.O. 1990, c. S.5, AS AMENDED**

**- AND -**

**IN THE MATTER OF SANJIV SAWH AND VLAD TRKULJA**

**REASONS FOR DECISION  
(Section 8 of the *Securities Act*)**

**Hearing:** September 9, 12, 14, 15 and 16, 2011  
November 7, 2011

**Decision:** August 1, 2012

**Panel:** Mary G. Condon - Vice-Chair and Chair of the Panel  
Judith N. Robertson - Commissioner

**Appearances:** Robert Goldstein - For Staff of the Commission  
Mark Skuce  
Ari Kulidjian - For Sanjiv Sawh and Vlad Trkulja

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## REASONS FOR DECISION

### I. OVERVIEW

#### A. Introduction

[1] This is an application (the “**Application**”) by Sanjiv Sawh (“**Sawh**”) and Vlad Trkulja (“**Trkulja**”), pursuant to subsection 8(2) of the *Securities Act*, R.S.O. 1990, c. S.5, as amended (the “**Act**”), for the Ontario Securities Commission (the “**Commission**”) to review a decision of a Director of the Commission dated January 25, 2011 ((2011), 34 O.S.C.B. 1059 (the “**Director’s Decision**”)).

[2] The Director’s Decision denied the reinstatement of the Applicants’ registrations as dealing representatives of a mutual fund dealer (“**MFD**”). The Director found that neither of the Applicants demonstrated the required integrity or proficiency of securities professionals and that the reinstatement of the Applicants’ registrations was objectionable.

[3] A hearing before a Panel of the Commission to consider the Application commenced on September 9, 2011 (the “**Hearing and Review**”). The Applicants were represented by counsel and also appeared in person. Staff of the Commission (“**Staff**”) appeared to oppose the Application. The Application was heard as a hearing *de novo*, at which ten witnesses, including the two Applicants, five witnesses for the Applicants and three witnesses for Staff, testified on September 9, 12, 14, 15 and 16, 2011. The parties made closing submissions on November 7, 2011.

#### B. The Applicants

[4] Sawh was registered as a salesperson (and later dealing representative) from December 27, 1995 to May 10, 2010. Trkulja was registered as a salesperson (and later dealing representative) from April 25, 1994 to May 10, 2010.

[5] The Applicants were the founders, owners, directors and officers of the Investment House of Canada (“**IHOC**”). IHOC was registered under the Act as an MFD and a limited market dealer (“**LMD**”) (now exempt market dealer (“**EMD**”)). From September 2003 to May 2010, IHOC was a member of the Mutual Fund Dealers Association of Canada (the “**MFDA**”). Sawh held positions as Chief Compliance Officer, Executive Vice President and Managing Director. Trkulja held positions as President and Chief Executive Officer. The Applicants collectively held all of the shares of IHOC at the time IHOC and the Applicants entered into a settlement with the MFDA (In these reasons, the settlement will be referred to as the “**MFDA Settlement**”, and the settlement agreement (*Re Investment House of Canada*, 2010 CanLII 93086 (CA MFDAC)) will be referred to as the “**MFDA Settlement Agreement**”).

## C. History of Proceedings

### 1. The MFDA Proceeding

[6] The MFDA issued a Notice of Hearing dated November 30, 2009, announcing that it proposed to hold a hearing concerning a disciplinary proceeding commenced by the MFDA against IHOC and the Applicants in relation to 13 alleged violations of MFDA Rules, By-laws or Policies (the “**MFDA Proceeding**”). On April 8, 2010, IHOC and the Applicants entered into the MFDA Settlement Agreement with the MFDA in relation to the MFDA Proceeding, in which IHOC and the Applicants admitted to 11 contraventions of MFDA Rules, By-laws or Policies. The MFDA Settlement Agreement was approved by order of a hearing panel of the MFDA dated April 9, 2010 (*Re Investment House of Canada*, 2010 CanLII 85828 (CA MFDAC)). The reasons for approving the MFDA Settlement were issued on June 29, 2010 (*Re Investment House of Canada Inc.*, 2010 CanLII 86173 (CA MFDAC)) (the “**MFDA Settlement Reasons**”).

[7] The terms of the MFDA Settlement are that IHOC was required to resign its membership in the MFDA and, in the interim, its membership was suspended until the MFDA approved its resignation (MFDA Settlement Agreement, *supra*, at para. 79). As section 6.4 of National Instrument 31-103 – Registration Requirements, Exemptions and Ongoing Registrant Obligations (“**NI 31-103**”) stipulates, “[i]f a registered firm’s registration in a category is suspended, the registration of each registered dealing, advising or associate advising representative acting on behalf of the firm in that category is suspended until reinstated or revoked under securities legislation”. Accordingly, the Applicants’ individual registrations as dealing representatives were suspended as a result of the suspension and resignation of IHOC’s membership in the MFDA.

### 2. The Commission Proceedings

[8] On May 18, 2010, Staff received the Applicants’ requests to reinstate their registrations as dealing representatives in the categories of MFD and EMD. Staff refused the Applicants’ requests by letters dated September 20, 2010. The letters state that Staff had “significant concerns in respect of [the Applicants’] integrity and proficiency” because of the Applicants’ admissions in the MFDA Settlement Agreement and the pattern of behaviour of the Applicants as disclosed in the complaints from former IHOC clients.

[9] By email dated September 22, 2010, the Applicants gave notice to the Commission that they wished to exercise their right for an Opportunity to be Heard pursuant to section 31 of the Act (“**OTBH**”). On November 2, 2010, a joint OTBH was held on consent of the parties. At the OTBH, both Applicants clarified that they were only seeking reinstatement of their registrations as dealing representatives in the category of MFD. They were not seeking reinstatement of their registrations as dealing representatives in the category of EMD.

[10] On January 25, 2011, the Director issued a written decision and reasons refusing the reinstatement of the Applicants’ registrations.

#### **D. Reasons for the Director’s Decision to Refuse Registration**

[11] As referenced at paragraphs [2] and [10] above, the Director refused the reinstatement of the Applicants’ registrations as dealing representatives. Based on the Applicants’ admissions in the MFDA Settlement Agreement, the affidavits of several clients of IHOC about the Applicants’ conduct and the Applicants’ failure to disclose a conflict of interest to clients of IHOC, the Director made the following decision:

My decision is to deny the reinstatement of registration of both Applicants. In my view, the past conduct of both Applicants (based on the test set out in *Re Mithras*) leads me to conclude that their conduct in the future may well be detrimental to the integrity of the capital markets. As well, in my view, neither Applicant has demonstrated the required integrity or proficiency of securities professionals. I also find that the reinstatement of registration of each Applicant would be objectionable.

(Director’s Decision, *supra*, at para. 29)

#### **E. Application for Hearing and Review pursuant to Subsection 8(2) of the Act**

[12] On February 18, 2011, the Applicants filed an Application for a hearing and review of the Director’s Decision pursuant to subsection 8(2) of the Act. The Application was filed in accordance with Rule 14 of the Commission’s *Rules of Procedure* (2010), 33 O.S.C.B. 8017.

[13] The Applicants argue that the Director made important findings of fact based on a misapprehension of the evidence and on an incomplete record. They submit that she made findings of fact relying solely on the MFDA Settlement Agreement and uncontested affidavits of former investor clients while disregarding the evidence of the Applicants which was under oath and subject to cross-examination. The Applicants further submit that the Director’s Decision fails to deliver proper reasons, because the Director’s Decision provides little to no evidence of her reasoning, or why she reached the conclusion that she did. It is the Applicants’ position that, by rendering the Director’s Decision in this fashion, the Director mischaracterized the facts and issues before her, prejudicing the Applicants’ right to a fair hearing.

[14] Staff takes the position that the Applicants are unsuitable for registration and that the reinstatement of their registrations is “objectionable”. Staff’s submissions are set out in more detail at paragraphs [28] to [33] below.

## **II. HEARING AND REVIEW PURSUANT TO SECTION 8 OF THE ACT**

[15] Section 8 of the Act governs a hearing and review of a decision of the Director. It provides that:

**8. (1) Review of decision** – Within 30 days after a decision of the Director, the Commission may notify the Director and any person or company directly affected of its intention to convene a hearing to review the decision.

**(2) Review of Director’s decisions** – Any person or company directly affected by a decision of the Director may, by notice in writing sent by registered mail to the Commission within thirty days after the mailing of the notice of the decision, request and be entitled to a hearing and review thereof by the Commission.

**(3) Power on review** – Upon a hearing and review, the Commission may by order confirm the decision under review or make such other decision as the Commission considers proper.

**(4) Stay** – Despite the fact that a person or company requests a hearing and review under subsection (2), the decision under review takes effect immediately, but the Commission may grant a stay until disposition of the hearing and review.

[16] Subsection 8(3) of the Act gives the Commission the power in a hearing and review to confirm the decision under review or make such other decision as the Commission considers proper. The case law interpreting this subsection has established that, in a hearing and review of a Director’s decision, a panel of the Commission may substitute its own decision for that of the Director. In *Re Triax Growth Fund Inc.* (2005), 28 O.S.C.B. 10139 at para. 25, for example, the Commission stated that “when conducting a review of the Director’s decision pursuant to section 8 of the Act, [the Commission is] not bound in any way by the Director’s determination” (see also *Re Istanbul* (2008), 31 O.S.C.B. 3799 (“*Istanbul*”) at para. 14).

[17] In addition, it is well established in the Commission’s jurisprudence that a review of a Director’s decision pursuant to section 8 of the Act is a hearing *de novo*. As such, this is a fresh consideration of the matter, as if it had not been heard before and no decision had been previously issued. An applicant does not have the onus of demonstrating that the Director was in error in making the decision (*Istanbul, supra*, at para. 15; and *Re Biocapital Biotechnology* (2001), 24 O.S.C.B. 2843 (“*Biocapital*”) at p. 2846).

### **III. ISSUE**

[18] The issue is whether the registrations of the Applicants as dealing representatives should be reinstated. The legal framework for consideration of this issue is outlined at paragraphs [141] to [154] below.

### **IV. POSITIONS OF THE PARTIES**

[19] Both counsel for the Applicants and counsel for Staff made oral and written submissions.

#### **A. The Applicants**

[20] The Applicants are seeking to be reinstated as dealing representatives in the category of MFD to continue their gainful employment in the securities industry. The Applicants emphasize that the Application is related to their individual registrations. IHOC, the subject of the MFDA Proceeding, is not part of the Application. This is not an

attempt, according to the Applicants, to minimize or ignore the issues related to the dealer, but the question before the Panel is their proficiency and integrity to be registered as individual dealing representatives.

[21] The Applicants submit that they both have an extensive education and have worked in the financial services industry for over eighteen years. They submit that there is no evidence of a lack of proficiency in the sense that they appear less than qualified.

[22] The Applicants further submit that there is no evidence that their integrity is at issue. They submit that, in their operation of IHOC, they recognized certain shortcomings, took proactive steps to address them and were responsive, responsible and diligent in addressing regulatory issues presented to them during MFDA compliance examinations. They argue that the issues relating to the sale of certain limited partnership securities were isolated. They submit that, while not error-free, they did not lack good faith, honesty and integrity at any time and generally operated their dealer honestly, professionally and mindful of their clients' best interests.

[23] The Applicants put forward a number of cases decided by the Commission, the MFDA and the Investment Industry Regulatory Organization of Canada (“**IIROC**”), including *Re Farm Mutual Financial Services Inc.*, 2009 CanLII 89376 (CA MFDAC), *Re Irwin*, 2010 CanLII 85836 (CA MFDAC), *Re Lambros*, 2011 CanLII 30213 (CA MFDAC) and *Re Nivet*, 2010 CanLII 86169 (CA MFDAC), as cases that are instructive concerning the manner in which re-registration applications should be considered. The Applicants argue that the conduct found to exist in these cases was dishonest, egregious, motivated by financial gain or involved willful blindness. They argue that their conduct is distinguishable from these prior cases.

[24] The Applicants note that they had not been involved in any regulatory proceedings prior to the MFDA Proceeding. They submit that they only became subject to regulatory attention arising from the sale of certain exempt products when the particular investments failed due to the “mismanagement and fraud” of its principal in the case of Golden Gate or because of “a severe U.S. real estate market decline” in the case of Alterra.

[25] The Applicants take the position that the MFDA Settlement Agreement explicitly contemplates the Applicants' continuing employment in the securities industry. In the Applicants' submission, this is evidenced by the approval provided by the MFDA Settlement hearing panel to implement the minimum suggested fine for this type of conduct, \$10,000, against each of the Applicants, to prohibit the Applicants from acting only in the capacity of branch manager, compliance officer or ultimate designated person for three (3) years, and to place no restriction on the Applicants in acting as dealing representatives.

[26] At the time of the Hearing and Review, the Applicants pointed out that they had not been registered as dealing representatives for 18 months. In the Applicants' submission, “[t]he further sanction of the Applicants through a denial by the Ontario Securities Commission (“OSC”) of their re-registration will be wholly incommensurate with the magnitude of their misconduct”. As well, it is the Applicants' position that “[a] denial to the Applicants of an opportunity to rehabilitate their reputations will magnify their

punishment beyond the scope intended by the Applicants, the MFDA Hearing Panel, and the MFDA Staff”.

[27] The Applicants acknowledge that there were mistakes or potential mistakes in their operation of IHOC. However, they submit that the standard to be applied is not whether they were perfect, but whether they pose any risk to the investing public. They submit that there is no such evidence that would warrant the exercise of the Commission’s jurisdiction to prevent likely future harm to Ontario’s capital markets.

## **B. Staff**

[28] Staff takes the position that the Application should be dismissed because the Applicants are wholly unsuitable for registration.

[29] Staff submits that the best evidence of the unsuitability of the Applicants to be registered is the admissions made in the MFDA Settlement Agreement. According to Staff, the Applicants’ own admissions of their failures with regard to the sale of certain exempt products, their failures with regard to undisclosed conflicts of interest and their compliance failures demonstrate that the Applicants lack the requisite proficiency and integrity for registration.

[30] Staff takes the position that the evidence given by the Applicants during the Hearing and Review further supports the claim that they remain unsuitable for registration. Staff submits that the Applicants demonstrated by their own words that they have learned nothing from the MFDA Proceeding. In their evidence, according to Staff, the Applicants blamed others for problems of their own making, refused to accept responsibility for things that they previously agreed to in the MFDA Settlement Agreement, minimized their compliance failures and were not even slightly remorseful.

[31] It is Staff’s submission that even if the Commission found that the Applicants had the requisite integrity and proficiency for registration, the Commission should dismiss the Application on the grounds that the reinstatement of the Applicants’ registrations is “objectionable”.

[32] In response to the disciplinary cases relied upon by the Applicants, Staff submits that none of the IIROC or MFDA cases, save one, is relevant. According to Staff, this is because the suspension of the dealer itself, which is “the most serious penalty [the MFDA] can impose” and, in the case of IHOC, “may be the first time in Canadian securities history that a going concern [was] wound down as a result of breaches of securities legislation”, was not a sanction sought in those cases (MFDA Reasons, *supra*, at paras. 20 and 27). The one case that involves the re-registration of the dealer, *Re Trafalgar Associates Ltd.* (2010), 32 O.S.C.B. 1197 (“*Trafalgar*”), is in Staff’s view distinguishable from this case. In *Trafalgar*, the applicant recognized its misconduct and compensated the investors for their losses. Further, seven years had passed since the misconduct. Staff submits that these mitigating factors are absent in this case.

[33] In response to the Applicants’ argument that “[a] denial to the Applicants of an opportunity to rehabilitate their reputations will magnify their punishment beyond the scope intended by the Applicants, the MFDA Hearing Panel, and the MFDA Staff”, Staff

submits that the Applicants have misconstrued the nature of the registration process and the Hearing and Review. Staff takes the position that a Hearing and Review pursuant to section 8 of the Act is not about sanctioning the Applicants. Nor is it about giving effect to what they think the MFDA intended. In Staff's submission, the Commission has not delegated to the MFDA all of its regulatory jurisdiction. Accordingly, the responsibility remains with the Commission to independently determine whether the Applicants are suitable for registration in accordance with section 27 of the Act.

## **V. EVIDENCE**

### **A. Overview**

[34] The Applicants testified at the Hearing and Review and called five witnesses, four of whom were IHOC clients (W.T., N.R., J.S. and C.D.) and one investment advisor with IHOC (A.C.). Staff called three witnesses who were all IHOC clients (J.T., K.M., and I.D.). The names of the witnesses who are not the Applicants are anonymized to protect the privacy of those witnesses.

[35] Fourteen (14) exhibits were introduced into evidence.

[36] Both the Applicants and Staff referred to hearsay evidence which is admissible in Commission proceedings pursuant to subsection 15(1) of the *Statutory Powers Procedure Act*, R.S.O. 1990, c. S.22, as amended. For example, the Applicants referred to the Affidavit of A.V., sworn September 3, 2011. A.V. was a client of Trkulja. In his affidavit, he indicated that he was prepared to testify on Trkulja's behalf, however, he was scheduled to be out of the country. As a result, he did not appear before us.

[37] As well, in closing, Staff referred to a memorandum by Staff to the Director of the Compliance and Registrant Regulation Branch of the Commission recommending the refusal of the reinstatement of the Applicants' registrations. Staff referred to this memorandum for the proposition that a number of IHOC clients who were not called to testify at the Hearing and Review were not accredited investors but were sold products pursuant to the accredited investor exemption.

[38] We were also presented with evidence relating to the negotiation of the MFDA Settlement.

[39] In this case, we did not find it necessary to rely on the hearsay evidence or the evidence relating to the negotiation of the MFDA Settlement. We find that we have sufficient direct evidence to determine whether the registrations of the Applicants should be reinstated.

### **B. Background Facts**

[40] To provide a framework for our analysis, we find it helpful to set out the background facts that are not in dispute.

## 1. Sale of Exempt Products

[41] The Applicants, along with one other director, founded IHOC in 2003. Initially, IHOC operated as an MFD and sold products such as Guaranteed Investment Certificates, high-interest saving accounts, mutual funds and principal protected notes. IHOC became registered as an LMD on or around November 1, 2004. In 2005, IHOC expanded its product offerings to include certain exempt products.

[42] More specifically, IHOC entered into two distribution agreements which later gave rise to significant regulatory concerns. According to the MFDA Settlement Agreement, they are: (i) the distribution agreement with Alterra Asset Management Inc., dated October 1, 2005, to distribute units of Alterra Preferred Equity Real Estate Limited Partnership (we note that IHOC also distributed units of another Alterra entity, Alterra Preferred Equity Fund Real Estate Limited Partnership. The Alterra entities will collectively be referred to as “**Alterra**” in these reasons); and (ii) the distribution agreement with GP Golden Gate Ltd., dated December 20, 2005, to distribute units of Golden Gate Funds Limited Partnership (the Golden Gate entities will collectively be referred to as “**Golden Gate**” in these reasons)(MFDA Settlement Agreement, *supra*, at paras. 16 and 20). Limited partnership units of Alterra and Golden Gate together will be referred to as the “**Exempt Products**” in these reasons.

[43] From October 2005 to February 2007, IHOC sold \$1,635,000 of Alterra limited partnership units and \$2,960,000 of Golden Gate limited partnership units to its clients (MFDA Settlement Agreement, *supra*, at paras. 19 and 23).

[44] Staff commenced regulatory proceedings against Golden Gate and its principal, Ernest Anderson (“**Anderson**”), by way of a Statement of Allegations dated September 21, 2009. Golden Gate and Anderson settled with Staff and the settlement was approved by the Commission on October 2, 2009 (*Re Anderson* (2009), 32 O.S.C.B. 9253). In the settlement agreement, Anderson and Golden Gate admitted to trading securities without registration and engaging in an illegal distribution of Golden Gate securities, contrary to sections 25 and 53 of the Act. They admitted that money raised in the scheme was used to pay operating costs for Golden Gate and monthly interest payments to other investors. They also admitted that investor money was used to repay investors from a previous investment scheme operated by Anderson (*Re Anderson, supra*, at para. 9). Investors in Golden Gate, including those who were IHOC clients, received few or no interest payments, nor were their principal investments repaid.

[45] With respect to Alterra, Trkulja gave evidence that the money raised by Alterra would be invested in condominium projects in various states in the U.S. through an entity called Tidewater Capital. Trkulja testified that he understood Tidewater Capital had projects in various southern U.S. states, including Florida and Arizona. Investors in Alterra received few or no interest payments nor were their principal investments repaid.

## 2. Consolidation Discussions with Other Entities

[46] From 2006 to 2008, the Applicants engaged in discussions with various other entities with the intention of consolidating IHOC with another entity. During their

testimony, the Applicants named six (6) entities with which they were in such discussions. Amongst these entities were Golden Gate and Alterra.

[47] According to the MFDA Settlement Agreement, IHOC provided notice to the MFDA in February 2006 that it proposed to sell a significant equity interest in IHOC to Alterra (MFDA Settlement Agreement, *supra*, at para. 40). However, a timeline provided to us by the Applicants at the Hearing and Review indicates that IHOC's consolidation discussions with Alterra commenced on March 31, 2006. Those discussions did not come to fruition and were terminated on or around June 1, 2006.

[48] Subsequent to the discussions with Alterra, on June 5, 2006, the Applicants began consolidation discussions with Golden Gate and gave notice to the MFDA requesting regulatory approval for the sale of 51% of IHOC to Golden Gate. On June 23, 2006, the MFDA approved the proposed acquisition. However, the transaction did not close and the discussions between IHOC and Golden Gate were terminated on or around July 19, 2006 (MFDA Settlement Agreement, *supra*, at paras. 43-44).

[49] On April 16, 2007, the Applicants were once again in discussions with Golden Gate, and met with Staff of the MFDA ("**MFDA Staff**") to request approval for the share purchase of IHOC by Golden Gate. The MFDA gave conditional approval to the proposed transaction by letter dated November 19, 2007. However, the transaction did not close and the discussions were terminated on or around December 19, 2007. On January 11, 2008, the MFDA withdrew approval for the transaction because IHOC failed to fulfill the terms and conditions set out in the letter dated November 19, 2007 (MFDA Settlement Agreement, *supra*, at paras. 45-47).

### **3. MFDA Compliance Examinations**

[50] During the time IHOC was a member of the MFDA, the MFDA conducted various compliance reviews of IHOC, in 2003, 2006 and 2009 (respectively, the "**2003 MFDA Compliance Examination**", the "**2006 MFDA Compliance Examination**" and the "**2009 MFDA Compliance Examination**" and collectively, the "**MFDA Compliance Examinations**").

[51] The 2006 MFDA Compliance Examination identified a number of deficiencies in the following areas: (a) approval of new accounts; (b) timeliness of branch trade supervision; (c) suitability of investments; (d) adequacy of know-your-client and suitability information; (e) branch review program; and (f) review for excessive trading (MFDA Settlement Agreement, *supra*, at para. 52). As the MFDA Settlement Agreement indicates, the Applicants made representations to MFDA Staff on various occasions after the 2006 MFDA Compliance Examination that new policies and procedures as well as hiring of additional staff would be implemented (MFDA Settlement Agreement, *supra*, at para. 53).

[52] During the 2006 MFDA Compliance Examination, MFDA Staff also advised that it considered the Exempt Products to be high risk investments. The Exempt Products were originally given a medium risk rating by IHOC. IHOC changed the risk rating of the Exempt Products from medium risk to high risk and continued selling these Exempt

Products until February 2007 (MFDA Settlement Agreement, *supra*, at paras. 27-28 and 30).

[53] The 2009 MFDA Compliance Examination determined that the deficiencies identified in the 2006 MFDA Compliance Examination had not been addressed. Some of the repeated deficiencies were: (a) inadequate head office supervision; (b) suitability of trades; (c) failure to maintain complete know-your-client and New Account Application Form (“NAAF”) information; (d) branch review program; and (e) failure by the Applicants as directors and officers to maintain an adequate compliance program (MFDA Settlement Agreement, *supra*, at paras. 56-77).

#### **4. Transfer of IHOC’s business to MGI**

[54] In the MFDA Settlement Reasons, the MFDA Panel “viewed as significant that [the Applicants] agreed to an orderly wind down of their business and the transfer of client files and accounts to another MFDA Member” (MFDA Settlement Reasons, *supra*, at para. 26). The evidence presented at the Hearing and Review is that IHOC’s client files and accounts were transferred to MGI Financial (“MGI”). The evidence of Trkulja further suggests that approximately 12 advisors from IHOC transferred to MGI after IHOC was wound down.

### **C. The Witnesses**

[55] Given that a number of witnesses, including the Applicants, testified at the Hearing and Review, we find it helpful to provide some background information about each witness. Further, the Applicants and some of the witnesses who were clients of IHOC gave conflicting evidence about the events leading to the Applicants’ sale of Exempt Products to those client witnesses. To provide a fair account of the evidence given by the witnesses, we therefore set out the evidence provided by each of the client witnesses and the Applicants about the relevant interactions between them.

#### **1. Witnesses for the Applicants**

##### **(a) Trkulja**

[56] Trkulja holds a Bachelor of Arts degree from York University and testified that he completed various “industry-related courses” while he was a university student (Hearing Transcript dated September 9, 2011 at p. 43). As set out at paragraph [4] above, Trkulja was registered as a salesperson (and later dealing representative) from April 25, 1994 to May 10, 2010.

[57] Prior to founding IHOC in 2003, Trkulja was employed at various financial institutions, including the Toronto Dominion Bank (“TD”), Canadian Imperial Bank of Commerce (“CIBC”) and Royal Bank of Canada (“RBC”), where he held various positions as registered representative, options specialist, WRAP portfolio manager, investment specialist and investment and retirement planner. He testified that he was “the top salesperson for [TD Securities’] managed program across Canada”, “a member of CIBC’s President’s Club for one or two straight years” and “the top salesperson [for

RBC] in the country for two or three years” (Hearing Transcript dated September 9, 2011 at p. 47).

[58] At the time of the Hearing and Review, Trkulja was registered as a life insurance agent and a mortgage agent with the Financial Services Commission of Ontario (“FSCO”). He informed us that, at the time, he was involved in selling insurance and mortgage related products through 2193176 Ontario Inc., an Ontario corporation jointly owned by him and Sawh with the registered name TS Wealth Inc. (“TS Wealth”).

[59] As indicated at paragraph [55] above, we now proceed to describe Trkulja’s evidence concerning his interactions with the three client witnesses called by Staff relating to the events leading up to the client witnesses’ purchases of the Exempt Products.

**(i) Interaction with J.T.**

[60] In his testimony, Trkulja summarized his interaction with J.T. prior to executing J.T.’s purchase of Alterra securities. He stated:

The only time I remember dealing with Mr. [J.T.] is he had already received the information with regards to the Alterra product. So I don’t remember if I talked to him first or whether Sanjiv [Sawh]...someone in our office that actually talked to Mr. [J.T.] prior to sending him out the information on the Alterra product, but when Mr. [J.T.] received the information, that’s when he called our office and that’s when he started communicating with me. So I never had the opportunity to meet Mr. [J.T.]. I simply sent him out the forms as he wanted to. After he received the information from Alterra, he wanted to make an investment into the Alterra product. So I simply sent him the – via the mail, I sent him the new account application form as well as the subscription agreement, offering memorandum for the Alterra product. Those were my dealings with Mr. [J.T.]. It was a one product purchase. He wanted to purchase it.

...

I believe he specified he had a million dollars of investable assets but I’m not the individual that actually sent him out the information package, I don’t think. He completed the offering memorandum himself. We didn’t direct him on how to complete it. We didn’t meet with him. We simply sent it out to him and told him he had to send back the document over. I did tell him with regards to the know your client form, how to complete that because on numerous times, you would get back the know your client forms and people would forget that they would have to initial it in certain spots. So I told him that on the – I believe that’s in the e-mail correspondence. I did specify in my e-mail to Mr. [J.T.] that I’m going to put arrows basically, like, I’m going to indicate where you need to sign on the know your client form but nowhere did we indicate where he needs to

sign on the offering memorandum or subscription agreement. That was simply sent to him for him to read and complete as needed.

(Hearing Transcript dated September 9, 2011 at pp. 94-96)

[61] In cross-examination, Trkulja was asked to provide further details about his interaction with J.T. Trkulja said that someone from IHOC would have “screened” J.T. as to whether he was an accredited investor. According to Trkulja, this was a pre-requisite for sending out an information package about the Alterra investment.

[62] Trkulja confirmed that he filled out a NAAF for J.T. over the telephone (the “**First J.T. NAAF**”), made a decision about whether J.T. was qualified to make the Alterra investment based on what J.T. told him over the telephone and sent J.T. the First J.T. NAAF and the subscription agreement for J.T.’s signature.

[63] During cross-examination, it was pointed out to him that the First J.T. NAAF only contains J.T.’s basic personal information and states that J.T. had a medium level of investment knowledge. Certain information, such as J.T.’s net worth, investment objectives, risk tolerance and time horizon, was missing. When asked why information such as net worth was not filled out on the First J.T. NAAF, Trkulja explained variously that “I don’t know why I didn’t get the net worth” and that “[t]hat’s as much information as I got from him, and I sent out the forms, and he said he’d fill out the rest” (Hearing Transcript dated September 14, 2011 at pp. 49-51). He also stated in cross-examination that “[J.T.] did have a risk tolerance of high. That’s what he would have disclosed to us” (Hearing Transcript dated September 14, 2011 at p. 69).

[64] Trkulja acknowledged that he had never met with J.T. in person and that he communicated with J.T. over the telephone and email. He stated, however, that he spent about an hour on the telephone with J.T.

#### **(ii) Interaction with I.D.**

[65] Trkulja gave evidence that he first met I.D. when I.D. visited IHOC’s office in Etobicoke. At that time, I.D. invested in some U.S. dollar mutual funds and signed a NAAF, completed by Trkulja, for this mutual funds investment (the “**First I.D. NAAF**”). Trkulja testified that he filled out the First I.D. NAAF, including the information that I.D. had a risk tolerance of 90% low risk and 10% high risk, based on his conversations with I.D. and the “investments that he made at the time that the form was completed” (Hearing Transcript dated September 9, 2011 at p. 82).

[66] It is unclear whether the First I.D. NAAF was dated February 4, 2006 or April 2, 2006. The First I.D. NAAF indicates that I.D. had a medium level of investment knowledge, investment objectives of “100% income”, risk tolerance of 90% low risk and 10% medium risk, a time horizon of 3 years and net worth of \$25,000 to \$50,000.

[67] Trkulja testified that I.D. later contacted Trkulja by email and telephone numerous times indicating that he wished to purchase the Alterra investment. Trkulja testified that he made it clear to I.D. on several occasions that the investment involved high risks. According to Trkulja, he “made it loud and clear to Mr. [I.D.], loud and clear, that this

was a high risk investment and that I did not think it was the right thing for him for a verity [*sic*] of reasons” (Hearing Transcript dated September 9, 2011 at p. 77). Despite this, I.D. insisted that they should meet.

[68] According to Trkulja, this resulted in a meeting at a coffee shop. Trkulja testified that he reviewed the product with I.D. and I.D. indicated he wanted to purchase this product. Trkulja testified that he cautioned I.D. that this was a very high risk investment and that only an accredited investor would be qualified to make this investment. Trkulja also testified that he offered I.D. the alternative of investing more money into the U.S. dollar mutual funds that I.D. was holding. It is Trkulja’s testimony that, however, I.D. insisted that he had “over a million dollars” and wished to make this investment (Hearing Transcript dated September 9, 2011 at p. 77).

[69] Trkulja confirmed in his testimony that he filled out a second NAAF for I.D.’s signature for the Alterra investment (the “**Second I.D. NAAF**”; the First I.D. NAAF and the Second I.D. NAAF together will be referred to as the “**I.D. NAAFs**”). According to Trkulja, I.D. told him that “he was comfortable with completing the documents with 100 percent risk associated with the documents and he clearly specified that he had over a million dollars in investable assets” (Hearing Transcript dated September 9, 2011 at pp. 83-84). Trkulja referred to the Second I.D. NAAF in evidence and emphasized that I.D. initialed certain statements and signed the document acknowledging its content to be true.

[70] The Second I.D. NAAF, dated January 11, 2007, states that I.D. had a medium level of investment knowledge, investment objectives of “100% growth”, risk tolerance of 100% high risk, a time horizon of 4 to 5 years, net worth of over \$250,000, “net fixed assets” of more than \$300,000 and “net liquid assets” of more than \$1 million.

[71] Trkulja testified that he would have made more commissions by selling mutual funds than Alterra securities. He further testified that he would not secure an investment of \$10,000 from someone who he did not believe was an accredited investor.

### **(iii) Interaction with K.M.**

[72] Trkulja testified that K.M. called IHOC initially to inquire about CIBC principal protected notes. Following a meeting in K.M.’s home, K.M. and his wife invested a small amount of money in that product and in “RSPs” [*sic*] (Hearing Transcript dated September 9, 2011 at p. 72). Trkulja stated that he was “kind of intimidated by dealing with Mr. [K.M.]” because he learned, in the process of filling out a NAAF, that K.M. was an investigator with a financial regulatory agency (Hearing Transcript dated September 9, 2011 at p. 72). As a result, he was “always extremely, extremely explanatory on what we are talking about” (Hearing Transcript dated September 9, 2011 at p. 72). In Trkulja’s words, “with [K.M. and his wife] we did everything in the most professional and ethical way possible from start until finish” (Hearing Transcript dated September 9, 2011 at p. 73).

[73] Trkulja testified that, shortly after, K.M. and his wife transferred “their whole CIBC account over to [IHOC]....” (Hearing Transcript dated September 9, 2011 at p. 72).

[74] According to Trkulja, K.M. then approached him with the stated intention of investing in Alterra. Trkulja testified that he discussed the risks of the investment, the accredited investor exemption and the “sophisticated investor rules” with K.M. and his wife. Trkulja testified that while there was no specific figure given with respect to the value of K.M.’s financial assets or net worth, K.M. indicated to Trkulja that he had “well over a million dollars” and “close to \$2 million in assets” (Hearing Transcript dated September 9, 2011 at pp. 74-75). Trkulja also testified that he felt the investment to be suitable for K.M. because “1, 2, 3 percent of his net worth is not a crazy figure to take a small percentage of his net worth, a couple of percent, and invest it into higher risk products, especially if he is aware that they were higher risk products which it was” (Hearing Transcript dated September 9, 2011 at p. 75).

**(b) Sawh**

[75] Sawh holds a Bachelor of Science degree from the University of Toronto and a Master of Business Administration degree from Dalhousie University. As set out at paragraph [4], Sawh was registered as a salesperson (and later dealing representative) from December 27, 1995 to May 10, 2010. He testified that he completed “a lot of the industry courses”, and holds designations including Certified Financial Planner and Chartered Financial Analyst (Hearing Transcript dated September 16, 2011 at p. 63). Prior to founding IHOC, he was employed at RBC for approximately 13 years. There, he held various positions including account manager, customer service manager, executive professional account manager and investment specialist.

[76] At the time of the Hearing and Review, Sawh had been licensed as a life insurance agent and a mortgage broker with FSCO since 2004 or 2005. Together with Trkulja at the time of the Hearing and Review, he was involved in selling insurance and mortgage related products through TS Wealth.

**(i) Sawh’s Evidence with respect to Trkulja’s Sale of Exempt Products to J.T.**

[77] Following the testimony of Trkulja and J.T., Staff and counsel for the Applicants located a NAAF and an Alterra subscription agreement, both dated December 8, 2006, that were signed by J.T. This NAAF shows that J.T. had a medium level of investment knowledge, investment objectives of “100% growth”, risk tolerance of 100% high risk, a time horizon of 10 years or more and net worth of over \$250,000 (the “**Second J.T. NAAF**” and together with the First J.T. NAAF, the “**J.T. NAAFs**”). These documents were put to Sawh during his testimony. He gave evidence on these documents as well as on his conduct in relation to Trkulja’s interaction with J.T.

[78] Sawh testified that Trkulja received a signed subscription agreement and the First J.T. NAAF from J.T. Sawh further testified that Trkulja expressed his concerns to Sawh that the First J.T. NAAF was incomplete. In particular, Sawh testified as follows with respect to the instructions that he gave to Trkulja about the steps to be taken in the circumstances:

What I recall from this was Vlad [Trkulja] receiving a package from Mr. [J.T.]. He brought it over to me because he was concerned that the

package sent back with the subscription agreement, the KYC, with the New Account Application Form, that there were parts not completed, specifically the risk tolerance objectives, et cetera.

What I told him we should do is – normally, we would just send the whole package back. Because of the delay in getting it originally, I told him make a call to Mr. [J.T.], explain what had happened, discuss with him what was missing, and get an understanding that he knows what we're filling out, and then send him back a copy so that he knows.

(Hearing Transcript dated September 16, 2011 at pp. 149-150)

[79] In cross-examination, Sawh expressed his understanding that Trkulja had followed his instructions. He also indicated that a note should have been taken. However, he admitted that he did not have such a note. Sawh testified that, in hindsight, the best course of action would have been to return the package to J.T.: “In hindsight, we should have stuck to – what we should have done is just send the whole package back” (Hearing Transcript dated September 16, 2011 at p. 150).

**(c) W.T.**

[80] W.T. was in the hotel business prior to his retirement more than 25 years ago. At the Hearing and Review, he indicated that he had invested in the stock market and that he considered himself to be a knowledgeable investor, although he gave evidence that he did not know what a limited partnership is. In his testimony, W.T. was asked by counsel for the Applicants whether his “net worth, excluding retirement savings plans or [his] principal residence, was over \$1-million”. W.T.’s response was “I would say so, yeah” (Hearing Transcript dated September 14, 2011 at p. 181).

[81] According to his testimony, W.T. became a client of IHOC in or around 2007, as a result of his investment in Alterra. After learning about the Alterra investment opportunity from a newspaper advertisement, he called IHOC, met with Trkulja to discuss the investment and invested \$150,000 in Alterra. He made no other investments through IHOC.

[82] W.T. testified that Trkulja reviewed the risk of the investment with him, did not pressure him into making the Alterra investment and did not mislead him in any way.

[83] W.T. only received one interest payment from his Alterra investment during the first year. At the time of the Hearing and Review, his principal investment had not been returned to him.

**(d) N.R.**

[84] At the time of the Hearing and Review, N.R. was 47 years old, married with one child and worked as a photographer. In relation to his investment experience, he testified that he held mutual funds and stocks prior to 2007. He characterized himself as having low to medium risk tolerance.

[85] N.R. first learned about IHOC in 2004 from a newspaper advertisement about CIBC principal protected notes. N.R. contacted IHOC and met with Trkulja at N.R.'s residence, but decided not to make this investment.

[86] There was no further contact between Trkulja and N.R. until N.R. approached Trkulja again in late 2007 to purchase a "teachers mortgage" (Hearing Transcript dated September 15, 2011 at p. 22). N.R. described the "teachers mortgage" as being similar to the "Smith Manoeuvre". N.R. further explained the "Smith Manoeuvre" investment strategy as "an investment that a certain amount of the equity is taken and invested in mutual funds...And that helps to pay down the mortgage" (Hearing Transcript dated September 15, 2011 at p. 28).

[87] N.R. found Trkulja professional, punctual and responsive. He felt that Trkulja had never pressured him into purchasing any products, and that Trkulja provided him with full disclosure of the risks and the fees involved.

[88] Trkulja did not offer N.R. any Golden Gate or Alterra securities. N.R. had never heard of Golden Gate or Alterra prior to the Hearing and Review.

**(e) J.S.**

[89] J.S. was, at the time of the Hearing and Review, 45 years old, single, with no children. He testified that he owned and operated a number of private career and tutoring centres. He testified that he was an accredited investor, but did not consider himself to be a sophisticated investor.

[90] J.S. testified that he was introduced to Trkulja by a friend and became a client of IHOC in 2005 after meeting with Trkulja two or three times. According to J.S., Trkulja asked him about, among other things, his long-term, medium-term and short-term financial aspirations, how well J.S.'s business was doing, how much money J.S. would like to invest and how liquid J.S. would like his investments to be.

[91] At the outset, J.S. purchased mutual funds through IHOC. Limited partnership flow-throughs and "IPPs" were later added to his investments. J.S. testified that Trkulja discussed the risks of these investments with him, did not pressure him into any kind of investments, provided him with timely, accurate and complete disclosure and was always available when J.S. needed to consult him.

[92] J.S. did not invest in either Alterra or Golden Gate. These investments were not recommended to him by Trkulja, nor was he aware that IHOC was selling those particular Exempt Products in 2006.

**(f) C.D.**

[93] C.D., aged 50, characterized his investment knowledge as "slightly above average" (Hearing Transcript dated September 16, 2011 at p. 10). He described his risk tolerance as "medium" at the time he was a client of IHOC and "low" at the time of the Hearing and Review (Hearing Transcript dated September 16, 2011 at p. 10).

[94] C.D. was a client of Sawh at RBC and transferred his portfolio to IHOC in 2004, shortly after Sawh left RBC and established IHOC. C.D. described the investments that he held at the time of the transfer as follows: “I was more or less in the stock market with some bonds, perhaps some more conservative ones” (Hearing Transcript dated September 16, 2011 at p. 9). C.D. testified that Sawh maintained “similar-type products” for C.D. after C.D. became a client of IHOC (Hearing Transcript dated September 16, 2011 at p. 9). Later, Sawh also assisted C.D. with his mortgage application.

[95] C.D. described Sawh as very accessible. He testified that Sawh would provide full disclosure by, for example, explaining the risks and advantages of the investments and the way fees and commissions worked. He did not feel that Sawh influenced his decision about what to buy or sell.

[96] C.D. had never heard of Alterra or Golden Gate prior to the preparation for the Hearing and Review.

**(g) A.C.**

[97] A.C. testified that he was a benefits and pension consultant at the time of the Hearing and Review. He worked with IHOC for approximately four years as an investment advisor prior to IHOC’s suspension. At the Hearing and Review, he described his relationship with IHOC as that of an independent contractor with a commission-splitting arrangement. When he began working with IHOC, he was asked to sign a code of conduct which required advisors to “[p]ut the client first” and “[t]reat your client with responsibility” (Hearing Transcript dated September 16, 2011 at p. 26).

[98] A.C. considered his personal experience with the Applicants at IHOC to be “excellent” and the compliance and management of IHOC to be “excellent”, “efficient” and “run well” (Hearing Transcript dated September 16, 2011 at pp. 24, 25 and 31). He testified that there was an “on-going” and an “open channel” of communication to discuss any regulatory issues (Hearing Transcript dated September 16, 2011 at p. 32).

[99] He testified that IHOC provided its advisors with professional training sessions and product seminars, including one about limited partnerships. He recalled that the seminar about limited partnerships discussed the accredited investor rule, the suitability obligations and the importance of full disclosure.

[100] A.C. did not sell limited partnership units of Alterra or Golden Gate when he was working with IHOC. He testified that he was not required to sell these Exempt Products by the dealer.

**2. Witnesses for Staff**

**(a) J.T.**

[101] J.T. testified that he was an instructor with a school board in Ontario. Prior to being an instructor, he had worked with special needs children and, as well, had operated a dairy farm and a natural food store. He testified that he usually described himself as having “average or medium” investment knowledge (Hearing Transcript dated September

12, 2011 at p. 103). He further testified that, at the time he became a client of IHOC, his annual salary from the school board was in the range of \$25,000 to \$30,000 and his net worth, consisting his “[p]roperty, house and investments in the form of mutual funds”, was in the range of \$400,000 to \$500,000 (Hearing Transcript dated September 12, 2011 at p. 104).

[102] J.T. invested US\$25,000 in Alterra but made no other investment through IHOC. At the Hearing and Review, he testified that he had not received any funds pursuant to his investment. J.T. believed that Trkulja was trying to help him get money back.

[103] As indicated at paragraph [55] above, we will now turn to J.T.’s evidence about his interaction with the Applicants prior to J.T.’s purchase of the Exempt Products.

#### **(i) Interaction with the Applicants**

[104] J.T. gave evidence that he first learned about IHOC from a newspaper advertisement about the Alterra investment opportunity. J.T. testified that he phoned IHOC to inquire about the investment opportunity and had a preliminary conversation with someone he believed to be a receptionist. It is J.T.’s evidence that the receptionist did not ask him about his financial situation. He testified that the receptionist then put him in contact with both Applicants, although he was not clear about the order in which he spoke to them.

[105] In a subsequent conversation, an individual who he believed to be Sawh or Trkulja provided him with a general overview of the Alterra investment opportunity. According to J.T., he asked for additional information and was told that he would be receiving an information package about the investment. J.T. testified that no one asked him about his financial situation during this conversation.

[106] J.T. testified that following those initial conversations, he received an information package which included the Alterra offering memorandum. His testimony is supported by a letter dated November 3, 2006 that he received from IHOC. J.T. described the information package as “tough reading for myself” and testified that he “didn’t quite understand what [*sic*] most of it...” (Hearing Transcript dated September 12, 2011 at pp. 93 and 95).

[107] Having reviewed the information package, J.T. then called IHOC and indicated that he was interested in investing in Alterra. He did not recall whether he spoke to Trkulja or Sawh, although he testified that he spoke to one of the two. This exchange resulted in the First J.T. NAAF being sent to him, supported by an email in evidence dated November 16, 2006. J.T. testified that the First J.T. NAAF was already filled out when he received it.

[108] According to J.T., the information on the First J.T. NAAF was provided to IHOC by him in a ten to fifteen minute telephone conversation. J.T. testified that he was asked about his personal information, his income, his investment knowledge and his net worth, but did not recall being asked or was not asked about his investment objectives, risk tolerance or time horizon. He also testified that he was not asked detailed questions about his financial situation.

[109] It is J.T.'s evidence that he only received the First J.T. NAAF and no other documents. He confirmed that he signed the First J.T. NAAF and returned it to IHOC. He testified that he made payment for the product within days or a week of returning the First J.T. NAAF to IHOC. J.T. received a letter dated January 4, 2007 evidencing his investment in Alterra.

[110] J.T. testified that he did not know exactly what a limited partnership is, but recalled that there was a ten to fifteen minute discussion about that issue during the course of his dealings with either Trkulja or Sawh. He also testified that there was a "brief communication" about the risks of the investment which he described as being less than five (5) minutes long (Hearing Transcript dated September 12, 2011 at p. 113). However, he did not remember the details of the discussion and did not have much of an understanding about the risks involved.

[111] J.T. testified that he never met with anyone from IHOC prior to or following his investment in Alterra until the Hearing and Review.

[112] In cross-examination, counsel for the Applicants suggested that Trkulja spent about 45 to 60 minutes on the telephone with J.T. in the aggregate prior to J.T.'s investment, and J.T. agreed "[t]hat would be pretty close" (Hearing Transcript dated September 12, 2011 at p. 123).

**(b) K.M.**

[113] K.M. testified that he was an investigator for a financial regulatory agency at the time of the Hearing and Review and that he worked as a police officer with the Toronto Police prior to working for the financial regulatory agency. He further testified that, at the time he became a client of IHOC, he had annual income of \$80,000, "liquid investable assets" of approximately \$900,000 and net worth of approximately \$1.8 million.

[114] K.M. and his wife invested US\$25,000 in Alterra and \$20,000 in Golden Gate. They received nothing in relation to their Alterra investments and interest payments of approximately \$500 on their Golden Gate investments.

[115] As set out at paragraph [55] above, we will now turn to K.M.'s evidence about his interaction with Trkulja prior to his purchase of the Exempt Products.

**(i) Interaction with Trkulja**

[116] According to K.M., he phoned IHOC around late 2005 or early 2006, after he saw an advertisement about some mutual funds investments in a newspaper. Trkulja attended K.M.'s house, met with K.M. and his wife, spoke with them about "investments" and their financial situation and completed a know-your-client form on their behalf (Hearing Transcript dated September 14, 2011 at p. 137). The initial investments made by K.M. and his wife through IHOC related to some mutual funds and the transfer of K.M.'s RRSP accounts.

[117] K.M. testified that Trkulja later suggested both the Alterra and Golden Gate investments to him and his wife. During the Hearing and Review, he described his

understanding of the Alterra and Golden Gate investments to be “a group of investments and mortgages like a partnership” (Hearing Transcript dated September 14, 2011 at p. 141). He further testified that, with respect to the risks of these two investments, he understood from Trkulja that “[t]here was slight risk, but it was more secure” (Hearing Transcript dated September 14, 2011 at p. 141).

[118] K.M. also gave evidence about what he was asked by Trkulja about his financial situation. His evidence is that he was asked about his net worth, the value of his “liquid investable assets”, his RRSP accounts, his non-registered brokerage accounts, his real estate holdings and his income. He believed that he told Trkulja he was an accredited investor. K.M. testified that, with respect to some of these questions asked, such as those about his non-registered brokerage accounts, he only disclosed the fact that he held those accounts but did not provide detailed information such as where the accounts were held or the total value of those accounts.

[119] During cross-examination, K.M. confirmed the proposition advanced by counsel for the Applicants that he reviewed extensive documentation in fulfilling his duty as an investigator with a financial regulatory agency.

[120] K.M. also confirmed that he reviewed the offering memorandum related to the Alterra investment. More specifically, he confirmed that he read and understood the section about risk factors and potential loss of investment. However, in cross-examination, K.M. stated the following with respect to his understanding of the risks of the investments: “I didn’t believe there was significant risk. If there was, I wouldn’t have invested in it” (Hearing Transcript dated September 14, 2011 at p. 167).

[121] Counsel for the Applicants sought to challenge this statement by producing a note written by Trkulja, dated July 12, 2006, purportedly about a meeting between Trkulja and K.M. K.M. confirmed that the personal information about him and his wife in this note was accurate. However, when he was asked about the references in the note to “invested in LP’s” and two entities, K.M. indicated that he did not know what was being referred to. When asked whether a statement of “okay w higher risk” in the note suggests a discussion about the risks of a limited partnership product, K.M. said “it’s possible” (Hearing Transcript dated September 14, 2011 at p. 170).

[122] Counsel for the Applicants also suggested that some of the mutual funds in which K.M. invested involved higher risks. In response, K.M. pointed out that they were investments recommended by Trkulja. He further stated that he relied on his advisor for information about the risks of the products and that “I don’t believe we would have invested in high risk mutual funds. If he said, listen, this [REDACTED] is a pretty high risk, I would have said, I don’t think so” (Hearing Transcript dated September 14, 2011 at p. 174).

[123] K.M. also agreed in cross-examination with the comment made by counsel for the Applicants that he did not provide detailed information, such as the details relating to his non-registered brokerage accounts, because this information would be provided on a “need-to-know basis”. That is, in the words of the counsel for the Applicants, he was

“prepared to provide as much information as was required to sort of get to the next stage” (Hearing Transcript dated September 14, 2011 at p. 177).

**(c) I.D.**

[124] I.D. testified that he was an educational assistant with a school board. He received a Bachelor of Education, a Bachelor of Arts and a Master of Education from the “Lviv University” (officially known as the Ivan Franko National University of Lviv) in Ukraine in 1991 and is fluent in seven (7) Slavic languages. He considered himself to have limited investment knowledge. I.D. testified that, in 2007, his annual salary was \$22,000. While I.D. provided testimony as to the value of his net financial assets or net assets, his testimony appeared to us to indicate some confusion on his part as to the meaning of these concepts.

[125] I.D. invested US\$10,000 in Alterra. He never received any interest payments in his Alterra investment and the principal investment was not returned to him.

[126] As indicated at paragraph [55] above, we will now turn to I.D.’s evidence about his interaction with Trkulja prior to his purchase of the Exempt Products.

**(i) Interaction with Trkulja**

[127] I.D. gave evidence about the circumstances surrounding his becoming a client of IHOC. In 2006, he invested approximately \$25,000 in mutual funds through IHOC. At that time, Trkulja completed the First I.D. NAAF which was signed by I.D. I.D. testified that the basic personal information such as his address, occupation, employer and income, was accurate. However, he indicated at the Hearing and Review that he had limited investment knowledge and did not know why the First I.D. NAAF indicated that he had a medium level of investment knowledge: “I didn’t know how it work [*sic*], and I ask him so many times to explain it to me. And he did it, and I trust him” (Hearing Transcript dated September 15, 2011 at p. 52).

[128] He testified that the information on the First I.D. NAAF that he had investment objectives of “100% income” was accurate. However, I.D. went on to indicate that he understood that to mean “they’re going to be invested 100 percent in Alterra” despite the fact that the Alterra investment did not take place until 2007 (Hearing Transcript dated September 15, 2011 at p. 53).

[129] I.D. further testified that the information on the First I.D. NAAF that his risk tolerance was 90% low risk and 10% high risk was accurate because it was filled out based on Trkulja’s “evaluation” (Hearing Transcript dated September 15, 2011 at p. 53).

[130] I.D. testified that Trkulja asked him how much money he had, and his response was that “I have some money, and I want to invest it, but I don’t know where” (Hearing Transcript dated September 15, 2011 at p. 57). With respect to the information on the First I.D. NAAF that I.D.’s net worth was in the range of \$25,000 to \$50,000, I.D. indicated that Trkulja completed that information on his behalf. When asked by Staff where Trkulja obtained that information, I.D. indicated “[m]aybe he asked me” and “I

believe he got this information because I got the annual income, 22,000” (Hearing Transcript dated September 15, 2011 at p. 54).

[131] He also testified that he told Trkulja about his condominium purchase.

[132] I.D. then gave evidence about his purchase of Alterra securities through Trkulja. In 2007, I.D. saw an advertisement about the Alterra investment opportunity in a newspaper and phoned Trkulja indicating that he wished to invest some money in Alterra. According to I.D., Trkulja’s response was: “no problem. Come in, and we’re going to talk about this” (Hearing Transcript dated September 15, 2011 at p. 62).

[133] It is I.D.’s evidence that he attended the IHOC office to discuss the Alterra investment. He described the meeting as a “very quick meeting” in which Trkulja and I.D. spoke about the investment (Hearing Transcript dated September 15, 2011 at p. 63). According to I.D., Trkulja told him that the Alterra investment was a real estate investment in the U.S., and “nothing you have to be worried. Everything is safety [*sic*]” (Hearing Transcript dated September 15, 2011 at p. 63). However, I.D. testified that he was worried at the time and would prefer to invest in Canada. I.D. believed that Trkulja gave him a brochure about Alterra some time later. According to I.D., Trkulja “never provide [*sic*] [him] with all the details” about the Alterra investment (Hearing Transcript dated September 15, 2011 at p. 88).

[134] I.D. gave evidence about the completion of the Second I.D. NAAF during that meeting. He said that Trkulja “filled out this application by himself. I just signed it” (Hearing Transcript dated September 15, 2011 at p. 63). I.D. confirmed that while the Second I.D. NAAF shows that he had an investment objective of “growth of funds”, this information was filled out by Trkulja. He testified that he did not provide this information to Trkulja, although he initialed the information to be true. According to I.D., no one explained to him what “growth of funds” means. However, he believed that “growth of funds” means “I’m going to invest my money and going to grow. For me, it means that [*sic*] safety” (Hearing Transcript dated September 15, 2011 at p. 68).

[135] I.D. testified that he did not tell Trkulja that he had a risk tolerance of 100% and did not know why his risk tolerance had changed on the Second I.D. NAAF. Further, he testified that he was not asked about the value of his “net fixed assets” or “net liquid assets” even though the Second I.D. NAAF describes them as more than \$300,000 and \$1 million respectively. He believed that his net worth, “net fixed assets” and “net liquid assets” as they appear on the Second I.D. NAAF were filled out by Trkulja based on “his evaluation” (Hearing Transcript dated September 15, 2011 at p. 73). I.D. testified that he signed and initialed the Second I.D. NAAF because Trkulja “told [him] to do this” (Hearing Transcript dated September 15, 2011 at p. 75).

[136] I.D. testified that he believed that Trkulja told him what “accredited investor” means but that he did not remember the explanation given. He believed that being an accredited investor would make him “eligible to invest the money at Alterra Capital” (Hearing Transcript dated September 15, 2011 at p. 71).

[137] During cross-examination, I.D. acknowledged that the 14% return in the Alterra advertisement “caught [his] eyes” (Hearing Transcript dated September 15, 2011 at p. 115). As a result, I.D. “told [Trkulja] that I’m interested to buy, but I’m not sure if my needs fit your requirements” (Hearing Transcript dated September 15, 2011 at p. 137).

[138] I.D. acknowledged that Trkulja did not recommend the investment to him. However, he indicated that if “[Trkulja] would told [him] that...this is not for you, just forget about those 14 percent...I everything [sic] trusted on him...I would never sign paper or consider those 14 percent” (Hearing Transcript dated September 15, 2011 at pp. 121-122). According to I.D., Trkulja “didn’t tell me anything about this risky stuff” (Hearing Transcript dated September 15, 2011 at p. 123).

#### **D. The Sponsoring Firm**

[139] According to the Applicants, their Application for reinstatement is supported by MGI. We received no evidence directly from MGI with respect to the intended relationship with the Applicants, including the compliance and oversight regime that would apply. We received testimony from the Applicants about their roles in MGI if the reinstatement of their registrations is granted. Trkulja testified that his role would be that of a salesperson and that he had no desire to take on any supervisory role. He testified that:

But that’s what the agreement was going to be, that we would be working under one of their offices. So one of their compliance people would be overseeing Sanjiv [Sawh] and my – our sales, our clients. So we’d have no supervisory role whatsoever. We would be a planner with MGI Financial.

(Hearing Transcript dated September 14, 2011 at p. 115)

[140] Sawh testified as follows regarding his anticipated role in MGI:

COMMISSIONER ROBERTSON: ...Can you just share with us your expectations for your future role at MGI?

THE WITNESS: In our discussions with MGI, my role would be that of a salesperson. There would be no supervisory role, compliance, nothing like that. Just strict sales.

(Hearing Transcript dated September 16, 2011 at p. 191)

## **VI. ANALYSIS**

### **A. Legal Framework for Registration**

#### **1. Registration under the Act**

[141] Subsection 25(1)(b) of the Act sets out the registration requirement for an individual dealing representative:

**25. Registration – (1) Dealers** – Unless a person or company is exempt under Ontario securities law from the requirement to comply with this subsection, the person or company shall not engage in or hold himself, herself or itself out as engaging in the business of trading in securities unless the person or company,

...

- (b) is a representative registered in accordance with Ontario securities law as a dealing representative of a registered dealer and is acting on behalf of the registered dealer.

[142] Registration is a privilege, not a right, that is granted to individuals and entities that have demonstrated their suitability for registration (see *Re Trend Capital Services Inc.* (1992), 15 O.S.C.B. 1711 at p. 1765; and *Istanbul, supra*, at para. 60).

[143] Section 27 of the Act specifies the test that must be applied when determining whether to grant registration. Section 27 of the Act states:

**27. (1) Registration, etc.** – On receipt of an application by a person or company and all information, material and fees required by the Director and the regulations, the Director shall register the person or company, reinstate the registration of the person or company or amend the registration of the person or company, unless it appears to the Director,

- (a) that, in the case of a person or company applying for registration, reinstatement of registration or an amendment to a registration, the person or company is not suitable for registration under this Act; or
- (b) that the proposed registration, reinstatement of registration or amendment to registration is otherwise objectionable.

**(2) Matters to be considered** – In considering for the purposes of subsection (1) whether a person or company is not suitable for registration, the Director shall consider,

- (a) whether the person or company has satisfied,
  - (i) the requirements prescribed in the regulations relating to proficiency, solvency and integrity, and
  - (ii) such other requirements for registration, reinstatement of registration or an amendment to a registration, as the case may be, as may be prescribed by the regulations; and
- (b) such other factors as the Director considers relevant.

...

[144] According to subsection 27(1) of the Act, registration will be granted unless the applicant is not suitable for registration or the registration is otherwise objectionable. Our analysis of the Applicants' suitability for registration begins at paragraph [155]. The analysis of whether the reinstatement of the Applicants' registrations is otherwise objectionable begins at paragraph [285] below.

## **2. Onus**

[145] The Applicants submit that the language of subsection 27(1) of the Act is mandatory and places the onus on Staff to prove that the registrant is "not suitable for registration" or that the registration is "otherwise objectionable".

[146] In closing, Staff argued that it is not the applicant on this Application but is "responding", and as such, the "burden is not on Staff" (Hearing Transcript dated November 7, 2011 at p. 50).

[147] The issue of where the onus of proof lies in a Hearing and Review of a Director's decision to refuse registration under section 8 of the Act does not appear to have been squarely addressed in the Commission's jurisprudence, nor did we receive detailed submissions on this issue. However, a number of Director's decisions dealing with registration under section 27 of the Act (or its predecessor) state that the onus rests with Staff to prove that an applicant is not suitable for registration or that the registration is otherwise objectionable (see *Re Jaynes* (2000), 23 O.S.C.B. 1543 ("*Jaynes*") at p. 1546; *Re Curia* (2000), 23 O.S.C.B. 7505 at p. 7506; and *Re Adams* (2011), 34 O.S.C.B. 10042 at para. 11).

[148] We accept that Staff bears the onus of demonstrating that the Applicants are not suitable for registration or that the proposed reinstatement is otherwise objectionable. We are mindful, however, that section 27 gives the Director broad discretion in considering whether the person or company is not suitable for registration or whether the proposed registration is otherwise objectionable. Further, as discussed at paragraph [152] below, one of the primary means for achieving the purposes of the Act is the "requirements for the maintenance of high standards of fitness and business conduct to ensure honest and responsible conduct by market participants".

[149] In this Hearing and Review, we must decide whether, based on the evidence presented before us, Staff has demonstrated that the Applicants are not suitable for registration or that the proposed registration is otherwise objectionable. In any event, based on all the evidence and submissions below, we are satisfied that we would reach the same conclusion on this Application irrespective of which party bears the onus of proof.

## **3. Public Interest Jurisdiction**

[150] It is well established in the Commission's jurisprudence that, "[w]hen exercising its discretion to review the decision of a Director, the Commission is required to act in the public interest with due regard to its mandate/purpose under the Act, set out in section 1.1 of the Act" (See *Re Michalik* (2007), 30 O.S.C.B. 6717 ("*Michalik*") at para. 44; and *Biocapital, supra*, at p. 2846).

[151] Section 1.1 of the Act provides that:

**1.1 Purposes** – The purposes of this Act are,

(a) to provide protection to investors from unfair, improper or fraudulent practices; and

(b) to foster fair and efficient capital markets and confidence in capital markets.

[152] In pursuing the purposes of the Act, the Commission is required to have regard to certain fundamental principles, such as the “requirements for the maintenance of high standards of fitness and business conduct to ensure honest and responsible conduct by market participants” (Subparagraph 2(iii) of section 2.1 of the Act). Registrants have a very important function in the capital markets and they are also in a position where they may potentially harm the public. Regulating the conduct of registrants is therefore a matter of public interest (*Michalik, supra*, at para. 48).

[153] In *Re Mithras Management Ltd.* (1990), 13 O.S.C.B. 1600 (“*Mithras*”), the Commission noted that its discretion in the public interest is to be exercised prospectively to protect the public and the integrity of the capital markets. The Commission stated that:

...the role of this Commission is to protect the public interest by removing from the capital markets – wholly or partially, permanently or temporarily, as the circumstances may warrant – those whose conduct in the past leads us to conclude that their conduct in the future may well be detrimental to the integrity of those capital markets. We are not here to punish past conduct; that is the role of the courts... We are here to restrain, as best we can, future conduct that is likely to be prejudicial to the public interest in having capital markets that are both fair and efficient. In so doing we must, of necessity, look to past conduct as a guide to what we believe a person’s future conduct might reasonably be expected to be; we are not prescient, after all.

[Emphasis added]

(*Mithras, supra*, at pp. 1610-1611)

[154] These principles are relevant to our consideration of the Applicants’ request for reinstatement under section 27 of the Act.

## **B. Are the Applicants Suitable for Registration?**

[155] The three criteria for determining suitability for registration are codified in subsection 27(2) of the Act, following its amendment on September 28, 2009. Subsection 27(2) of the Act sets out the considerations for determining whether a person or a company is not suitable for registration. These are whether the person or company has satisfied the requirements prescribed in the regulations (now NI 31-103) relating to

proficiency, solvency and integrity (Subsection 27(2)(a)(i) of the Act) as well as such other factors as the Director considers relevant (Subsection 27(2)(b) of the Act).

[156] The parties agree that the issues at play with respect to suitability for registration are proficiency and integrity. There is nothing in the record indicating that the Applicants lack financial solvency. The analysis of whether the Applicants are suitable to be registered will therefore focus on the application of both the proficiency and integrity criteria, established by subsection 27(2) of the Act and previous case law (see, for example, *Istanbul, supra*, at para. 65), to the Applicants.

[157] In determining whether the Applicants are suitable for registration, we must assess their suitability on the basis of their integrity and proficiency. As referenced at paragraph [153] above, their past conduct is relevant to this assessment because it assists in determining whether the Applicants are likely to meet the standards of suitability imposed by Ontario securities law now and in the future (*Mithras, supra*, at pp. 1610-1611). Accordingly, the past conduct of the Applicants will be assessed against the statutory requirements and the requirements and guidance provided by the MFDA existing at the time of the conduct, which governed those registered at the time. This analysis will form one of the bases for determining whether the Applicants are suitable for registration under the current regulatory regime. In addition, the Applicants' testimony before us at the Hearing and Review provides us with additional grounds for making the determination as to the Applicants' suitability for registration.

## **1. Proficiency**

[158] In *Michalik*, the Commission discussed the purpose of proficiency requirements in Ontario securities law. As registrants have a very important function in the capital markets and are also in a position where they may harm the public, proficiency requirements are established to ensure that the public deals with qualified registrants (*Michalik, supra*, at para. 48). Proficiency requirements for registrants support, promote and enhance the purposes of the Act, which, as set out at paragraphs [151] and [152] above, include protecting the investing public by maintaining high standards of fitness and business conduct to ensure honest and reputable conduct by registrants. They also contribute to ensuring regulatory compliance and enhance the efficiency of the capital markets (*Michalik, supra*, at paras. 48-49).

[159] Subsection 3.4(1) of NI 31-103 sets out the proficiency requirement that: “[a]n individual must not perform an activity that requires registration unless the individual has the education, training and experience that a reasonable person would consider necessary to perform the activity competently...”

[160] In *Michalik*, the Commission noted in reference to the then existing OSC Rule 31-505 – Conditions of Registration (“**OSC Rule 31-505**”) that registrants are required to apply the “know your client” and “suitability” standards in carrying out their functions and that they must have the proficiency to discharge the application of these standards (*Michalik, supra*, at para. 23).

[161] It is not contested that the Applicants have the education and qualifications to be considered suitable for registration. However, the evidence presented at the Hearing and Review raises the issue of whether the Applicants are sufficiently proficient in meeting certain know-your-client and suitability obligations required of dealing representatives of an MFD.

[162] In conducting our analysis of this issue, we first set out the law relating to know-your-client and suitability obligations at paragraphs [164] to [171]. Under Ontario securities law, the requirement to determine the suitability of an investment for a client contains a number of discrete elements. Accordingly, we set out the law relating to each of the specific elements at issue in this matter at paragraphs [172] to [182] below. We note that we set out the statutory requirements and the requirements and guidance provided by the MFDA that existed at the time of the conduct because, as discussed at paragraph [157] above, the past conduct of the Applicants will be assessed against those requirements and guidance. We also set out the requirements and guidance in place at the time of the Hearing and Review, because if the registrations of the Applicants are reinstated, the Applicants would be expected to have the proficiency to meet those requirements and follow that guidance.

[163] We then turn to the application of the proficiency criterion to the Applicants at paragraphs [183] to [255] below. As the regulatory requirements and previous case law discussed at paragraphs [164] to [182] below have established a number of specific dimensions to the know-your-client and suitability obligations that are of particular concern to us in this case, we separate them for ease of applying them to the Applicants' past conduct. They are the obligations to: ensure that the client is an accredited investor for trades of securities pursuant to the accredited investor exemption; obtain know-your-client information, including information regarding a client's investment needs and objectives, financial circumstances and risk tolerance; and "know your product". We address each of these issues in turn beginning at paragraph [183].

#### **(a) The Law on Proficiency**

##### **(i) Know-Your-Client and Suitability Rules**

[164] The Commission has recognized that the know-your-client and suitability requirements "are an essential component of the consumer protection scheme of the Act 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" (*Re Daubney* (2008), 31 O.S.C.B. 4817 ("*Daubney*") at para. 15 citing *Re E.A. Manning Ltd.* (1995), 18 O.S.C.B. 5317 at p. 5339).

[165] In *Daubney*, the Commission considered these obligations and noted that:

The Alberta Securities Commission (the "ASC") described these two obligations as follows:

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. (*Re Marc Lamoureux* (2001), ABSECCOM 813127 (“*Re Lamoureux*”) at 10.)

Canadian 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 judgement 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.

(*Re Foresight Capital Corp.*, 2007 BCSECCOM 101 (“*Re Foresight*”) at para. 52.)

Knowing the client involves learning the client’s “essential facts and characteristics”, including the client’s:

- age;
- assets, both liquid and illiquid;
- income;
- investment knowledge;
- investment objectives, including plans for retirement; and
- risk tolerance.

(*Re Lamoureux, supra* at 12-13.)

In addition, we consider that other essential facts and characteristics would include the client's:

- net worth;
- employment status; and
- investment time horizon.

(*Daubney, supra*, at paras. 16-19)

[166] At the time the Applicants sold mutual funds and Exempt Products, the know-your-client and suitability standards, which salespersons (now dealing representatives) must apply, were set out at section 1.5 of OSC Rule 31-505:

**1.5 Know your Client and Suitability** — (1) A person or company that is registered as a dealer or adviser and an individual that is registered as a salesperson, officer or partner of a registered dealer or as an officer or partner of a registered adviser shall make such enquiries about each client of that registrant as

(a) subject to section 1.6, enable the registrant to establish the identity and the creditworthiness of the client, and the reputation of the client if information known to the registrant causes doubt as to whether the client is of good reputation;

(b) subject to section 1.7, are appropriate, in view of the nature of the client's investments and of the type of transaction being effected for the client's account, to ascertain the general investment needs and objectives of the client and the suitability of a proposed purchase or sale of a security for the client.

[167] NI 31-103 now creates two separate rules that apply to registrants, one dealing with know-your-client obligations, and the other dealing with suitability obligations. Section 13.2 of NI 31-103 contains the know-your-client requirements. It provides that:

**13.2 Know your client** – ... (2) A registrant must take reasonable steps to

(a) establish the identity of a client and, if the registrant has cause for concern, make reasonable inquiries as to the reputation of the client,

(b) establish whether the client is an insider of a reporting issuer or any other issuer whose securities are publicly traded,

(c) ensure that it has sufficient information regarding all of the following to enable it to meet its obligations under section 13.3 or, if applicable, the suitability requirement imposed by an SRO:

- (i) the client's investment needs and objectives;

- (ii) the client's financial circumstances;
- (iii) the client's risk tolerance, and

...

(4) A registrant must take reasonable steps to keep the information required under this section current.

[168] Section 13.3 of NI 31-103 describes the suitability obligation as follows:

**13.3 Suitability** – (1) A registrant must take reasonable steps to ensure that, before it makes a recommendation to or accepts an instruction from a client to buy or sell a security, or makes a purchase or sale of a security for a client's managed account, the purchase or sale is suitable for the client.

(2) If a client instructs a registrant to buy, sell or hold a security and in the registrant's reasonable opinion following the instruction would not be suitable for the client, the registrant must inform the client of the registrant's opinion and must not buy or sell the security unless the client instructs the registrant to proceed nonetheless.

...

[169] Section 9.4 of NI 31-103 provides for an exemption from the suitability obligations set out in section 13.3 of NI 31-103. If a registered firm is a member of the MFDA, the suitability obligations set out in Rule 2.2.1 of the MFDA Rules, rather than section 13.3 of NI 31-103, apply to a dealing representative of an MFD.

[170] As the MFDA Settlement Agreement shows, MFDA Rule 2.2.1 was the applicable MFDA Rule that governed the conduct of the Applicants at the time they sold mutual funds and Exempt Products. As noted at paragraph [169] above, this rule continued to govern the conduct of its members at the time of the Hearing and Review. From the time the Applicants engaged in the sale of mutual funds and the Exempt Products to the time of the Hearing and Review, Rule 2.2.1 provided:

**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.

[171] In addition, the MFDA acknowledges that there are specific suitability issues arising from the sale of securities pursuant to an exemption. According to MFDA Member Regulation Notice MR-0048 – Know-Your-Product (“**MFDA Member Regulation Notice MR-0048**”), issued on October 31, 2005, some additional considerations apply when products are sold pursuant to exemptions under securities law:

Members should be particularly careful when examining suitability issues in relation to exempt securities. It should be noted that the classification of an investor as a “sophisticated purchaser” or an “accredited investor” does not negate the obligations of the Member with respect to suitability review. Members may consider providing training for Approved Persons and supervisory staff on the particular characteristics and concerns relating to exempt securities, to ensure such products are recommended only in appropriate circumstances.

Members should also have policies and procedures in place with respect to the information to be provided to clients, to help ensure that clients fully understand the products being offered before entering into any transaction. The client should be clearly advised where a security is being sold under an exemption....

## **(ii) The Accredited Investor Exemption**

[172] The legal framework for selling securities pursuant to the accredited investor exemption is also relevant to our consideration of the Applicants' proficiency for registration. The evidence shows that the Applicants sold Exempt Products pursuant to the accredited investor exemption set out in National Instrument 45-106 – Prospectus and Registration Exemptions (“**NI 45-106**”):

### **Accredited investor**

**2.3 Accredited Investor** – (1) The dealer registration requirement does not apply in respect of a trade in a security if the purchaser purchases the security as principal and is an accredited investor.

(2) The prospectus requirement does not apply to a distribution of a security in the circumstances referred to in subsection (1).

[173] An “accredited investor” is defined in section 1.1 of NI 45-106 to include:

...

j) an individual who, either alone or with a spouse, beneficially owns, directly or indirectly, financial assets having an aggregate realizable value that before taxes, but net of any related liabilities, exceeds \$1,000,000,

k) an individual whose net income before taxes exceeded \$200,000 in each of the 2 most recent calendar years or whose net income before taxes combined with that of a spouse exceeded \$300,000 in each of the 2 most recent calendar years and who, in either case, reasonably expects to exceed that net income level in the current calendar year,

l) an individual who, either alone or with a spouse, has net assets of at least \$5,000,000,

...

[174] Further, at the time the Applicants sold Exempt Products, section 1.10 of Companion Policy 45-106CP – Prospectus and Registration Exemptions provided guidance to a seller of securities in determining the availability of the accredited investor exemption:

**1.10 Responsibility for compliance** – A person trading securities is responsible for determining when an exemption is available. In determining whether an exemption is available, a person may rely on factual representations by a purchaser, provided that the person has no reasonable grounds to believe that those representations are false. However, the person trading securities is responsible for determining whether, given the facts available, the exemption is available. Generally, a person trading securities under an exemption should retain all necessary documents that show the person properly relied upon the exemption.

...

... under the accredited investor exemption, the seller must have a reasonable belief that the purchaser understands the meaning of the definition of “accredited investor”. Prior to discussing the particulars of the investment with the purchaser, the seller should discuss with the purchaser the various criteria for qualifying as an accredited investor and whether the purchaser meets any of the criteria.

It is not appropriate for a person to assume an exemption is available. For instance an [*sic*] seller should not accept a form of subscription agreement that only states that the purchaser is an accredited investor. Rather the seller should request that the purchaser provide the details on how they fit within the accredited investor definition.

[175] Staff referred us to *Re Goldpoint Resources Corp.* (2011), 34 O.S.C.B. 5478 (“*Goldpoint*”), a case involving non-registrants who purported to rely on the accredited investor exemption in their distribution of Goldpoint securities. Staff cites *Goldpoint* for the proposition that accredited investor status cannot be established simply on the basis of

a statement from the investor certifying that he or she meets the accredited investor definition. Rather, accredited investor status should be determined on the basis of factual information provided by the investor about his or her financial position (*Goldpoint, supra*, at para. 100).

[176] In our view, a registrant subject to the MFDA Rules should meet at least the minimum standards set out in *Goldpoint* and should conduct appropriate due diligence on the financial circumstances of a prospective investor prior to making a determination of whether a product can be sold pursuant to the accredited investor exemption.

### **(iii) Know-Your-Product**

[177] MFDA Member Regulation Notice MR-0048, issued on October 31, 2005, provides that Members should perform as part of the suitability obligations reasonable due diligence on products before offering them for sale. MFDA Member Regulation Notice MR-0048 notes that suitability obligations can only be properly discharged if the products are fully understood. It states:

A basic level of due diligence must be completed on all products being considered for sale by the Member before the products are approved. Member procedures should provide for different levels of analysis for different types of products. For example, an extensive formal review may not be required for many conventional mutual funds. However, a more comprehensive review should be performed on products that are novel or more complex in structure. In the event that products are presently being sold that have not been subjected to a reasonable due diligence review, such a review must be performed before continuing to sell the products.

In determining whether to approve a product for sale, Members should not merely rely on the representations of the issuer, or on the fact that the product appears to be similar to others, or that other firms are already offering the product. In all cases, the approval process must be independent and objective. Members are advised that simply making inquiries will not be sufficient to discharge their responsibility to conduct due diligence. Members must properly follow up on any questions they have raised until they have been satisfied that they have a complete understanding of the products they propose to sell.

...

It is critical that the Member develops an understanding of all features of the product. Issues such as liquidity of the product and the nature of any underlying investments and their inherent risks must be examined before assigning a risk ranking to the product. The Member should develop guidelines or an investor profile for which the product would be generally suitable, including [*sic*] risk levels, time horizon, income and net worth. The Member should also clearly identify investors for whom the product

is not suitable. Concentration limits should be assigned to products and/or general classes of products where appropriate.

[178] Section 3.4 of NI 31-103 now sets out an independent requirement for a registrant to understand the structure, features and risks of each security the registrant recommends. Section 3.4 of Companion Policy 31-103CP – Registration Requirements, Exemptions and Ongoing Registrant Obligations (“**31-103CP**”) further describes the know-your-product obligations as follows:

The requirement to understand the structure, features and risks of each security recommended to a client is a proficiency requirement. This requirement is in addition to the suitability obligation in section 13.3 and applies even where there is an exemption from the suitability obligation such as, for example, the exemption in subsection 13.3(4) in respect of permitted clients.

[179] CSA Staff Notice 33-315 – Suitability Obligation and Know Your Product (“**CSA Staff Notice 33-315**”), issued on September 4, 2009, provides additional guidance to registrants on how to meet their suitability and know-your-product obligations.

[180] Although we appreciate that section 3.4 of NI 31-103 and CSA Staff Notice 33-315 were not part of the regulatory landscape at the time IHOC sold mutual funds and Exempt Products, know-your-product obligations are part of the regulatory regime which now would have to be adhered to if the Applicants were registered. These newer requirements are evidence of securities regulators’ increasing concern to ensure that registrants understand the features of products they sell to clients and that this is a component of the required suitability analysis.

[181] As part of the know-your-product obligations, MFDA Member Regulation MR-0048 also states that MFDA members should explain certain specific risks of products sold to clients pursuant to exemptions:

...It is important that the client also understands the implications of any restrictions that may apply with respect to liquidity and the potential absence of a secondary market for the securities. Finally, the client should be aware that an offering memorandum that may be provided prior to the sale of some exempt securities is not a prospectus, and that certain protections, rights and remedies that may exist under securities legislation in relation to prospectus offerings, including statutory rights of rescission and damages, may not be available to the client.

[182] Finally, CSA Staff Notice 33-315, issued on September 4, 2009, which provides that “[i]ndividual registrants should...explain the risks of products they are recommending to their clients”, broadens this aspect of know-your-product to products generally.

## **(b) Application of Proficiency Criteria to the Applicants**

### **(i) Ensuring that Clients Qualify as Accredited Investors**

[183] The obligation to ensure that an investor meets the criteria to be an accredited investor arises in the context where securities are being sold pursuant to the accredited investor exemption in NI 45-106. The Applicants have indicated that they are not seeking to sell exempt products as dealing representatives in the future. Nevertheless, we are of the view that the evidence presented to us about the Applicants' approach to selling securities pursuant to the accredited investor exemption in the past speaks to their proficiency in both understanding relevant requirements under Ontario securities law and their ability to exercise appropriate judgment in meeting their regulatory obligations.

[184] At the Hearing and Review, we heard evidence from J.T. which shows that, based on the thresholds established by NI 45-106, he was not an accredited investor at the time he purchased Alterra securities.

[185] Although I.D.'s evidence does not provide us with a clear understanding of the actual value of his net financial assets or net assets, we find that the evidence does not support a conclusion that I.D. was an accredited investor at the time he purchased Alterra securities.

[186] The evidence we heard raises the question of whether adequate steps were taken by the Applicants to ascertain the accredited investor status of certain IHOC clients. On the one hand, Trkulja testified that he never sold any Exempt Products to clients whom he knew were not accredited investors. He testified that, at the time they invested in the Exempt Products, J.T., I.D. and K.M. provided information which led him to believe that they were accredited investors.

[187] On the other hand, all of the Staff witnesses, I.D., J.T. and K.M., gave testimony which suggests that they were not asked about their financial situation in adequate detail.

[188] We recognize that there is conflicting evidence about the steps taken by the Applicants to obtain financial information from these client witnesses and about the information communicated to the Applicants. However, we conclude that the Applicants' version of events is in itself demonstrative of their inadequate approach to their obligations.

[189] More specifically, in the case of I.D., it is Trkulja's evidence that he informed I.D. during a meeting that only an accredited investor could invest in Alterra. According to Trkulja, I.D. responded that he had more than \$1 million in net financial assets and insisted that he wanted the Alterra investment. Based on what I.D. told him about his financial situation, Trkulja formed the view that I.D. qualified as an accredited investor.

[190] Trkulja justified his actions by stating that he had no reason to believe the information conveyed to him by I.D. was false:

I have no reason to believe that someone tells me something that is not true when it's something as simple as, you know, what is your net worth?

Do you have – you know, what is your income? What is your total investable assets? I have no reason to not believe someone.

(Hearing Transcript dated September 9, 2011 at p. 88)

[191] According to Trkulja, he also made the determination that the information provided to him by I.D. for the Second I.D. NAAF was accurate based on his past experience that clients are often unwilling to disclose their complete financial situation:

I have been doing this for 18 years, and I can tell you at least 50 to 100 times I would meet with someone, and they wouldn't disclose all of their financial assets. That's common sense. If they tell a financial advisor that they have so much money, then the financial adviser is going to try to consolidate so much business.

...

So what I'm trying to say is that in many, many situations, a client or a potential client doesn't want to disclose all of their assets for a variety of reasons. They just met you. It's like, why do you need to know all of my assets? So they give you what you need to know.

(Hearing Transcript dated September 14, 2011 at pp. 40-41)

[192] In addition, Trkulja testified as follows with respect to the relationship between income and net financial assets or net assets:

I'm sure there is a relationship. Like, there's more likely a possibility that, I was going to say a lawyer or a doctor or a dentist who is going to have a million dollars than, you know, someone that is a blue collar worker, but the reality is there's a lot of people out there that don't make a substantial amount of money that can still have millions of dollars. There's lots of people that run businesses, there's lots of people that trade businesses. I have friends that are roofers. I have friends that are plumbers. I have friends that are electricians, builders. They all have over a million dollars easily. So it's not – and I guarantee you their declared income is probably 50-, 60-, \$70,000 a year. It's nothing significant.

(Hearing Transcript dated September 9, 2011 at pp. 89-90)

[193] He further elaborated:

When you look at statistics in this country, a million dollars is nothing significant anymore...So when someone tells me they have a million dollars in investable assets, it's not as though I should look at it as, you know, that's a lot of money. It is a lot of money but it's not unheard of anymore.

(Hearing Transcript dated September 9, 2011 at p. 89)

[194] Contrary to Trkulja's statements above, we find that there was every reason to make further inquiries about I.D.'s net assets or net financial assets. Based on Trkulja's account of the events, I.D. insisted that he had net financial assets in excess of \$1 million approximately one year after having indicated that the value of his net assets was in the range of \$25,000 to \$50,000. That I.D.'s net worth could have changed so drastically in one year when his income did not appear to have changed significantly and no other explanation was provided in itself warrants further inquiry.

[195] In addition, when asked in cross-examination why I.D. was sharing different information about his financial circumstances one year later, Trkulja offered the explanation that "[I.D.] was interested in the product maybe" (Hearing Transcript dated September 14, 2011 at p. 128). Although Trkulja recognized the possibility that I.D. may have been claiming that he had more than \$1 million in net financial assets because he was interested in purchasing Alterra securities, he did not appreciate at that time the importance of taking further steps to verify I.D.'s financial position or to request an explanation of the change in his financial circumstances. His testimony also shows that he continued not to understand the importance of this obligation at the Hearing and Review.

[196] Having heard from I.D. during the Hearing and Review, it is also clear to us that, despite his education and his facility with Slavic languages, I.D. did not have the necessary understanding of financial terms to accurately describe his financial situation. It is apparent that I.D. did not have a clear understanding of the difference between income and net worth. Nor did he understand other terms on the NAAF such as "net fixed assets" or "net liquid assets".

[197] As discussed at paragraphs [194] to [196] above, these circumstances would reasonably create a question regarding the accuracy of the information that I.D. allegedly provided and the validity of his classification as an accredited investor. In our view, the reasonable course of action in those circumstances would have been to make further inquiries about I.D.'s financial situation and take extra steps to ensure that I.D. understood what was being asked. Simply inquiring about I.D.'s financial information in a perfunctory way and accepting at face value his statements that he owned net financial assets in excess of \$1 million did not satisfy Trkulja's regulatory obligations with respect to the accredited investor exemption. In addition, Trkulja's testimony at paragraphs [190] to [193] shows that not only did he not appreciate the impropriety of his actions in the past, he continued not to demonstrate an understanding of their shortcomings at the time of the Hearing and Review.

[198] With respect to J.T., Trkulja's claim that J.T. qualified as an accredited investor appears to be based on his representation that another IHOC staff member would have performed a "screening function" and ensured that J.T. was an accredited investor prior to sending him an information package about Alterra. However, we received no further corroborating evidence, such as policies or procedures in place at the time, regarding this "screening function", nor were we presented with evidence about the steps involved in executing this function. In any event, we are of the view that, as the registrant who ultimately facilitated J.T.'s purchase of Alterra securities, Trkulja had the responsibility

to ensure that his client met the criteria to be an accredited investor before providing J.T. with the opportunity to purchase Exempt Products.

[199] We note that the First J.T. NAAF did not contain information about J.T.'s net assets or net financial assets. Further, Trkulja testified as follows about the missing information: "I don't know why I didn't get the net worth" and "[t]hat's as much information as I got from him, and I sent out the forms, and he said he'd fill out the rest" (Hearing Transcript dated September 14, 2011 at pp. 49-51). In light of the foregoing, we are unable to conclude that Trkulja had that information at the time the First J.T. NAAF was completed.

[200] We further observe that the First J.T. NAAF was not designed to identify financial assets as opposed to other assets, in accordance with the requirements of the accredited investor exemption. Therefore, even if the NAAF was complete, it would not form an adequate basis to conclude that J.T. was an accredited investor. However, Trkulja was prepared to execute J.T.'s purchase of Alterra securities in the face of this missing information, as evidenced by the e-mail message dated November 16, 2006 which directed J.T. to write a cheque payable to Alterra and informed J.T. that the subscription agreement and the First J.T. NAAF had been sent to J.T. for his signature.

[201] We note that information missing from the First J.T. NAAF appears on the Second J.T. NAAF. Nonetheless, as discussed at paragraph [200] above, Trkulja was prepared to execute J.T.'s purchase without obtaining information about J.T.'s net assets or net financial assets. Taken at its highest, the evidence shows that the information was not collected on a timely basis for the purchase of Alterra securities. More importantly, Trkulja's cursory approach, which focused only on the completion of the NAAF, demonstrates his failure to fully understand his obligations in respect of the accredited investor exemption. We therefore have concerns about whether Trkulja can adequately discharge the obligations of a registrant in the future.

[202] The fact that an investor declared himself to be an accredited investor does not absolve a registrant of the responsibility to take adequate steps in the circumstances to ascertain that the investor meets the criteria to be accredited based on his or her financial circumstances. We also note that Trkulja's testimony demonstrates a lack of precision about the distinction between net financial assets and net assets in the qualifying rule in NI 45-106, set out at paragraph [173] above. In order for an investor to avail himself or herself of the accredited investor exemption, he or she (either alone or with a spouse) must own net financial assets having an aggregate realizable value that exceeds \$1,000,000 or net assets having an aggregate realizable value that exceeds \$5,000,000. For example, with respect to K.M., Trkulja's testimony that he was told that K.M. owned "well over a million dollars" and "close to \$2 million in assets" is not sufficiently precise to make a determination about whether K.M. met the requirements for an accredited investor (Hearing Transcript dated September 9, 2011 at pp. 74-75).

[203] Turning to Sawh, in his testimony regarding J.T. which we set out at paragraphs [78] and [79] above, Sawh's efforts appear to have been merely focused on having the NAAF completed. He does not appear to have questioned the information received, and in particular, the lack of information about J.T.'s financial situation to support J.T.'s

eligibility to purchase Exempt Products. This lack of inquiry raises questions about whether Sawh fully understood his obligations with respect to the accredited investor exemption and therefore whether he can adequately discharge the obligations of a registrant in the future.

[204] We have considered the evidence from J.S. and W.T. who appeared to have made investments with IHOC pursuant to the accredited investor exemption. More specifically, counsel for the Applicants led evidence from W.T. that he invested in Alterra and had net financial assets of more than \$1 million. Counsel for the Applicants also led evidence from J.S. that he invested in products such as “limited partnership flow-throughs” and was an accredited investor. In addition, Trkulja testified that he refused the order of a client, S.B., to purchase Golden Gate securities, despite the client’s claim that he qualified as an accredited investor, because Trkulja reviewed the NAAF, “looked at obviously his age, his income and everything and it just didn’t make sense” (Hearing Transcript dated September 9, 2011 at p. 93).

[205] We find that this evidence, at its highest, shows that Trkulja and Sawh sold exempt products to some investors who met the requirements to be accredited and declined one purchase where it was appropriate to do so. However, in light of the evidence from Staff’s witnesses which shows that they were not asked about their financial situation in adequate detail, we are not convinced that Trkulja had a sufficient understanding of the regulations and their purpose to allow him to consistently discharge those obligations (Hearing Transcript dated September 12, 2011 at pp. 160-161; and Hearing Transcript dated September 14, 2011 at p. 45).

[206] In sum, we are troubled by Trkulja’s reliance on the financial information represented to him by his clients where there were clear indications of a need to exercise due diligence. We are also troubled by his failure to recognize the impropriety of that reliance at the Hearing and Review. Trkulja’s continued insistence in his testimony that the client witnesses were accredited investors, despite the strong evidence to the contrary in the case of J.T. and I.D., supports the finding that his proficiency to be registered, at the time of the Hearing and Review, remained inadequate.

#### **(ii) Obtaining Know-Your-Client Information and Determining Suitability**

[207] The analysis set out at paragraphs [184] to [206] about the Applicants’ performance of their accredited investor obligations is directly applicable to the consideration of whether the Applicants have the ability to proficiently discharge their know-your-client and suitability obligations more generally. In particular, that analysis also shows that the Applicants failed to discharge their obligation to obtain know-your-client information about their clients’ financial circumstances, and that they continued not to understand the importance of this requirement at the Hearing and Review.

[208] For example, with respect to the First I.D. NAAF completed in order for I.D. to purchase mutual funds, Trkulja acknowledged in cross-examination that he was “just taking the information that’s provided to me. I’m not trying to overanalyze it. I’m taking the information that was provided to me” (Hearing Transcript dated September 14, 2011 at p. 35). Trkulja simply accepted the information without making further inquiries

notwithstanding his admission that he found it unusual for I.D. to have a net worth in the range of \$25,000 to \$50,000 because, according to Trkulja, “Net worth is usually substantially higher than that” (Hearing Transcript dated September 14, 2011 at p. 35).

[209] The testimony of the Applicants also demonstrates their lack of understanding of other aspects of the know-your-client and suitability obligations. We take it from the evidence that we summarized at paragraph [69] above that I.D. completed the Second I.D. NAAF in order to trade in exempt securities. We are troubled by the evidence regarding the change of risk tolerance and investment objectives from the First I.D. NAAF to the Second I.D. NAAF. According to the I.D. NAAFs, I.D.’s risk tolerance changed from 90% low risk and 10% medium risk to 100% high risk, and his investment objectives changed from “100% income” to “100% growth”.

[210] In Trkulja’s evidence, when I.D. first became a client of IHOC, he made the assessment that I.D. had a risk tolerance of 90% low risk and 10% medium risk based on his conversations with I.D. and “the investments that [I.D.] made at the time that the form was completed” (Hearing Transcript dated September 9, 2011 at p. 82). It is Trkulja’s evidence that, when I.D. first approached him about the Alterra investment, Trkulja did not think the Alterra investment was suitable for I.D. because of the initial assessment that he made. Trkulja also testified that he cautioned I.D. on various occasions that the investment involved high risks and was not suitable for I.D.

[211] However, when I.D. insisted that he wished to purchase the Alterra investment, Trkulja, in his own words:

...explained to [I.D.], we have to change your KYC because you are now saying that you are willing to take a greater amount of risk with your funds.

Your objectives have changed from investing into mutual funds that may pay out a quarterly distribution to now investing into a real estate limited partnership where you can lose your money. Your objectives have changed. Your risk tolerance has changed.

And it works the other way as well. We have clients that have invested into hedge funds in the past where – one client specifically had all of his money with us in hedge funds. And all of a sudden, he wanted all of his money in money market funds and – I believe it was just money market funds. So we had to change his KYC from 100 percent high risk to 100 percent safe. Because people change their investment objectives based on what’s going on sometimes with the market if they’re traders.

(Hearing Transcript dated September 14, 2011 at pp. 130-131)

[212] According to Trkulja, I.D. also said that “he was comfortable with completing the documents with 100 percent risk associated with the documents” (Hearing Transcript dated September 9, 2011 at p. 83).

[213] Trkulja's statements reflect a fundamental misunderstanding of the law. A person's risk tolerance and investment objectives do not, as Trkulja suggested above, change simply because he or she wishes to invest in a riskier product. In considering the risk tolerance of a client, registrants not only have to take into account the client's indication about his or her risk tolerance, but also the client's personal circumstances such as age and ability to sustain financial losses (*Jaynes, supra*, at p. 1547; and *Daubney, supra*, at para. 18). In that regard, we adopt the comments made by the Director in *Jaynes*, where, with respect to the registrant in that case, there were concerns:

...as to whether he, in fact, understands what is entailed in addressing "suitability" and "know your client" obligations. [The applicant's] responses with regard to these issues were confused; he appeared to be saying that there is nothing wrong with executing speculative trades for clients provided they have indicated that they have a certain level of tolerance for risk. In fact, notwithstanding what a client may indicate as their risk tolerance level, speculative trades may be wholly unsuitable based on their personal circumstances; a registrant's responsibility is to properly identify when this is the case and even refuse to execute unsuitable trades on behalf of a client when necessary.

(*Jaynes, supra*, at p. 1547)

[214] MFDA Member Regulation Notice MR-0025 – Suitability Obligations for Unsolicited Orders ("**MFDA Member Regulation Notice MR-0025**"), issued on February 24, 2004, provides the following guidance with respect to unsuitable orders: "Members are not obliged to accept a purchase order from a client that is determined by the Member to be unsuitable. Whether or not a Member wishes to refuse such a trade is an internal policy decision of the Member".

[215] The Applicants' record provided at the Hearing and Review included a copy of IHOC's policies and procedures manual (the "**Compliance Manual**"). The Compliance Manual outlined the internal policies and procedures that would have been applicable in these circumstances. Section 8.1 of the Compliance Manual provided that, "If the client proposes changing his or her investment objectives or risk tolerance, you should discuss this with your client. Under no circumstances should such a change be made solely to suit a specific order. All changes should be consistent with the client's other KYC/NAAF information". Section 8.3 of the Compliance Manual stated "You are required to use good judgment to ensure that a trade in mutual funds by a client is suitable for that client, in light of that client's particular needs and objectives". Section 8.3.1.2 of the Compliance Manual in fact instructed that an order in these circumstances should be refused. However, Trkulja, by his own admission, changed the risk tolerance to facilitate the purchase of Alterra securities and accepted the trade order from I.D.

[216] We also find the evidence relating to Trkulja's interaction with J.T. to be troubling. It is not contested that the First J.T. NAAF was incomplete. Much of the information required to determine suitability, including J.T.'s investment objectives, risk tolerance and net worth, was missing from the First J.T. NAAF. According to Trkulja, as set out paragraph [199] above, "[J.T.] said he'd fill out the rest" (Hearing Transcript

dated September 14, 2011 at p. 50). We find the fact that Trkulja asked his client to fill out information such as net worth, investment objectives and risk tolerance amounted to an abdication of his know-your-client and suitability obligations.

[217] Further, as mentioned at paragraphs [200] and [201] above, at the time Trkulja sent out the First J.T. NAAF, Trkulja was prepared to execute J.T.'s purchase of Alterra securities. As set out at paragraph [62], Trkulja takes the position that he made a decision that J.T. qualified for the investment based on what J.T. told him over the telephone. It is unclear to us how Trkulja could have determined the suitability of the investment for J.T. when the information referenced at paragraph [216] was missing.

[218] Trkulja's testimony appears to suggest that he owed a lesser obligation to J.T., who made what he described as a "one product purchase", than to clients such as J.S. and K.M. with whom Trkulja had a long-term relationship (Hearing Transcript dated September 9, 2011 at p. 95). As MFDA Member Regulation Notice MR-0025 states, the obligation to make a suitability determination applies to all proposed trades, regardless of whether a trade was recommended by the registrant or was unsolicited, or whether or not the registrant has a continuing relationship with the client.

[219] We also find that the instructions given by Sawh to Trkulja regarding the missing information on the First J.T. NAAF, set out at paragraphs [78] and [79], to be inadequate and to raise concerns about his understanding of the know-your-client and suitability obligations. Although Sawh was presented with a NAAF with missing information in relation to the purchase of an Exempt Product that was classified as high risk, there is no evidence that he questioned whether it was a suitable investment for J.T. Despite his clear obligations as the chief compliance officer of IHOC to ensure that a suitability assessment was conducted, there is no evidence that he took any steps to oversee the determination of suitability in this situation. Rather, as set out at paragraphs [78] and [79] above, he simply asked Trkulja to call J.T. and obtain the missing information, complete the NAAF and send a copy back to J.T., in order to execute the purchase.

[220] At the Hearing and Review, Sawh was given an opportunity to describe the appropriate conduct for this situation. We take from Sawh's testimony on this point, set out at paragraphs [78] and [79] above, that he considered the appropriate course of action to be to send the package back to J.T. for him to complete the relevant forms. He said nothing about a suitability analysis for a new client purchasing a high risk product. This indicates that Sawh still did not understand at the time of the Hearing and Review the proper steps to be taken in the circumstances, as described paragraph [219] above.

[221] The shortcomings in Sawh's application of the know-your-client and suitability obligations, both at the time of J.T.'s purchase of Alterra securities and at the Hearing and Review, lead us to the view that he does not possess the required judgment to apply these regulatory requirements in the future.

[222] Finally, we note that Trkulja contended that J.T., I.D. and K.M. were accredited investors and relied on that classification in arguing that they qualified for the investment. We note that, as set out in MFDA Member Regulation Notice MR-0048, classification as

an accredited investor does not absolve a registrant of the responsibility to determine the suitability of a transaction for the client.

[223] We have considered the evidence from the witnesses on behalf of the Applicants. This evidence shows that, in these cases, the Applicants had discussions with those witnesses about their financial circumstances. However, that evidence is not sufficiently detailed and compelling to mitigate our concerns about the Applicants' inadequate conduct with respect to I.D. and J.T. and to convince us that the Applicants understood the know-your-client and suitability obligations.

[224] In summary, in the case of Trkulja, we are troubled by his exclusive reliance on the financial and other know-your-client information represented to him by his clients. Despite his education and extensive experience in the securities industry, the evidence shows that Trkulja failed to exercise good judgment and was not able to identify situations where aspects of a client's personal circumstances called for careful analysis with regard to suitability. Accordingly, he did not make reasonable inquiries in those circumstances and this led to a failure to properly and independently discharge his know-your-client and suitability obligations. The position taken by Trkulja at the Hearing and Review, as exemplified by his testimony set out at paragraphs [190] to [193] and [211], shows a continuing failure to recognize the impropriety of his past actions. It further shows a lack of understanding of the policy rationale underlying the know-your-client and suitability standards and the importance of their careful application by registrants. We accept Staff's argument that Trkulja does not have the required proficiency to be registered.

[225] In the case of Sawh, we recognize that while Sawh fell below the standards required of him in his role as a compliance officer, he is not seeking to act in a similar capacity in the future. However, the evidence shows that, with respect to J.T. and the First J.T. NAAF, he had an opportunity to review and apply know-your-client and suitability standards. He appeared not to have applied the standards mandated by Ontario securities law at the relevant time, nor did he turn his mind to the substantive requirements of suitability when given the opportunity at the Hearing and Review to revisit them. This shows an incomplete understanding of the know-your-client and suitability obligations, a continued failure to exercise good judgment, leading, in our view, to a lack of proficiency to be registered.

### **(iii) Know-Your-Product**

#### ***Conducting Due Diligence on Products***

[226] From the testimony of the Applicants, we understand that both of the Applicants were involved in conducting due diligence on the Exempt Products and the determination to sell Exempt Products to IHOC clients. Although Sawh was more involved in the compliance responsibilities of IHOC and the review of Exempt Products, Trkulja also had significant involvement in interviewing various individuals from Alterra and Golden Gate along with Sawh.

[227] At the Hearing and Review, the Applicants gave evidence regarding the steps they took to conduct due diligence on the Exempt Products. With respect to Alterra, they both testified that they met with the individuals comprising the management team of Alterra, reviewed their background and felt comfortable with their qualifications. They reviewed the product by reading the offering memorandum. Having done so, they felt that the percentage return of 14% and the “numbers and what they were saying made sense” when compared to similar products in the market at the time (Hearing Transcript dated September 16, 2011 at p. 130; see also Hearing Transcript dated September 14, 2011 at p. 80).

[228] As well, they reviewed Alterra’s partners in the United States and the general nature of the properties in which Alterra would invest. This appears to be supported by a letter entitled “Example of Due Diligence on Property” which sets out a description of the property, its development, the estimated project costs, capital structure, ratio analysis, profit margin summary and a breakdown of construction costs. This letter was put to Sawh during the Hearing and Review. Sawh confirmed that it was a document prepared by IHOC and he testified about IHOC’s due diligence activities based on the letter:

Regarding this specific letter, this is some of the due diligence we did looking at the types of properties, where it’s located, to get an idea where they’re planning to build; the development itself, what they’re looking to build; the economy in the area at the time, more or less the demand for those types of properties.

Actually, to confirm the demand we had someone who works at Re/Max here, we had them contact someone out in this same area to tell me a little bit more about that area to get a comfort of where they’re building and so on, the estimated project costs, and this was how they were using it to develop. Not very much different than a development structure.

(Hearing Transcript dated September 16, 2011 at pp. 131-132)

[229] Trkulja testified that he met with the lawyer who was engaged in drafting the offering memorandum as part of the due diligence process. Sawh testified that he reviewed “[t]he operations side of things...because we knew as an infrastructure what you need to run” (Hearing Transcript dated September 16, 2011 at p. 130). According to Sawh, he also “tried to see what type of relationships [Alterra was] also trying to foster, and that was, in part, some of the due diligence work” (Hearing Transcript dated September 16, 2011 at p. 133). He elaborated that Alterra had a relationship with a large brokerage house. He felt that this relationship “would sort of confirm our feelings. If a large organization that had a legal department to assess risk, et cetera, if they would approve of a company or align themselves, it would give us more of a comfort level” (Hearing Transcript dated September 16, 2011 at p. 133).

[230] With respect to Golden Gate, the Applicants testified that they reviewed the documents provided by Golden Gate, including the offering memorandum and the subscription agreement, as well as the structure of the product. A letter that Sawh wrote

to the MFDA dated August 13, 2008 about IHOC's due diligence efforts was put to him at the Hearing and Review, and based on this letter, he testified:

Asked for assessment of the risk to our product, and our assessments – what we did was we looked at the structure once again, looked at what the fund was going to be doing. So we assessed a risk of the underlying investments and tried to assess it with that.

The cost of the product? Based on the fact that our costs are associated with mortgage broker fees and finance fees, the numbers made sense as far as how they plan on paying out 8 percent.

(Hearing Transcript dated September 16, 2011 at pp. 134-135)

[231] Both Applicants testified that they attended the Golden Gate office where they met with a number of Golden Gate staff members and discussed with them the mortgage-based products offered by Golden Gate, a type of product with which they were familiar. They also discussed the size of the fund, the infrastructure of the company, the management of the fund and a staff member's own investment in Golden Gate. The Applicants were shown an unaudited financial statement of the company and felt that "as far as the numbers go, they seemed reasonable" (Hearing Transcript dated September 16, 2011 at p. 135).

[232] Sawh also noted that Golden Gate had a "mortgage brokers license". He testified that he spoke to Golden Gate's mortgage agents and they "didn't have anything negative to say" about Golden Gate (Hearing Transcript dated September 16, 2011 at pp. 135-136).

[233] In cross-examination, Trkulja described the way in which he rated the Exempt Products as medium risk:

Because we looked at the underlying portfolio or the way it was supposed to be structured. And if you look at the types of mortgages that should have been held in the LP, first mortgages, small percentage of first mortgages, high quality second mortgages, the values up to 85 percent, and a small amount of commercial mortgages. If you actually look at the product as a whole, okay, outside of the fact it's an LP, it's a medium type risk investment.

[Emphasis added]

(Hearing Transcript dated September 14, 2011 at p. 30)

[234] Trkulja testified that the Applicants considered the steps taken above to be "sufficient due diligence" at the time (Hearing Transcript dated September 14, 2011 at p. 21).

[235] In our view, the due diligence process employed by the Applicants as described at paragraphs [227] to [233] was deficient. The Applicants clearly fell short of the

expectations imposed on MFDA Members set out in MFDA Member Regulation Notice MR-0048 and reproduced at paragraph [177] above. The Applicants also failed to follow IHOC's own policies and procedures set out in section 2.2.1 of the Compliance Manual, the substantive elements of which are closely consistent with MFDA Member Regulation Notice MR-0048.

[236] As both of the Applicants acknowledged, their evaluation of the Exempt Products was based largely upon the representations of, and the documents provided to them by, the issuers. It emerged from Sawh's response to the questions posed by the Panel about the analysis in the letter entitled "Example of Due Diligence on Property" referenced at paragraph [228] above that, while the document was prepared by IHOC, the analysis in the document was based solely on the documents provided to them by Alterra:

THE WITNESS: That was from Alterra and the sub-agreements, et cetera, what they were going to do...Like, their sub-agreements in reading through it, and then these numbers came from Alterra as far as how they're going to be producing it...These numbers came from Alterra. Like, this is their projections, so to speak. So these are their projections, and what we did is, by reading through the sub-agreement, compared to see if this made sense on other products like this.

CHAIR: So you didn't calculate these numbers yourself, then.

THE WITNESS: No.

CHAIR: They came directly from Alterra?

THE WITNESS: We just verified if they were reasonable.

(Hearing Transcript dated September 16, 2011 at pp. 196-197)

[237] Sawh also confirmed that he initially assigned a risk ranking of "medium" to the Exempt Products based on the information in the subscription agreements of Alterra and Golden Gate. IHOC only changed the risk rating to "high" upon the MFDA's request following the 2006 MFDA Compliance Examination.

[238] In our view, the Applicants' due diligence process was particularly inadequate in light of the fact that Golden Gate and Alterra securities were sold pursuant to exemptions under applicable securities legislation. Limited partnership units sold under an exemption from securities law do not benefit from the same transparency and liquidity characteristics or regulatory oversight as other products. For example, securities sold under an exemption will not be liquid investments. Offering memoranda are not prospectuses and are not subject to regulatory review. Given the absence of such safeguards, we find that the Applicants failed to conduct an adequate review of the Exempt Products. This issue is particularly important when determining the suitability of these products for clients. The evidence shows that the Applicants focused their due diligence on the underlying investments in mortgages and compared them to other mortgage pools that may or may not have shared the same legal structure. As Trkulja's testimony at paragraph [233] shows, he did not appear to understand the fact that the

structure of a limited partnership sold pursuant to an exemption is a risk factor in and of itself which may be relevant to the determination of suitability.

[239] We also have concerns about the Applicants' judgment arising from the factors on which they appeared to have relied with respect to reviewing the Exempt Products. The Applicants, and in particular, Trkulja, placed significant reliance on media accounts of the issuers' principals and the issuers' association with high profile political figures. Also, as discussed at paragraph [229] above, Sawh testified that he relied on Alterra's relationship with other companies that he assumed had conducted due diligence on the products. These factors, along with the other steps taken by the Applicants as discussed above, are not an adequate approach to due diligence in this context.

[240] The Applicants ought to have taken from the MFDA's request in 2006 to change the risk rating of the Exempt Products that their initial review was deficient. In accordance with MFDA Member Regulation Notice MR-0048, the Applicants should have conducted another due diligence review. They nonetheless continued to sell these products, as exemplified by the sales to I.D. and J.T. in January 2007 and December 2006 respectively.

[241] We take note of Trkulja's admission during the Hearing and Review that he "should have done more due diligence" and that he had "learned to look beyond more than what employees of a corporation will say" (Hearing Transcript dated September 14, 2011 at p. 22; and Hearing Transcript dated September 12, 2011 at p. 63). Despite this acknowledgement, we are of the view that his testimony as a whole shows that he did not fully appreciate the shortcomings of his conduct. For example, Trkulja insisted at the Hearing and Review that:

We did due diligence. I don't know if it was considered enough by the regulators, but we did do due diligence.

(Hearing Transcript dated September 14, 2011 at pp. 18-19)

[242] We find Trkulja's insistence that he conducted "an independent objective and comprehensive review...but again it wasn't a one hundred complete full independent objective and comprehensive review" shows an unduly literal approach toward the know-your-product obligations (Hearing Transcript dated September 12, 2011 at p. 62). It is not clear to us that Trkulja understood the regulatory policy underpinning of the know-your-product assessment, which is for registrants to achieve a sufficient understanding of the underlying features and risks of the product in order to assess the suitability of the investment for specific clients.

### ***Explaining Risks of Products to Clients***

[243] As part of the know-your-product and suitability obligations, registrants now have an obligation to explain to their clients the risks of products they invest in. We have concerns about whether the Applicants fulfilled regulatory expectations about explaining the risks of the Exempt Products that they sold, and hence their capacity to discharge this aspect of proficiency requirements in the future.

[244] We find that the evidence about the interaction between Trkulja and J.T. shows that Trkulja did not adequately explain the risks of the Alterra investment to J.T. J.T. testified that there were limited discussions about the risks of the Alterra investment. He found the offering memorandum to be “tough reading” (Hearing Transcript dated September 12, 2011 at p. 95). Trkulja provided no evidence that he discussed the risks of the investment with J.T. Based on the above, we find J.T.’s testimony that there were limited discussions about the risks of the investment to be consistent with Trkulja’s summary of his interaction with J.T. set out at paragraph [60] above. More specifically, Trkulja’s evidence shows that he simply sent J.T. information about the Alterra investment, such as the offering memorandum, “as he [J.T.] wanted to”, and relied on J.T. to review the information (Hearing Transcript dated September 9, 2011 at p. 95). In particular, Trkulja testified that:

He completed the offering memorandum himself. We didn’t direct him on how to complete it...nowhere did we indicate where he needs to sign on the offering memorandum or subscription agreement. That was simply sent to him for him to read and complete as needed.

(Hearing Transcript dated September 9, 2011 at p. 96)

[245] We also find that the evidence about the interaction between Trkulja and I.D. supports a finding that Trkulja failed to adequately explain the risks of the Exempt Products to I.D. We are cognizant of the inconsistencies between the evidence of Trkulja and I.D. As set out at paragraphs [67] and [68] above, Trkulja testified that he cautioned I.D. that the Alterra investment was a high risk investment on many occasions, whereas, as set out at paragraphs [133] and [138], I.D.’s evidence is that the product and its risks were not explained to him.

[246] We are troubled by the lack of evidence supporting Trkulja’s testimony. If he did provide clear warnings about the high risk nature of this investment and was concerned about its suitability for I.D., we would have expected to see written notes in the file, a discussion with the compliance officer (Sawh) or at the extreme, a refusal to process the order as outlined by the MFDA Rules and directed by the following sections in IHOC’s Compliance Manual:

### **8.3.1.1 Reasonable Orders**

A client may wish to make a purchase which would result in a portfolio more heavily weighted in equities than the model portfolios currently suggest, given the investment objectives of the client. Although such an order would not be recommended, the purchase may still be considered reasonable once the client’s circumstances are taken into account and you may accept the transaction. As a general rule, more leeway can be given to sophisticated clients – those who have a relatively good understanding of investing. In such cases, a simple word of caution and a notation on the trade ticket followed by the client’s initials acknowledging that the client was cautioned is sufficient. The following warning is to be printed on the trade ticket as well as in the notes section of the client profile:

“This order was unsolicited. The client has been advised that the order might not meet the client’s investment needs and objectives and is not recommended by the Investment House of Canada Inc.”

### **8.3.1.2. Unreasonable Orders**

If, for example, an income-oriented investor indicates that he or she wants to invest 100% of his or her liquid assets in [REDACTED] Energy Fund or [REDACTED] International Equity Fund, such an order would be completely inappropriate. In such cases, you should:

- Explain that the purchase does not meet with the client’s stated investment objectives (i.e., the investor is income oriented and the investment will not produce any income);
- Suggest that the clients either change the trade order or inquire as to whether the client’s personal circumstances have changed. You must not change investment objectives only to correspond to the trade;
- If the client refuses to change the trade order, or to change the investment objective, or such a change is totally unwarranted given the client’s age, financial circumstances or other factors, the order should be refused. Determining whether an order is reasonable or not requires consideration of many factors and is, in the end, a judgment call. In case of uncertainty about this decision, consult your BCO.

It is the responsibility of the Representative to ensure that the investments recommended and acted upon are suitable for the client...

[Emphasis added]

[247] Instead, we are presented with evidence of a significant change to the risk tolerance on a NAAF, that apparently passed without further review by the compliance regime. These factors, coupled with the evident lack of financial sophistication revealed in I.D.’s testimony, support the finding that Trkulja did not adequately explain the risks of the Alterra investment to I.D.

[248] We have considered the evidence of W.T., N.R., J.S. and K.M., set out at paragraphs [82], [87], [91] and [117] above, that the risks of the investments they made through Trkulja were explained to them. We note that, in the case of K.M., there is conflicting evidence about what level of risk in relation to the Exempt Products was communicated to him. We have also considered the evidence of C.D. with respect to his interaction with Sawh which we set out at paragraph [95]. He testified that Sawh explained the risks of his mutual funds investment to him.

[249] We adopt our reasons at paragraph [223] that the testimony, at its highest, suggests that Trkulja may have explained the risks of specific investments to these witnesses. However, in light of the findings about Trkulja’s interactions with I.D. and J.T., we are not persuaded that he has consistently discharged this aspect of know-your-

product and suitability in the past or that he has the proficiency to meet future obligations if his registration is reinstated.

[250] We note that although W.T. considered himself to be a knowledgeable investor and appears to meet the criteria to be an accredited investor, he demonstrated by his evidence that he did not understand the terms “accredited investor” or “limited partnership”. This underscores the importance of ensuring that the risks of investments are adequately explained. Even investors who have the ability to sustain a loss or who have some investment knowledge may still require the assistance of a registered individual to provide them with information about the attributes of a particular type of product that is unfamiliar to them.

### ***Findings on Know-Your-Product***

[251] In summary, we find the Applicants’ past failure to conduct due diligence on the Exempt Products and provide explanation of the risks of these products to clients, along with their failure at the Hearing and Review to show that they understood these shortcomings, raise further questions about their proficiency for registration. The Applicants’ roles as the senior managers of IHOC allowed them together to implement a compliance regime that emphasized form over substance in a manner antithetical to the proficiency standards of securities regulation. The Applicants’ failure to conduct adequate due diligence and to explain the risks of products to clients contributed to failures in their role as gatekeepers facilitating the connection between the issuers and IHOC’s clients. In light of the fact that the know-your-product requirement is now more significant to current regulatory obligations, we do not believe that the Applicants will be able to discharge these responsibilities appropriately if their registrations are reinstated.

### **(c) Findings on the Proficiency of the Applicants**

[252] Viewed in its entirety, the evidence shows that the Applicants fell below the standards required of registered individuals during the period at issue. Both Applicants failed in the fundamental responsibility of registrants to deal with their clients in a proficient manner. The testimony of all the clients witnesses, even I.D. and J.T., revealed that the Applicants had successfully developed professional relationships with their clients. Their registrations, educational background and significant employment experience in the industry should have supported their successful discharge of the requirements imposed on registrants. Unfortunately, neither of the Applicants exercised the required level of judgment and responsibility to satisfy the regulatory requirements.

[253] In addition, as the senior managers and directing minds of IHOC, the Applicants also failed to create and maintain an appropriate compliance regime that demonstrated their understanding of the substance of the regulatory requirements. Although they had created a Compliance Manual, they either did not apply or implement the policies and procedures set out therein or applied them in a cursory fashion, apparently without regard to the regulatory objective sought to be achieved. This leads us to doubt their ability to understand and comply with Ontario securities law requirements on an ongoing basis.

[254] The Applicants represented to us that the failures of suitability assessment that were uncovered were isolated. In light of the direct evidence from the Applicants themselves about their approach to suitability, the MFDA Compliance Examinations and the Applicants' demonstrated failure to understand the need to conduct due diligence on complex products, we take the view that these failures reflect an absence of appropriate judgment expected in the circumstances rather than isolated failures.

[255] As a result of their failure to meet their know-your-client, know-your-product and suitability obligations, some of their clients invested in high risk Exempt Products that they did not understand and suffered financial losses they had no ability to sustain. At the Hearing and Review, the Applicants continued to show that they failed to understand the shortcomings of their actions and the importance of registration requirements in protecting investors. Accordingly, we find that the Applicants do not have the proficiency to be registered as dealing representatives of an MFD.

## **2. Integrity**

[256] Having considered the proficiency of the Applicants to be registered, we now turn to the issue of the integrity of the Applicants as a criterion for their registrations. For the reasons set out at paragraph [162] above, we first set out the law relating to the integrity requirement both at the time of the relevant conduct and at the time of the Hearing and Review. We then consider two issues relevant to the assessment of whether the Applicants satisfy the integrity requirement.

### **(a) The Law on Integrity**

[257] While integrity is not defined under the Act, the Commission in *Istanbul* stated that an assessment of integrity should be "guided by the criteria set out in paragraph 2.1(1)(iii) of the Act. This provision states that an important principle that the Commission shall consider in pursuing the purposes of the Act is 'the maintenance of *high standards of fitness and business conduct* to ensure *honest and responsible conduct* by market participants'" [Emphasis in original] (*Istanbul, supra*, at para. 68). In *Istanbul, supra*, at para. 66, the Commission cited an earlier decision by the Director in *Re Wall* (2007), 30 O.S.C.B. 7521 which addresses the issue of integrity. The latter decision explains that:

OSC staff look at the honesty and the character of the applicant when analyzing integrity. In particular, staff examines the applicant's dealings with clients, compliance with Ontario securities law and other applicable laws, and the use of prudent business practices.

(*Re Wall, supra*, at para. 23)

[258] In *Istanbul* itself, the Commission found that the applicant misappropriated his clients' loyalty points and that he lacked the trustworthiness and integrity required of a registrant (*Istanbul, supra*, at para. 80). In particular, the Commission made the following findings with respect to conflict of interest arising from the applicant's conduct:

There is also a self-dealing aspect to the Applicant's conduct. By improperly issuing Air Miles to his wife, the Applicant engaged in conduct that benefited not only his spouse but also himself. Further we note that during the period from 2002 to 2007 the Applicant also issued Air Miles directly to himself. The Applicant justified the issuance of Air Miles coupons to his wife on the basis that she had significant holdings with the bank; however, four out of the five accounts in question were held jointly by the Applicant and his wife. Thus, the Applicant as a joint holder of four of the accounts knowingly benefited. This aspect of his conduct is troubling to us because registrants should be able to identify and avoid conflicts of interest that result from a non-arm's length relationship.

[Emphasis added]

(*Istanbul, supra*, at para. 73)

[259] At the time the Applicants sold Exempt Products and mutual funds, OSC Rule 31-505 and the MFDA Rules imposed a standard of integrity on salespersons of an MFD. More specifically, section 2.1 of the OSC Rule 31-505 provided that:

**2.1 General Duties** – (1) A registered dealer or adviser shall deal fairly, honestly and in good faith with its clients.

(2) A registered salesperson, officer or partner of a registered dealer or a registered officer or partner of a registered adviser shall deal fairly, honestly and in good faith with his or her clients.

[260] Rule 2.2.1 of the MFDA Rules states:

**2.1.1 Standard of Conduct.** Each Member and each Approved Person of a Member shall:

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

...

[261] As referenced at paragraph [258] above, the way in which an applicant addresses conflicts of interest is a reflection of the applicant's integrity. Rule 2.1.4 of the MFDA Rules deals with a Member's obligations with respect to conflicts of interest or potential conflicts of interest:

**2.1.4. Conflicts of Interest**

(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.

- (b) In the event that such a conflict or potential conflict of interest arises, the Member and the Approved Person shall ensure that it is addressed by the exercise of responsible business judgment influenced only by the best interests of the client and in compliance with Rules 2.1.4(c) and (d).
- (c) Any conflict or potential conflict of interest that arises as referred to in Rule 2.1.4(a) shall be immediately disclosed in writing to the client by the Member, or by the Approved Person as the Member directs, prior to the Member or Approved Person proceeding with the proposed transaction giving rise to the conflict or potential conflict of interest.
- (d) Each Member shall develop and maintain written policies and procedures to ensure compliance with Rules 2.1.4(a), (b) and (c).

[262] In MFDA Member Regulation Notice MR-0054 – Conflicts of Interest (“**MFDA Member Regulation Notice MR-0054**”), issued on June 22, 2006, the MFDA takes the position that the concept of materiality is implicit in Rule 2.1.4 of the MFDA Rules:

MFDA staff does not expect Members to anticipate every potential conflict, regardless of the remoteness of a problem arising, and provide written disclosure to clients of such conflicts. However, written disclosure must be provided in all cases where there is a reasonable likelihood that a client would consider the conflict important when entering into a proposed transaction. For example, this would include a situation where an Approved Person refers a client to a company in which the Approved Person has an ownership interest for tax preparation services.

[263] Rules 2.2.1 and 2.1.4 of the MFDA Rules and the MFDA Member Regulation Notice MR-0054 remain in force today to govern and provide guidance about the obligations of its Members and their representatives in relation to conflicts of interest. In addition, sections 13.4 and 13.6 of NI 31-103 set out the requirements that currently apply to registrants with respect to conflicts of interest. Guidance with respect to the current interpretation of integrity under the Act can also be found in section 1.3 of 31-103CP, which states that conflicts of interest include “other employment or partnerships, service as a member of a board of directors, or relationships with affiliates...”.

#### **(b) Application of Integrity Criteria to the Applicants**

[264] We note that no allegations of fraud, misappropriation or high pressure sales tactics were made against the Applicants, nor is there any evidence before us that raises these issues. In determining the integrity of the Applicants, however, we are guided by the principle that the Commission shall consider in pursuing the purposes of the Act which, as set out in *Istanbul, supra*, at para. 68 and subparagraph 2(iii) of section 2.1 of the Act, excerpted at paragraph [152] above, is “the maintenance of *high standards of fitness and business conduct* to ensure *honest and responsible conduct* by market participants” [Emphasis in original].

**(i) Proposed Transactions with Alterra and Golden Gate**

[265] As established in Rule 2.1.4 of the MFDA Rules, registrants have an obligation to conduct themselves with integrity by addressing conflicts or potential conflicts of interest in an appropriate manner. It is not contentious that IHOC and the Applicants entered into discussions with Golden Gate and Alterra whereby the Applicants proposed to sell a significant equity interest in IHOC to Alterra or Golden Gate. It is also not disputed that these proposed transactions were not disclosed to IHOC clients. The parties, however, disagree as to whether these proposed transactions created conflicts of interest or potential conflicts of interest which required IHOC and the Applicants to mitigate or to otherwise address such conflicts or potential conflicts “by the exercise of responsible business judgment influenced only by the best interests of the client” (Rule 2.1.4 of the MFDA Rules).

[266] The Applicants testified that in 2006, they recognized that the regulatory environment of the mutual fund business was changing rapidly and that IHOC’s infrastructure was no longer sufficient to respond to the changing environment. As a result, they explored various options to protect the interest of their clients while operating a viable business, and one such option was to sell IHOC to another dealer. The Applicants testified that their intention was to look for a place with “good infrastructure for compliance, operations” (Hearing Transcript dated September 16, 2011 at p. 120).

[267] As set out at paragraphs [46] to [49] above, the Applicants engaged in such discussions with various entities from 2006 to 2008. IHOC was not successful in its efforts to consolidate with another dealer. According to the Applicants, these proposed transactions were not concluded for a variety of reasons. For example, both Applicants testified that they terminated their discussions with one of them, because that entity “wanted to tie the purchase with sales into their product” which, according to the Applicants, would constitute a conflict of interest (Hearing Transcript dated September 16, 2011 at p. 119; see also Hearing Transcript dated September 12, 2011 at pp. 40-41)

[268] The Applicants further testified that they made the securities regulators, including the MFDA and the Commission, aware of the discussions between IHOC and other entities. According to the Applicants, they communicated with the regulators and kept them informed on a regular basis. Both Applicants testified and submit that they did not disclose their discussions with Alterra and Golden Gate to IHOC clients because the transactions did not materialize and therefore did not amount to a conflict or potential conflict of interest.

[269] More specifically, Trkulja justified the non-disclosure by stating, in reference to the MFDA Settlement, that:

Well, to me it doesn’t mean that there was a conflict of interest. It says that it may have constituted a potential conflict of interest...and in my opinion, there wasn’t a conflict of interest because the lawyer representing Alterra who was also representing us in the proposed transaction, clearly indicated to the Ontario Securities Commission via letter that we would not be disclosing any sort of conflict of interest to investors until the deal

closed. So that's why I don't view this as a potential conflict of interest because there was no deal that never closed [*sic*] and we informed the Ontario Securities Commission of that via letter.

(Hearing Transcript dated September 12, 2011 at pp. 70-71)

[270] Similarly, at the Hearing and Review, Sawh was asked questions about the transactions. In direct examination, he was asked to read the following excerpt from the MFDA Member Regulation Notice MR-0062 – Exempt Securities of Non-Arm's Length Issuers, issued on May 24, 2007:

A. "Where Members or Approved Persons have a significant direct or indirect interest in securities or other products being sold to clients through the Member there is a material conflict of interest that, under MFDA Rule 2.1.4, must be addressed by the exercise of responsible business judgment influenced only by the best interests of the client."

Q. All right, stop. When you read this, did the Alterra transaction or the Golden Gate transaction ever proceed to a point where that particular paragraph would apply?

A. No.

Q. Why is that?

A. It didn't materialize.

Q. In other words, there was no direct or indirect interest in securities –

A. No.

Q. – or other products being sold? It didn't actually occur?

A. No.

(Hearing Transcript dated September 16, 2011 at pp. 143-144)

[271] Despite the Applicants' testimony as summarized above, we find that there is a regulatory concern relating to conflict of interest arising from the Applicants' conduct. In this case, the MFDA Settlement Agreement shows that IHOC sold Alterra securities to clients between October 2005 and February 2007, and in particular, that Trkulja sold Alterra securities in two periods, between October 2005 and May 2006 and between October 2006 and February 2007 (MFDA Settlement Agreement, *supra*, at paras. 17-18 and 40). Meanwhile, the evidence shows that IHOC commenced consolidation discussions with Alterra in February or March 2006 and continued those discussions until June 1, 2006 (MFDA Settlement Agreement, *supra*, at paras. 40-41). As well, the evidence shows that the Applicants sold Golden Gate securities between February 1, 2006 and January 20, 2007 and had two rounds of discussions with Golden Gate from June 5, 2006 to July 19, 2006 and from April 16, 2007 to December 19, 2007 (MFDA Settlement Agreement, *supra*, at paras. 21, 43-47).

[272] By engaging in discussions with Alterra and Golden Gate to sell an equity interest in IHOC to one of them at periods that overlapped with their efforts to sell Alterra and Golden Gate's Exempt Products to IHOC clients, the Applicants placed themselves in a position of conflict or potential conflict of interest. We believe this is expressed in the MFDA Settlement Agreement where the Applicants admitted to "actual or potential conflicts" of interest (MFDA Settlement Agreement, *supra*, at paras. 49-50 and 78).

[273] Further, we disagree with the Applicants' submission that the negotiation discussions did not create a conflict or potential conflict of interest because no transaction was concluded. The question of whether there are obligations arising from a conflict of interest or a potential conflict of interest is not determined by a one-dimensional analysis of whether a transaction ultimately materialized. The issue that should be considered, in accordance with Subrule 2.1.4(b) of the MFDA Rules, is whether the Applicants addressed the conflicts or potential conflicts of interest "by the exercise of responsible business judgment influenced only by the best interests of the client".

[274] The Applicants submit that they were anxious about looking for a partner because they could not manage the structure of their dealer. By Trkulja's own admission, the Applicants were "desperately looking for a partner" during the period in which they sold Exempt Products (Hearing Transcript dated September 14, 2011 at p. 122). Sawh testified that Golden Gate and Alterra were "purchasing an equity share in us, right, because they're trying to build their financial service company so were looking at a mutual fund dealer and fund [*sic*] an infrastructure to help that" (Hearing Transcript dated September 16, 2011 at p. 164). Sawh's evidence also demonstrates that the negotiations between the Applicants and Alterra had progressed to the point where Sawh was "out as part of Alterra interviewing people from an executive search company to come in to head up that compliance department" for the newly amalgamated entity (Hearing Transcript dated September 16, 2011 at p. 164).

[275] In our view, there is a reasonable likelihood that investors would consider IHOC's sale of Alterra or Golden Gate Exempt Products to them at the same time as IHOC wished to develop its relationship with the issuers of the Exempt Products, and indeed at a time when the Applicants were actively discussing selling their equity interest in IHOC to one of these issuers, to be a material conflict between the interests of the investors and those of the Applicants. For example, although the Applicants argued that it was not financially advantageous to them to sell Exempt Products as compared to mutual funds on a transaction-by-transaction basis because the commissions on the Exempt Products were lower, the Applicants' desire to sell their equity interest in IHOC to one of these entities may have created a different type of incentive for the Applicants to sell the Exempt Products. This circumstance contributed at the least to a perception of a conflict or potential conflict of interest and a failure to exercise "responsible business judgment" in addressing that conflict or potential conflict.

[276] We were not referred to any evidence showing that the Applicants took any steps, such as disclosure to clients or implementing additional policies or procedures, to address such conflicts or potential conflicts of interest. In the circumstances, we are not persuaded that the Applicants conducted themselves "by the exercise of responsible business judgment influenced only by the best interests of the client". The testimony of

the Applicants at the Hearing and Review, which included a denial of the need to address such conflicts or potential conflicts, further adds to our discomfort as to whether they would be able to uphold the standards of integrity required of a securities industry professional.

**(ii) Failure to Disclose Change of Risk Rating to Clients**

[277] As set out at paragraph [52] above, IHOC initially rated the Exempt Products as medium risk investments. When the MFDA conducted the 2006 MFDA Compliance Examination, MFDA Staff advised IHOC and the Applicants that it considered the Exempt Products to be high risk investments.

[278] In his cross-examination at the Hearing and Review, Sawh was asked whether steps were taken to inform IHOC clients that the risk rating of the Exempt Products was changed following the 2006 MFDA Examination. Sawh responded that he understood Trkulja to be responsible for calling the clients and informing them of this change, but he did not personally take any such steps:

Q. Did you take steps to ensure that all your clients were informed that the risk levels for those particular funds had been changed?

A. Yes.

Q. You did?

A. Not me personally, but Vlad [Trkulja] had made calls to everyone.

Q. You did?

A. Discussions.

Q. Really? When did you do that?

A. We were notified in the November 6th examination that we were to change the risk ranking to “high” and amend all the KYCs.

Q. I see. Did you inform your clients that you had changed the risk ranking?

A. Well, when we had to go amend the KYCs, my understanding is Vlad [Trkulja] was discussing that with clients.

Q. But did you do it?

A. No, I didn't.

Q. No, you didn't. So you didn't actually call any clients.

A. No. We had a discussion, myself and Vlad [Trkulja], and that's what he was instructed to do.

[Emphasis added]

(Hearing Transcript dated September 16, 2011 at pp. 177-178)

[279] Sawh was then confronted with a statement that he made during an interview conducted by the MFDA on October 4, 2007, pursuant to section 22.1 of the MFDA Bylaw 1 (the “**MFDA Interview**”). During the MFDA Interview, he was asked the same question:

Mr. Smith: Did you go back to the clients and say, “We put you into this as medium, it’s really a high, are you comfortable?”

Mr. Sawh: And lose every client we have? No, we didn’t go back and speak to them. But if – in subsequent meetings and reviews we’d discuss it with them. And to date, everyone’s received their interest cheques, I know that, as well as – yes. If they’re called back and so on, we’d sit down with them. If we have to go through the new account applications, we’d explain what it is.

[Emphasis added]

(Transcript of the MFDA Interview dated October 4, 2007 at p. 25)

[280] Sawh confirmed at the Hearing and Review that he remembered being asked those questions and providing those responses. Sawh was then given an opportunity to explain the contradiction between the statements he made in the MFDA Interview and his testimony at the Hearing and Review. In reference to the excerpted portion of the MFDA Interview, Staff concluded with the following:

Q. That’s not what [page 25 of the transcript of the MFDA Interview] says. That’s clearly not what this states, is it.

What this says is...When you’re asked did you go back to the clients and say, “We put you into this as medium, it’s really a high, are you comfortable,” you said, “And lose every client we have? No, we didn’t go back and speak to them. But if – in subsequent meetings and reviews we’d discuss it with them.”

So which is it?

A. No, we went back in subsequent meetings. Vlad [Trkulja] was calling them, clients, and meeting with them.

Q. I see. But you didn’t go back and speak to them. You didn’t make an effort to; it was only if you were having a subsequent meeting?

A. No, no. Vlad [Trkulja] was calling to set up meetings with these clients.

Q. I see.

A. Some would come into the office; some wouldn’t.

[Emphasis added]

(Hearing Transcript dated September 16, 2011 at p. 181)

[281] We have difficulty accepting Sawh's testimony at the Hearing and Review as credible. In the first place, when asked the same question on two different occasions, he provided responses that are contradictory in nature. He testified at the Hearing and Review that he provided instructions to Trkulja to inform all affected clients about the change in risk rating of the Exempt Products. Meanwhile, he stated previously in the MFDA Interview that IHOC did not take steps to inform all affected clients about the change in risk rating because it would be adverse to IHOC and the Applicants' interests and that "And to date, everyone's received their interest cheques". His prior statements, which were closer in time to the 2006 MFDA Compliance Examination, as well as the reasons he provided in those prior statements for non-disclosure, which show an immediate concern about the viability of his business, cast doubt on the credibility of his testimony given at the Hearing and Review.

[282] In addition, there is no corroborating evidence before us to support the claim that IHOC put appropriate procedures in place to identify investors for whom the Exempt Products were no longer suitable as a result of the change in risk rating. We were not presented with, for example, any notes taken on the instructions given by Sawh to Trkulja about the communications to affected clients, nor were there policies and procedures before us about any concerted efforts by IHOC to communicate to affected clients about the change of the Exempt Products' risk rating.

[283] We are not persuaded that Sawh took adequate steps to ensure that affected clients were informed about the change in risk rating and, as a result of the change, to re-examine the suitability of the investments for those clients. In addition, Sawh's failure to adequately explain the discrepancies between the statements that he made during the MFDA Interview and his testimony at the Hearing and Review in a forthright manner also contributes to our concerns about his integrity.

**(c) Findings on the Integrity of the Applicants**

[284] We find that the Applicants' failure to appropriately disclose or otherwise manage the conflicts or potential conflicts of interest involved in their negotiations to sell their equity interest in IHOC to Alterra or Golden Gate, while selling those issuers' Exempt Products to IHOC clients, did not meet the "high standards of fitness and business conduct to ensure honest and responsible conduct by market participants". Their continued denial at the Hearing and Review of the need to disclose or otherwise manage such conflicts or potential conflicts further prevents us from concluding that they will address conflicts of interest in accordance with the integrity requirements of registration in the future. Sawh's testimony at the Hearing and Review about the process undertaken by IHOC to revisit the change in risk rating of the Exempt Products, which we do not find credible in light of his prior statements at the MFDA Interview, adds to our discomfort about his integrity to be registered. In sum, we find that the Applicants lack the integrity required to be registered as dealing representatives of an MFD and are not suitable for registration.

### **C. Is the Reinstatement of the Applicants' Registrations Otherwise Objectionable?**

[285] Staff submits that even if the Commission found that the Applicants have the requisite integrity and proficiency for registration, the Commission should refuse the reinstatement of their registrations on the grounds that the reinstatement is "objectionable".

[286] The Applicants did not make detailed submissions on this issue beyond making the general argument that "[t]here is no evidence that the Applicants pose any risk to the investing public, nor any evidence to warrant the exercise of the Commission's jurisdiction to prevent likely future harm to Ontario's capital markets".

[287] In light of our findings with respect to the Applicants' lack of suitability to be registered, it is not strictly necessary, in our view, to deal with the issue of whether the reinstatement of the Applicants' registrations is otherwise objectionable. However, for the sake of completeness, we address this issue briefly below.

#### **1. Law and Analysis**

[288] We were not provided with a great deal of guidance as to the considerations that would be relevant to an assessment of whether the registration of an applicant (or a reinstatement) would be "otherwise objectionable". No definition of the term is provided in the Act. We were not referred to any previous decisions at the Commission level that have considered this issue in any detail.

[289] In our view, a purposive approach should be taken to the analysis of the concept, that is to say, we should consider whether registration would be "otherwise objectionable" in light of the Commission's mandate, as expressed in section 1.1 of the Act and set out at paragraph [151] above, (a) to provide protection to investors from unfair, improper or fraudulent practices; and (b) to foster fair and efficient capital markets and confidence in capital markets. As referred to at paragraph [150] above, the Commission explained in *Michalik* that "[when] exercising its discretion to review the decision of a Director, the Commission is required to act in the public interest with due regard to its mandate/purpose under the Act, set out in section 1.1 of the Act" (*Michalik, supra*, at para. 44).

[290] As noted at paragraph [152] above, section 2.1 of the Act directs the Commission, in pursuing the purposes of the Act, to have regard to a number of principles, such as requirements for the maintenance of high standards of fitness and business conduct to ensure honest and responsible conduct by market participants. As the Commission stated in *Istanbul* and *Michalik*, registrants are in a position where they may harm the public, and regulating the conduct of registrants is therefore a matter of public interest (*Istanbul, supra*, at para. 57; and *Michalik, supra*, at para. 48).

[291] A number of aspects of the evidence led at the Hearing and Review about the Applicants' conduct shed light on the question of whether it would be in the public interest to reinstate the registrations of the Applicants. We consider these aspects below.

**(a) The Applicants' Representations about their Registration Status**

[292] As set out at paragraphs [58] and [76] above, the Applicants own TS Wealth through which they sell insurance and mortgage products. TS Wealth has a website at tswealth.ca.

[293] In cross-examination, Trkulja was referred to a TS Wealth webpage that captures the content of the website as of April 5, 2011. The page entitled "Investments" contained the following statements as of that date:

TS Wealth Inc. offers a broad range of investment products to investors including Guaranteed Investment Certificates, government and provincial bonds, mutual funds, wrap accounts, principal protected notes, annuities and guaranteed investment funds.

[294] Trkulja explained that references to government bonds, mutual funds and wrap accounts were inadvertently placed on the TS Wealth website:

...the reason why that was inadvertently put on our web site is because when we were going to transition over from the Investment House of Canada to MGI Financial, our brand was going to change to IHC Financial. So our web person...had created a new web site that wasn't live...we asked our web designer...to remove those specific words from the web site.

...

So that's my explanation on that. That should have never made the web site.

(Hearing Transcript dated September 14, 2011 at pp. 111-112)

[295] Email exchanges between Trkulja and the web designer were introduced into evidence through Sawh. Based on the email exchanges, the Applicants recalled that they began creating the TS Wealth website on or around February 22, 2011. On March 14, 2011, Trkulja sent a communication to the web designer requesting that the statements set out at paragraph [293] be replaced with a revised passage which would effectively remove the references to government bonds, mutual funds and wrap accounts.

[296] Since May 2010, following the MFDA Settlement, Trkulja and Sawh had not been registered to trade in securities and accordingly were not entitled to hold themselves out as being able to sell government bonds, mutual funds or wrap accounts. Although the email message dated March 14, 2011 shows that Trkulja took steps to remove the references to government bonds, mutual funds and wrap accounts, those references remained on the website as of April 5, 2011. The Applicants' lack of care in ensuring that they did not represent themselves as being able to carry out registerable activities, both at the initial creation of the webpage and the subsequent failure to remove those references in a timely manner, adds to our discomfort about their ability to conduct themselves in accordance with the requirements of regulated activity.

[297] We also have concerns about the Applicants' forthrightness in their disclosure to their former clients, with whom they maintained a professional relationship following the MFDA Settlement, about what activities they were licensed to carry out. N.R. testified that he continued to communicate with Trkulja and thought Trkulja was "working with similar investments, like mutual fund advising" (Hearing Transcript dated September 15, 2011 at p. 31). He understood himself to be receiving investment advice from Trkulja with respect to the "Smith Manoeuvre" investment strategy, described at paragraph [86] above, as recently as a few months prior to the Hearing and Review.

[298] In re-examination, counsel for the Applicants sought to clarify the identity of N.R.'s advisor after the suspension of IHOC. N.R. stated that, another advisor with MGI was the adviser meeting with him and directly giving him advice related to those accounts after IHOC's suspension. N.R. also stated that Trkulja was not present during those meetings. However, when asked whether Trkulja was part of the meetings, N.R. responded "Indirectly. I was still communicating with Vlad [Trkulja]" (Hearing Transcript dated September 15, 2011 at p. 43). Counsel for the Applicants also sought to clarify the nature of the recent discussions between Trkulja and N.R. N.R. described those discussions as "carryover from dealing with Vlad [Trkulja]. Just how the market conditions are affecting just the current state of the investment" (Hearing Transcript dated September 15, 2011 at p. 44).

[299] Although counsel for the Applicants attempted to clarify in re-examination the nature of the discussions between Trkulja and N.R., we remain troubled that the consequences of the suspension of Trkulja's registration were not made fully clear to N.R.

[300] Both examples of representations in the TS Wealth website and Trkulja's interaction with N.R. speak to the Applicants' failure to exercise appropriate judgment and a lack of respect for the need for precision and clarity concerning the privileges of registration.

### **(b) The Applicants' Responses to Questions about the MFDA Settlement**

[301] At the Hearing and Review, Staff put questions to the Applicants about their admissions in the MFDA Settlement Agreement. We observe that their responses to the questions about their conduct that formed the basis of the MFDA Settlement lacked forthrightness and candor. Where the Applicants admitted to failures, they admitted to failures of an administrative nature only rather than acknowledging their failures of judgment.

[302] For example, Trkulja was asked about his admissions in the MFDA Settlement Agreement, one of which was that he "sold Exempt Products to some clients without ensuring that the clients qualified as accredited investors in accordance with National Instrument 45-106" (MFDA Settlement Agreement, *supra*, at para. 31). He responded that he relied on the "sophisticated investor exemption", rather than the accredited investor exemption, as follows:

A. In some cases, clients were accredited investors – sorry, not accredited investors, sophisticated investors, and that’s what we relied on and it appears now, after seeing what we’ve been going through the last year or year-and-a-half, it appears that maybe one or two clients potentially may actually not be accredited investors but that’s not what we were told initially. It’s what we are being told now.

Q. And so to the best of your knowledge, speaking only for yourself, did you sell any exempt products to any clients at any time where you knew that they were not accredited?

A. Definitely not.

(Hearing Transcript dated September 12, 2011 at pp. 59-60)

[303] When asked the same question again on a different day of the Hearing and Review, Trkulja refused to acknowledge that he sold Exempt Products to I.D. and J.T. without ensuring that the Exempt Products were suitable for these clients. Staff read from the MFDA Settlement Agreement as follows:

Q. Between October 2005 and the 2006 examination in June 2006, Trkulja and Sawh sold one or more of the exempt products to clients without ensuring that the exempt products were suitable for some clients and in keeping with the client’s investment objectives.

A. Correct. Because we looked at –

Q. Wait a second. Which clients?

A. I don’t know. Some clients. One or two clients.

Q. Which ones?

A. I don’t recall.

Q. Okay. Did you ever know?

A. No.

Q. So it wasn’t Mr. [J.T.]?

A. I’m not certain it was Mr. [J.T.]. It could have been numerous clients.

Q. Was or wasn’t Mr. [I.D.]?

A. I don’t know.

[Emphasis added]

(Hearing Transcript dated September 14, 2011 at pp. 67-68)

[304] Sawh was similarly asked about the admissions in the MFDA Settlement Agreement at the Hearing and Review. For instance, he was asked about the admission that, in 2009, “the deficiencies identified in the 2006 MFDA Report described above had not been addressed and remained outstanding” (MFDA Settlement Agreement, *supra*, at para. 56). Sawh insisted that the deficiencies identified in the 2006 MFDA Compliance Examination had been remedied:

Q. Except that in paragraph 56, and you agreed because you signed off on this, the 2009 MFDA report identified, among other things, that:

“The deficiencies identified in the 2006 MFDA report described above had not been addressed and remained outstanding.”

A. They’re talking about similar deficiencies identified, not the exact same ones.

Q. Well, I mean, I don’t want to parse language here too much.

A. But you have to.

Q. But it says “the” deficiencies identified in the 2006 MFDA report.

A. Yes. So the deficiencies could be incomplete KYCs; that’s “the deficiency”. The specific deficiency of client A, B or C, that was rectified. The remedies to ensure that it didn’t happen again were approved by the MFDA. The remedies didn’t catch the same deficiencies to come back in the same category.

Q. So that’s your explanation of that paragraph, that they’re not the same deficiencies?

A. The same category.

Q. I see. Okay. So, in other words, it may not have happened to the same clients, but it was sill [*sic*] happening in the same way; is that what you’re saying?

A. There were some deficiencies that...We weren’t perfect. Like, some things we would have missed.

So it doesn’t quantify it in the sense that if there are a hundred deficiencies in one category, specific ones; the same category may show up and maybe there’s only four, but the deficiencies still existed.

(Hearing Transcript dated September 16, 2011 at pp. 169-171)

[305] Trkulja took the same position on this issue:

Not the same deficiencies. We actually – those deficiencies were actually addressed and corrected from the 2006. They just – they may have happened again in 2009.

(Hearing Transcript dated September 14, 2011 at p. 75)

[306] The Applicants' statements in cross-examination about the 2009 MFDA Compliance Examination do not provide us with comfort that they have learned from their past compliance failures and would endeavour to avoid similar deficiencies, particularly deficiencies relating to know-your-client and suitability issues, in the future. Although we have not engaged in an exhaustive comparison of the 2006 MFDA Compliance Examination and the 2009 MFDA Compliance Examination, we note that, for example, in the 2006 MFDA Compliance Examination, the MFDA identified 6 accounts in a sample of 45 client files that had incomplete, inadequate or no know-your-client information, and in the 2009 MFDA Compliance Examination, the MFDA identified at least 31 accounts out of a sample of 77 client files that had inadequate know-your-client information.

[307] We further observe that the Applicants' assertion that the deficiencies were corrected is at odds with the report given to IHOC by the MFDA following the 2009 MFDA Compliance Examination, which was referred to the MFDA Enforcement Department. Finally, we note Trkulja's perplexing comment at the Hearing and Review that "[i]t could have been numerous clients" to whom the Applicants sold Exempt Products without ensuring that those products were suitable for those clients, as set out at paragraph [303] above.

[308] Trkulja testified that he and Sawh have worked in the financial services industry for many years and understood their admissions. He also acknowledged that the MFDA Settlement was negotiated with the assistance of legal counsel. The Applicants now come before us and advance interpretations of the admissions in the MFDA Settlement Agreement which are contrary to the plain language of those admissions, as exemplified by paragraphs [302] to [305] above. The Applicants' position at the Hearing and Review demonstrates a failure to learn from their previous regulatory deficiencies, which leads us to be unwilling to reinstate their registrations.

## **2. Findings on Objectionability**

[309] Registrants hold positions of trust in the securities industry and towards their clients, creating a responsibility on their part to fulfill an important role directed towards the protection of investors and fostering fair and efficient capital markets and confidence in capital markets. However, the Applicants' conduct since the MFDA Settlement and their testimony at the Hearing and Review did not convince us that they understood the seriousness of their previous shortcomings or that they would behave differently in the future.

[310] In the intervening time since the MFDA Settlement, we were not told of any actions taken by the Applicants that would demonstrate their acknowledgement of their prior errors. The focus of testimony at the Hearing and Review was to minimize transgressions and to refuse to take responsibility for the admissions in the MFDA Settlement Agreement. Viewed in their entirety, the actions of the Applicants do not provide us with sufficient comfort that they would be able to achieve the high standards of business conduct required of securities industry professionals. Accordingly, we find

that the reinstatement of the registrations of the Applicants as dealing representatives of an MFD would not be in the public interest and is therefore otherwise objectionable.

## **VII. CONCLUDING REMARKS**

[311] Pursuant to section 27 of the Act, it is the responsibility of the Commission to register individual dealing representatives in Ontario. The framework of the registration regime requires a determination by the Commission as to the Applicants' suitability to be registered and whether the reinstatement of the Applicants' registrations is otherwise objectionable, which is separate from any agreements entered into with the MFDA.

[312] In coming to our decision, we considered the previous cases referred to us by the Applicants which they argue involve conduct that was dishonest, egregious, motivated by financial gain or involved willful blindness. While we acknowledge that, as the Applicants submit, no allegations of fraud were made against them in the MFDA Proceeding and they have no prior history of regulatory proceedings against them, the evidence presented to us at the Hearing and Review warrants the exercise of the Commission's jurisdiction to refuse the reinstatement of their registrations.

[313] In summary, we find that the Applicants lack the requisite proficiency and integrity to be registered as dealing representatives of an MFD and that the reinstatement of their registrations is otherwise objectionable. The evidence shows that the Applicants do not possess the requisite proficiency to adequately apply the know-your-client and suitability standards or to conduct the necessary due diligence on products. In addition, we find that the Applicants lack the integrity to be registered because of their failure to appreciate and implement appropriate measures to deal with conflicts or potential conflicts of interest and their lack of forthrightness at the Hearing and Review about the shortcomings of their conduct. Finally, we find that the reinstatement of the Applicants' registrations is otherwise objectionable based on their conduct following the MFDA Settlement and their testimony about that settlement at the Hearing and Review, neither of which provides us with comfort that they would be able to achieve the high standards of business conduct required of securities industry professionals.

[314] Finally, the Applicants asked us to consider the reinstatement of their registrations on the basis that MGI would be closely monitoring and supervising them. However, the Applicants did not provide sufficient evidence of how such an arrangement would address the Applicants' lack of suitability for us to consider granting the Application. Given the absence of detail, along with our findings on the Applicants' proficiency and integrity as well as the objectionability of their registrations, we do not find the Applicants' representations about their association with MGI to be a sufficient basis for granting the reinstatement of their registrations.

[315] Accordingly, we dismiss the Application and deny the reinstatement of the registration of each of Sawh and Trkulja as a dealing representative of an MFD.

DATED at Toronto this 1<sup>st</sup> day of August, 2012.

*“Mary G. Condon”*

*“Judith N. Robertson”*

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Mary G. Condon

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Judith N. Robertson