



Ontario
Securities
Commission

Commission des
valeurs mobilières
de l'Ontario

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FILE NO.: 2018-31

IN THE MATTER OF ROYAL MUTUAL FUNDS INC.

- and -

**IN THE MATTER OF A
SETTLEMENT AGREEMENT BETWEEN STAFF
OF THE ONTARIO SECURITIES COMMISSION AND
ROYAL MUTUAL FUNDS INC.**

SETTLEMENT AGREEMENT

PART I - INTRODUCTION

1. The Ontario Securities Commission (the “**Commission**”) will issue a Notice of Hearing to announce that it will hold a hearing to consider whether, pursuant to sections 127 and 127.1 of the *Securities Act*, RSO 1990, c S-5, as amended (the “**Act**”), it is in the public interest for the Commission to make certain orders in respect of Royal Mutual Funds Inc. (“**RMFI**”).
2. A principal distributor of a mutual fund that is also a participating dealer of another fund is prohibited from providing incentives to any of its representatives to recommend a mutual fund of which it is a principal distributor over a mutual fund of which it is a participating dealer, except in certain permitted circumstances, pursuant to section 4.2 of National Instrument 81-105 *Mutual Fund Sales Practices* (“**NI 81-105**”). The

Companion Policy to NI 81-105 states that NI 81-105 was adopted in order to discourage compensation arrangements that could be perceived as inducing dealers and their representatives to sell mutual fund securities on the basis of incentives they were receiving rather than on the basis of what was suitable for and in the best interests of their clients. The purpose of NI 81-105 is to provide a minimum standard of conduct to ensure that investor interests remain uppermost in the actions of mutual fund industry participants when they are distributing mutual fund securities and that conflicts of interest arising from compensation arrangements are minimized.

3. RMFI is a member of the Mutual Fund Dealers Association of Canada (“**MFDA**”) and is registered with the Commission as a mutual fund dealer. RMFI is wholly owned by the Royal Bank of Canada (“**RBC**”). RMFI is the principal distributor of RBC mutual funds, which include the RBC Portfolio Solutions suite of mutual funds (the “**RBC PS Funds**”), as well as other proprietary funds (the “**RBC Funds**”). The RBC PS Funds invest in other mutual funds. RMFI is also a participating dealer of non-proprietary mutual funds (the “**Third Party Funds**”). The Third Party Funds account for a small proportion of RMFI’s gross sales.
4. As summarized below, between November 2011 and October 2016, RMFI contravened NI 81-105 by providing to certain of its representatives a higher rate of commission for the sale of units of RBC PS Funds than for the sale of units of Third Party Funds. In addition, RMFI failed to establish, maintain and apply policies and procedures to establish a system of controls and supervision to ensure that it and each individual acting on its behalf complied with subsection 4.2(1) of NI 81-105 during this period.

PART II - JOINT SETTLEMENT RECOMMENDATION

5. Staff of the Commission (“**Staff**”) agree to recommend settlement of the proceeding commenced by the Notice of Hearing (the “**Proceeding**”) against RMFI according to the terms and conditions set out in Part VI of this Settlement Agreement (the “**Settlement Agreement**”). RMFI agrees to the making of an order in the form attached as Schedule “A” (the “**Order**”), based on the facts set out below.
6. For the purposes of this Proceeding, and any other regulatory proceeding commenced by a securities regulatory authority, RMFI agrees with the facts as set out in Parts III and IV and the conclusions set out in Part V of this Settlement Agreement.

PART III - AGREED FACTS

A. The Legislative Framework

7. Subsection 4.2(1) of NI 81-105 states that a principal distributor of a mutual fund that is also a participating dealer of another mutual fund shall not provide an incentive for any of its representatives to recommend a mutual fund of which it is a principal distributor over a mutual fund of which it is a participating dealer.
8. Pursuant to section 1.1 of NI 81-105 and section 1.1 of National Instrument 81-102 *Investment Funds*, for the purpose of subsection 4.2(1) of NI 81-105:
 - (a) a “principal distributor” includes a company through whom securities of a mutual fund are distributed under an arrangement with the mutual fund or its manager that provides (a) an exclusive right to distribute the securities of the mutual fund in a particular area, or (b) a feature that gives or is intended to give the company a

material competitive advantage over others in the distribution of the securities of the mutual fund; and

(b) a “participating dealer” means a dealer other than the principal distributor that distributes securities of a mutual fund.

9. Although subsection 4.2(2) of NI 81-105 provides an exception to the prohibition contained in subsection 4.2(1), that exception does not apply to the facts of this matter.

B. Enhanced Compensation Paid by RMFI

10. RMFI distributes mutual funds through representatives. According to RMFI, during the Material Period (defined below) approximately 11% of RMFI’s representatives were “Investment & Retirement Planning” financial planners (“IRPs”). IRPs are “representatives” of RMFI within the meaning of subsection 4.2(1) of NI 81-105.

11. The investments sold by IRPs include RBC PS Funds, RBC Funds and Third Party Funds.

12. For a period of five years, from November 1, 2011 to October 27, 2016 (the “**Material Period**”), RMFI offered and paid to IRPs ten basis points more in commissions for the sale of units of RBC PS Funds than for the sale of units of RBC Funds and Third Party Funds (the “**Enhanced Compensation**”).

13. According to RMFI, the Enhanced Compensation was intended to encourage IRPs to recommend the RBC PS Funds when consistent with clients’ investment goals.

14. The Enhanced Compensation resulted in additional payments from RMFI to IRPs of (i) \$24,517,931 in the aggregate for the Material Period, and (ii) on average, between \$4,848.22 and \$6,282.71 per IRP per year of the Material Period. As set out below, the Enhanced Compensation did not have any bearing on the fees charged to clients.

C. Circumstances Leading to RMFI's Reporting of the Enhanced Compensation to the Commission

15. In mid-2016, as part of a project known as the Targeted Review of Member Compensation and Incentive Programs, conducted by the MFDA in collaboration with the Commission, MFDA staff identified the Enhanced Compensation issue. Accordingly, in September 2016, RMFI contacted Staff to report the Enhanced Compensation issue. MFDA staff and Staff jointly investigated this matter.

D. Removal of the Enhanced Compensation by RMFI

16. Effective October 28, 2016, RMFI eliminated the Enhanced Compensation by equalizing the compensation offered and paid to IRPs for the sale of units of RBC PS Funds as compared to the sale of units of RBC Funds and Third Party Funds.

PART IV - MITIGATING FACTORS

17. The Enhanced Compensation structure had no bearing on the fees charged to clients for any of the RBC PS Funds, RBC Funds, or Third Party Funds.
18. Staff do not allege any harm to clients as a result of investments in the RBC PS Funds made during the Material Period.

19. According to RMFI, the Enhanced Compensation was intended to encourage the IRPs to recommend the RBC PS Funds in relation to both the conventional RBC Funds and Third Party Funds, rather than to specifically discourage investment in Third Party Funds, which account for a small proportion of RMFI's gross sales. RMFI considers the RBC PS Funds to be a suite of products with distinctive benefits for clients, including diversification and active portfolio management.
20. RMFI cooperated with MFDA staff and Staff during their investigation.
21. RMFI reported the issue of the Enhanced Compensation to the Commission following inquiries made by MFDA staff into RMFI's compensation practices.
22. Effective October 28, 2016, RMFI eliminated the Enhanced Compensation to its IRPs.
23. Following the identification of the Enhanced Compensation issue, RMFI has engaged in an extensive review and testing of its systems of control and supervision, and developed enhanced procedures, controls and procedures designed to prevent the reoccurrence of a breach of subsection 4.2(1) of NI 81-105. RMFI has advised Staff that there are no other instances of enhanced compensation to its representatives in breach of subsection 4.2(1) of NI 81-105.

PART V - CONDUCT CONTRARY TO ONTARIO SECURITIES LAW AND THE PUBLIC INTEREST

24. By engaging in the conduct described above, RMFI admits and acknowledges that it has breached Ontario securities law, and that it has acted contrary to the public interest.

25. In particular, during the Material Period, RMFI breached: (i) subsection 4.2(1) of NI 81-105 by providing an incentive for certain of its representatives to recommend certain of the mutual funds of which RMFI was the principal distributor over other mutual funds of which RMFI was a participating dealer, and (ii) section 11.1 of National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* by failing to establish, maintain and apply policies and procedures that establish a system of controls and supervision sufficient to provide reasonable assurance that RMFI and each individual acting on its behalf complies with subsection 4.2(1) of NI 81-105.

PART VI - TERMS OF SETTLEMENT

26. RMFI agrees to the terms of settlement listed below and consents to the Order in substantially the form attached hereto as Schedule "A", which provides that:
- (a) the Settlement Agreement is approved;
 - (b) RMFI is reprimanded, pursuant to paragraph 6 of subsection 127(1) of the Act;
 - (c) RMFI shall:
 - (i) pay an administrative penalty in the amount of \$1,100,000 by wire transfer to the Commission before the commencement of the Settlement Hearing, which amount shall be designated for allocation or for use by the Commission in accordance with subsections 3.4(2)(b)(i) or (ii) of the Act, pursuant to paragraph 9 of subsection 127(1) of the Act; and
 - (ii) pay costs of the Commission's investigation in the amount of \$20,000, by wire transfer to the Commission before the commencement of the Settlement Hearing, pursuant to section 127.1 of the Act.
27. RMFI agrees to attend in person at the hearing before the Commission to consider the proposed settlement.

PART VII - FURTHER PROCEEDINGS

28. If the Commission approves this Settlement Agreement, Staff will not commence any proceeding under Ontario securities law against RMFI in relation to the facts set out in Part III of this Settlement Agreement, subject to paragraph 29 below.
29. If the Commission approves this Settlement Agreement and RMFI fails to comply with any of the terms of the Settlement Agreement, Staff may bring proceedings under Ontario securities law against RMFI. These proceedings may be based on, but need not be limited to, the facts set out in Part III of this Settlement Agreement as well as the breach of the Settlement Agreement.

PART VIII - PROCEDURE FOR APPROVAL OF SETTLEMENT

30. The parties will seek approval of this Settlement Agreement at a public hearing (the “**Settlement Hearing**”) before the Commission scheduled for June 13, 2018 or on another date agreed to by Staff and RMFI, according to the procedures set out in this Settlement Agreement and the Commission’s Rules of Procedure.
31. Staff and RMFI agree that this Settlement Agreement will form all of the agreed facts that will be submitted at the Settlement Hearing on RMFI’s conduct, unless the parties agree that additional facts should be submitted at the Settlement Hearing.
32. If the Commission approves this Settlement Agreement:
- (a) RMFI irrevocably waives all rights to a full hearing, judicial review or appeal of this matter under the Act; and

- (b) neither party will make any public statement that is inconsistent with this Settlement Agreement or with any additional agreed facts submitted at the Settlement Hearing.
- 33. Whether or not the Commission approves this Settlement Agreement, RMFI will not use, in any proceeding, this Settlement Agreement or the negotiation or process of approval of this Settlement Agreement as the basis for any attack on the Commission's jurisdiction, alleged bias, alleged unfairness, or any other remedies or challenges that may otherwise be available.

PART IX - DISCLOSURE OF SETTLEMENT AGREEMENT

- 34. If the Commission does not approve this Settlement Agreement or does not make an order substantially in the form of the Order attached as Schedule "A" to this Settlement Agreement:
 - (a) this Settlement Agreement and all discussions and negotiations between Staff and RMFI before the Settlement Hearing takes place will be without prejudice to Staff and RMFI; and
 - (b) Staff and RMFI will each be entitled to all available proceedings, remedies and challenges, including proceeding to a hearing on the merits of the allegations contained in the Statement of Allegations. Any such proceedings, remedies and challenges will not be affected by this Settlement Agreement, or by any discussions or negotiations relating to this Settlement Agreement.
- 35. The parties will keep the terms of this Settlement Agreement confidential until the Commission approves the Settlement Agreement, except as is necessary to make submissions at the Settlement Hearing. If, for whatever reason, the Commission does not

approve the Settlement Agreement, the terms of the Settlement Agreement shall remain confidential indefinitely, unless Staff and RMFI otherwise agree in writing or if required by law.

PART X - EXECUTION OF SETTLEMENT AGREEMENT

36. This Settlement Agreement may be signed in one or more counterparts which, together, constitute a binding agreement.
37. A facsimile copy or other electronic copy of any signature will be as effective as an original signature.

Dated at Toronto this 8th day of June, 2018.

ROYAL MUTUAL FUNDS INC.

By: *“Michael Walker”*

Name: Michael Walker, President

COMMISSION STAFF

By: *“Jeff Kehoe”*

Jeff Kehoe
Director, Enforcement Branch

SCHEDULE “A” – DRAFT ORDER

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FILE NO.: 2018-31

IN THE MATTER OF ROYAL MUTUAL FUNDS INC.

**ORDER
(Subsections 127(1) and 127.1)**

WHEREAS on June 13, 2018, the Ontario Securities Commission (the “**Commission**”) held a hearing at the offices of the Commission, located at 20 Queen Street West, 17th Floor, Toronto, Ontario to consider the Application made jointly by respect of the Royal Mutual Funds Inc. (“**RMFI**”) and Staff of the Commission for approval of a settlement agreement dated June 8, 2018 (the “**Settlement Agreement**”);

ON READING the Joint Application Record for a Settlement Hearing, including the Statement of Allegations dated June 8, 2018, the Settlement Agreement and the Consent of the parties to an Order in substantially this form, and on hearing the submissions of counsel for both parties;

IT IS ORDERED THAT:

1. The Settlement Agreement is approved pursuant to subsection 127(1) of the Securities Act, RSO 1990, c S.5 (the “**Act**”);
2. RMFI is reprimanded, pursuant to paragraph 6 of subsection 127(1) of the Act; and
3. RMFI shall:
 - i. pay an administrative penalty in the amount of \$1,100,000, which amount shall be designated for allocation or for use by the Commission in accordance with subsections 3.4(2)(b)(i) or (ii) of the Act, pursuant to paragraph 9 of subsection 127(1) of the Act; and
 - ii. pay costs of the Commission’s investigation in the amount of \$20,000, pursuant to section 127.1 of the Act.