FAIR | Canadian Foundation *for* Advancement *of* Investor Rights
Fondation canadienne *pour* l'avancement *des* droits *des* investisseurs

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Paige Ward
General Counsel, Corporate Secretary and Vice President, Policy
Mutual Fund Dealers Association of Canada
121 King Street West, Suite 1000
Toronto, ON M5H 3T9

Sent via email to: pward@mfda.ca

RE: Request for Comment on Proposed MFDA Sanction Guidelines

FAIR Canada is pleased to offer comments in response to MFDA's proposed Sanction Guidelines dated May 2018 (the "Sanction Guidelines") as set out in Bulletin #0749-P dated May 23, 2018.

FAIR Canada is a national, charitable organization dedicated to putting investors first. As a national voice for Canadian investors, FAIR Canada is committed to advocating for stronger investor protections in securities regulation. Visit www.faircanada.ca for more information.

1. General Comments

1.1. The Sanctions Guidelines should be drafted so as to inclusively apply to both Members and individual registrants. Misconduct can occur by both dealer firms and individuals, but the wording often does not appropriately include Members.

Key Factor #1 - General and Specific Deterrence – Need to Reflect the Expectations of the Public

1.2. A given sanction determination necessarily needs to be informed by (i) the purposes of securities regulation – to provide protection to investors from unfair, improper or fraudulent practices and to foster fair and efficient capital markets and confidence in capital markets and (ii) that the purpose of the sanction is protective and preventative rather than punitive and is intended to be exercised to prevent likely future harm.[1] Accordingly, the expectations of the public are an important consideration in

[1] Committee for the Equal Treatment of Asbestos Minority Shareholders v. Ontario (Securities Commission) 2001 S.C.C. 37 at para 41 and 42.

determining the appropriate sanction since a sanction that is too lenient would not foster confidence in our capital markets nor would it be viewed as being an adequate deterrent (whether specific or general). FAIR Canada, therefore, recommends that a critical statement in the Sanction Guidelines should be modified as follows:

"General deterrence may be achieved if a sanction strikes an appropriate balance between a Respondent's specific misconduct and industry ***and the public's*** expectations as to appropriate sanction to be imposed."

Key Factor #2 – Industry [and the Public's] Expectations

1.3. Similarly, key factor #2 should ***be Industry and the Public's Expectations*** not simply industry's. While industry may be amongst those who expect wrongdoers amongst their own ranks to be appropriately sanctioned, the expectations of the public are key to furthering the goals of the disciplinary process.

1.4. It should be clarified that "…excessive sanctions that ***go beyond specific or general deterrence and are punitive in nature***, may reduce respect for the enforcement process."

Key Factor #3 – The seriousness of the allegations proved against the Respondent – was it unintentional, negligence, recklessness or intentional acts, was there undue influence, was the victim vulnerable?

1.5. The wording of this section needs revisions so as to make it clear it applies to both individuals and Member firms. For example, the section on deception should be amended as follows:

"Attempts by the Respondent to conceal his or her *or its* misconduct or to lull into inactivity, mislead, deceive or intimidate an investor*, regulatory authorities or in the case of an individual respondent*, the Member firm *with which he or she is associated*, should be considered an aggravating factor."

1.6. FAIR Canada believes that a key factor should be whether the misconduct was the result of an intentional act, involved recklessness or was an unintentional act of negligence. No qualification is needed for considering this factor only "in appropriate cases".

1.7. *Vulnerable Investors* - Undue influence exerted by a Respondent should be an explicit aggravating factor.

1.8. *Vulnerable Investors* - Investors who are vulnerable because they place a high level of trust or reliance on the Respondent are in need of protection and it should not depend

on the existence or absence of the fact that their reliance is a result of "…a unique or special relationship with him or her [or the Member firm]". We recommend deleting the preceding phrase, accordingly.

1.9. *Premeditation/Concealment* – We recommend adding that concealment of misconduct by a Respondent should be an aggravating factor as should failure to take reasonable steps to implement appropriate controls, including not properly implementing adequate supervisory, , operational and/or technical procedures or controls so as to deter and/or detect wrongful actions or misconduct.

Key Factor #6 – The harm suffered by investors [or risk of harm or losses] as a result of the Respondent's misconduct

1.10. FAIR Canada believes that actual harm or losses to investors as well as the *risk of losses to investors* should be considered a key factor. Simply because a significant risk did not actually materialize in losses, should not detract from considering placing investors at risk of harm or losses as a key factor.

Key Factor #7 – Whether the Respondent voluntarily implemented corrective measures after the misconduct [prior to detection and intervention by a regulator or other authority]

1.11. FAIR Canada believes that corrective measures taken by either the individual or Member should be a factor *if taken prior to detection and intervention by the MFDA or other regulator.* Cooperation and corrective measures taken after detection is expected behaviour of a dealer or individual registrant and should not be considered a mitigating factor.

Key Factor #8 – Whether the Respondent made voluntary acts of compensation, restitution or disgorgement to remedy the misconduct

1.12. Full compensation or restitution to investors for their losses should be a mitigating factor and it is important to encourage such payments. It is critical that such payments be independently assessed and verified to ensure their adequacy. **FAIR Canada recommends that independent assessment of the compensation determination be required as a precondition to treating it as a mitigating factor and also so as to increase confidence in the enforcement process and foster better transparency**.

FAIR Canada also recommends that Respondents (including Members) who under-compensate investors while obtaining releases of their claims should have this behaviour treated as an aggravating factor.

1.13. Disgorgement of ill-gotten profits or gains should be obtained so that individuals or Members do not benefit from their own wrong-doing or breaches of securities laws

and regulations (while disgorgement should not come at the expense of compensating investors and/or should be utilized to help compensate investors). Disgorgement should not be considered a mitigating factor in and of itself, but may be a mitigating or aggravating factor depending on whether the firm arranged its resources so as to facilitate or avoid disgorgement and/or payment of a fine.

1.14. FAIR Canada believes that it would assist in the consistency of sanctions along with their transparency if disgorgement amounts were amounts ordered separately from the amount of a fine. A fine should be separate from an amount ordered to disgorge profits or financial benefit earned. We therefore disagree with the MFDA's statement that "Generally, the amount of a fine should, at a minimum, have the effect of disgorging the amount of the financial benefit received by the Respondent as a result of the misconduct." Rather, the fine should be some amount beyond that, in order to achieve specific and general deterrence and be protective and preventative. Otherwise, the Respondent is only placed back in the position they were in before they committed the wrong but are no worse off – which is wholly inadequate deterrence.

Key Factor #9 – The Respondent's past conduct, including prior sanctions [and client complaint history]

1.15. The Hearing Panel should consider a Respondent's history of client complaints including decisions of the courts and OBSI (number of complaints, severity of harms, amount of losses, patterns of behaviour, failure to implement internal controls or address causes to prevent future occurrences, history of dragging heals in settling with complainants, etc.) in addition to the disciplinary history with securities regulators and SROs. This would include any client complaints associated with the regulatory breaches at issue and how the Respondent has conducted itself in response thereto.

Key Factor 12: The total or cumulative sanction should appropriately reflect the totality of the misconduct [including in situations where there are multiple violations or engaged in the misconduct over an extended period of time without correction]

1.16. The application of the totality principle should depend on the individual facts and circumstances as should the existence of multiple or similar violations being used as an aggravating factor. The wording of the guideline should therefore be revised accordingly. FAIR Canada believes the totality principle is more suitable in situations where breaches were unintentional or negligent and there was no harm or losses as a result to investors and the problem that caused the breach has been addressed so it will not reoccur.[2]

[2] FAIR Canada notes that the United States' Financial Industry Regulatory Authority ("FINRA") treats multiple violations as follows:

Key Factor 13: Ability to pay is [not] a consideration when imposing an appropriate monetary sanction [but severe financial hardship may be, if all requirements and conditions are met]

1.17. The Respondent's inability to pay should only be a relevant consideration where:

(i) it has resulted from the Member or individual paying out compensation to those harmed by the misconduct; and
(ii) payment of the fine over a period of time in installments has been considered and, nonetheless,
(iii) it would result in serious financial hardship,
(iv) it must be proven that there is objectively no ability to pay as a result of serious financial hardship given the amount of net income and net asset which should be objectively set for all cases. For example, the U.K. Financial Conduct Authority states as follows:

"In assessing whether a penalty would cause an individual serious financial hardship, the *FCA* will consider the individual's ability to pay the penalty over a reasonable period (normally no greater than three years). The *FCA's* starting point is that an individual will suffer serious financial hardship only if during that period his net annual income will fall below £14,000 and his capital will fall below £16,000 as a result of payment of the penalty. Unless the *FCA* believes that both the individual's income and capital will fall below these respective thresholds as a result of payment of the penalty, the *FCA* is unlikely to be satisfied that the penalty will result in serious financial hardship."[3] and

(v) If financial hardship is made out, the appropriateness of reducing the sanction will still need to be assessed. All of the circumstances need to be considered

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"Aggregation or "batching" of violations may be appropriate for purposes of determining sanctions in disciplinary proceedings. The range of monetary sanctions in each case may be applied in the aggregate for similar types of violations rather than per individual violation. For example, it may be appropriate to aggregate similar violations if: (a) the violative conduct was unintentional or negligent (i.e., did not involve manipulative, fraudulent or deceptive intent); (b) the conduct did not result in injury to public investors or, in cases involving injury to the public, if restitution was made; or (c) the violations resulted from a single systemic problem or cause that has been corrected.

Depending on the facts and circumstances of a case, however, multiple violations may be treated individually such that a sanction is imposed for each violation. In addition, numerous, similar violations may warrant higher sanctions, since the existence of multiple violations may be treated as an aggravating factor." See May 2018, FINRA Sanctions Guidelines, at 4; available online at http://www.finra.org/sites/default/files/Sanctions_Guidelines.pdf.

[3] Financial Conduct Authority's Handbook, Chapter 6, Penalties at 6.5D2.

including: (i) how much did the individual benefit from the misconduct; (ii) did the individual act fraudulently or dishonestly; or (iii) has money been spent or dissipated in anticipation of enforcement action?

Key Factor #14 – The Respondent's proactive and exceptional assistance to the MFDA only relevant if there is full compensation to investors

1.18. Proactive and exceptional assistance by a Respondent may be considered a mitigating factor in imposing sanctions, but only if accompanied by full compensation of those harmed by the misconduct (as discussed above).

2. <u>Another Key Factor FAIR Canada Recommends Including in the Penalty Guidelines</u>

2.1. ***Additional Key Factor - Whether the Respondent Member had developed adequate training and education initiatives*** – Firms should ensure that their individual registrants have adequate training and education to provide advice and services to their clients. For example, they should have adequate training and education on elder abuse and capacity issues in order to provide services to older, vulnerable investors, and should receive adequate training and education in order to provide appropriate services to new Canadians, as well as education and training so that they can meet their know-your-product requirements.

We thank you for the opportunity to provide our comments and views in this submission. We welcome its public posting and would be pleased to discuss this letter with you at your convenience. Please feel free to contact Frank Allen 647-256-6693/frank.allen@faircanada.ca or Marian Passmore at 647-256-6691/marian.passmore@faircanada.ca if you wish to discuss the foregoing.

Sincerely,

Canadian Foundation for the Advancement of Investor Rights