



MUTUAL FUND DEALERS ASSOCIATION OF CANADA
PENALTY GUIDELINES

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TABLE OF CONTENTS

PURPOSE OF THE MFDA PENALTY GUIDELINES	1
MFDA PENALTY GUIDELINES – PART I.....	2
GENERAL PRINCIPLES.....	2
FACTORS TO BE CONSIDERED IN DETERMINING THE NATURE AND DURATION OF THE PENALTIES	2
<i>Industry expectations</i>	2
<i>The seriousness of the allegations proved against the Respondent</i>	2
<i>The Respondent's past conduct, including prior penalties</i>	3
<i>General and specific deterrence</i>	3
<i>Whether the Respondent recognizes the seriousness of the improper activity</i>	4
<i>The harm suffered by investors as a result of the Respondent's activities</i>	4
<i>The benefits received by the Respondent as a result of the improper activity</i>	4
<i>Previous decisions made in similar circumstances</i>	5
TYPES OF PENALTIES	5
<i>Fine</i>	5
<i>Suspension</i>	5
<i>Permanent Prohibition and Termination</i>	6
<i>Other Penalties</i>	6
<i>Settlement Agreements</i>	6
MFDA PENALTY GUIDELINES – PART II.....	7
BOOKS AND RECORDS	7
COMPLAINT HANDLING	8
CONFLICT OF INTEREST	9
PERSONAL FINANCIAL DEALINGS	10
CHURNING AND EXCESSIVE TRADING	11
FORGERY/FRAUD/THEFT/MISAPPROPRIATION/MISAPPLICATION	12
FINANCIAL REQUIREMENTS	13
OUTSIDE BUSINESS ACTIVITY	14
POLICIES AND PROCEDURES	16
PROVINCIAL SECURITIES REQUIREMENTS (LEGISLATION, ORDERS, TERMS AND CONDITIONS OF REGISTRATION).....	17
REFERRAL ARRANGEMENTS	18
SALES COMMUNICATIONS	19
SUPERVISION.....	20
SUITABILITY & KNOW YOUR CLIENT.....	22
PRODUCT SELECTION/DUE DILIGENCE	24
FAILURE TO COOPERATE.....	25
DISCRETIONARY/UNAUTHORIZED TRADING.....	26
STANDARD OF CONDUCT	27

PURPOSE OF THE MFDA PENALTY GUIDELINES

The MFDA Penalty Guidelines (the “Guidelines”) have been prepared to assist:

- MFDA Staff and Respondents in conducting disciplinary proceedings (including negotiating settlement agreements) pursuant to s. 20 and 24 of MFDA By-law No. 1
- Hearing Panels in the fair and efficient imposition of penalties in settled or contested disciplinary proceedings commenced pursuant to s. 20 and s. 24 of MFDA By-law No.1.

Part I of the Guidelines sets out the general principles that should be considered in penalty decisions in all disciplinary cases. Part I also summarizes the various types of penalties that may be imposed pursuant to s. 24 of MFDA By-law No. 1.

Part II of the Guidelines provides a brief description of the case types that commonly arise. Part II also lists specific factors that are usually applicable to each case type and should be considered in addition to the general principles set out in Part I. Finally, Part II sets out the types and ranges of penalties appropriate to each case type.

Part II is not intended to be exhaustive of all possible case types. Where a disciplinary proceeding involves a case type other than one described in Part II, guidance as to the appropriate types and ranges of penalties to impose may be obtained by way of comparison with one of the existing case types.

Range is Guideline Only

The penalty types and ranges stated in the Guidelines are not mandatory. The Guidelines suggest the types and ranges of penalties that would be appropriate for particular case types. The Guidelines are intended to provide a basis upon which discretion can be exercised consistently and fairly in like circumstances but are not binding on a Hearing Panel.

Depending on the facts and circumstances of a case, MFDA Staff and Hearing Panels may determine that no purpose is served by imposing a penalty within the range stated in the Guidelines; i.e., that a penalty below the stated range, or no penalty at all, is appropriate. Conversely, MFDA Staff and Hearing Panels may determine that egregious misconduct, the need for increased deterrence, or certain policy considerations require the imposition of penalties above or otherwise outside of a stated range. Lastly, the facts and circumstances of a particular case may warrant that penalties of a different type than those stated in the Guidelines are appropriate.

MFDA Staff and Hearing Panels must always exercise judgment and discretion and consider appropriate aggravating and mitigating factors in determining appropriate penalties in every case. In addition, whether the penalties are within or outside of the range stated in the Guidelines, MFDA Staff and Hearing Panels must identify the basis for the penalties imposed.

MFDA PENALTY GUIDELINES – PART I

GENERAL PRINCIPLES

The primary goal of securities legislation is the protection of the investing public.¹

The penalties imposed in a securities regulatory context should be protective and preventative, intended to be exercised to prevent likely future harm to the capital markets.²

When determining the appropriate penalties to impose, the Hearing Panel should have regard to the following general principles:

- (a) The protection of the investing public;
- (b) The integrity of the securities markets;
- (c) Specific and general deterrence;
- (d) The protection of the MFDA's membership; and
- (e) The protection of the integrity of the MFDA's enforcement processes.³

FACTORS TO BE CONSIDERED IN DETERMINING THE NATURE AND DURATION OF THE PENALTIES

The following list of factors should be considered in fashioning an appropriate penalty. This list is illustrative, not exhaustive, and the Hearing Panel should consider case-specific factors in addition to those listed here.

Industry expectations

If a penalty is less than what others in the industry would reasonably expect for the misconduct under consideration, it may undermine the goals of the disciplinary process. Similarly, excessive penalties may reduce respect for the enforcement process and diminish its deterrent effect.⁴

The seriousness of the allegations proved against the Respondent

In appropriate cases, distinctions should be drawn between misconduct that was unintentional or negligent, and misconduct that was manipulative, fraudulent or deceptive. Distinctions should also be drawn between isolated incidents and repeated, pervasive or systemic violations of the MFDA's By-laws, Rules and Policies.

Factors to consider include:

¹ *Pezim v. British Columbia (Superintendent of Brokers)*, [1994] 2 S.C.R. 557 at para. 59.

² *Committee for the Equal Treatment of Asbestos Minority Shareholders v. Ontario (Securities Commission)*, [2001] 2 S.C.R. 132 at para. 42.

³ *Re Parkinson*, [2005] MFDA Ontario Regional Council, File No. 200501 at p. 21.

⁴ *Re Mills*, [2001] I.D.A.C.D. No. 7.

Deception – Attempts by the Respondent to conceal his or her misconduct or to lull into inactivity, mislead, deceive or intimidate a client, the Member or regulatory authorities.

Vulnerable clients – If there is evidence that the Respondent sought out or preyed upon “vulnerable” clients, then this should be seen as an aggravating factor worthy of a greater penalty. The MFDA disciplinary process must protect the investing public and in particular those clients with a lower level of investment knowledge or sophistication and those who place a high level of trust or reliance in a Respondent because of a unique or special relationship with him or her. The corollary is not true however: the fact that a client who was victimized by the Respondent is a sophisticated investor is not a mitigating factor.

Prior warnings – The Hearing Panel should consider whether the Respondent engaged in the misconduct at issue notwithstanding prior warnings or concerns expressed by the MFDA, another regulator, a supervisor or other individual.

Pre-meditation – Evidence of planning and pre-meditation are aggravating factors. Hearing Panels should consider the degree of organization and planning associated with the misconduct, including the number, size and character of the transactions.

The Respondent's past conduct, including prior penalties

Hearing Panels should consider a Respondent’s relevant disciplinary history in determining penalties. Relevant disciplinary history may include (a) past misconduct similar to that at issue; or (b) past misconduct that, while unrelated to the misconduct at issue, demonstrates prior disregard for regulatory requirements, investor protection or commercial integrity.

Past misconduct includes prior MFDA disciplinary proceedings, as well as warning letters and Agreements and Undertakings entered into with the MFDA. It may also include disciplinary measures imposed by other regulators and licensing tribunals, including terms and conditions or other restrictions placed on the Respondent.

Generally, Hearing Panels should impose progressive or escalating penalties on a Respondent for each successive instance of misconduct.

The fact that a Respondent has no prior disciplinary record should, in the absence of evidence to the contrary, lead a panel to a presumption that the Respondent was of good moral character prior to the misconduct. A good employment or internal discipline record is usually considered to be a mitigating factor because it demonstrates responsibility and compliance with regulatory requirements.

In certain cases, the misconduct at issue may be serious enough to nullify the mitigating effect of a clean disciplinary history or employment record.

General and specific deterrence

Deterrence refers to the imposition of a sanction for the purpose of discouraging the Respondent and others from engaging in similar conduct. When deterrence is aimed at the Respondent, it is

called “specific deterrence”, when directed at others, “general deterrence”. Investors must be able to rely on and have trust in the integrity and capability of mutual fund industry participants. Without effective deterrence, inappropriate conduct can continue and public confidence in the mutual fund industry and the fairness of the markets can be seriously damaged.⁵ An appropriate penalty will achieve both specific and general deterrence.⁶

A general deterrent is preventative. The notion of general deterrence is neither punitive nor remedial. A penalty that is meant to generally deter is a penalty designed to discourage or hinder like behaviour in others. It is therefore reasonable to consider general deterrence as a factor in imposing an appropriate penalty.⁷

Approved Persons and Members have significant responsibilities that they must meet if investors are to be protected and market integrity maintained. Approved Persons and Members who choose to act in ways that threaten the integrity of the capital markets must have the expectation that they will be held accountable through enforcement action by regulators.

General deterrence can be achieved if a penalty strikes an appropriate balance between a Respondent’s specific misconduct and industry expectations as to an appropriate penalty to be imposed. General deterrence serves to improve overall standards in the securities industry.

Whether the Respondent recognizes the seriousness of the improper activity

An admission of wrongdoing may also be a mitigating factor if it saves the MFDA and affected clients from a lengthy, complicated or expensive hearing. The extent of the cooperation provided by a Respondent during the course of the investigation and prosecution of the misconduct may also be a mitigating factor. Attempts by the Respondent to improperly frustrate, delay or undermine the investigation or hearing are aggravating factors.

The harm suffered by investors as a result of the Respondent's activities

Actual harm can sometimes be quantified by considering the types of transactions, the number of transactions, the size of the transactions, the number of clients affected by the misconduct, the length of time over which the misconduct took place and the size of the loss suffered by the client(s), other individuals or the Member. Harm can also be measured using less empirical, but more subjective factors, such as the impact of the misconduct on a client’s life (from an emotional, physical and/or mental perspective), the reputation of the Member and the reputation of the mutual fund industry or capital markets as a whole.

The benefits received by the Respondent as a result of the improper activity

Hearing Panels should consider the extent to which the Respondent received a financial or other benefit from the misconduct, whether directly or indirectly. Restitution or disgorgement of such

⁵ *Re Marc Lamoureux*, [2002] A.S.C.D. No, 125.

⁶ *Re Mills*, [2001] I.D.A.C.D. No. 7.

⁷ *Re Cartaway Resources Corp.*, [2004] 1. S.C.C. 672 at para. 60.

benefits by the Respondent is a mitigating factor. The extent of the mitigating value is affected by the timing: the sooner, the better; as well as the extent: full or partial.

Previous decisions made in similar circumstances

The amount of a fine or other penalty depends on the facts of each case, including the need for specific and general deterrence. While prior decisions are instructive, the nature and extent of the penalty to be imposed in a given case cannot necessarily be determined by comparison with the penalties imposed in similar proceedings.

TYPES OF PENALTIES

Fine

Although fines are frequently imposed in disciplinary proceedings, they are not required in all cases. A fine will normally be appropriate where the Respondent has received a financial or other benefit, whether directly or indirectly, as a result of the misconduct. Generally, the amount of the fine should reflect, at a minimum, the amount of the financial benefit. The amount of client loss or harm may also be a relevant consideration in determining the amount of a fine. The amount of the fine may be decreased or increased depending on the presence of mitigating or aggravating factors. As noted in the preceding section, any disgorgement or restitution made by the Respondent will normally be considered a mitigating factor in determining the amount of a fine.

A fine may also be appropriate in cases where there is no financial or other benefit to the Respondent. In such cases, the amount of the fine should be commensurate with the seriousness of the misconduct. In the most egregious cases, Hearing Panels should consider the maximum fines permitted under s. 24 of MFDA By-law No.1. The financial resources of the Respondent should also be taken into account in determining the appropriate fine. A fine must not be tantamount to a licensing fee to engage in the misconduct.

Suspension

The suspension of the rights and privileges of membership of a Member or the authority of an Approved Person to conduct securities related business may be appropriate where:

- there have been numerous serious transgressions;
- there has been a pattern of misconduct;
- the Respondent has a disciplinary history;
- the misconduct in question has caused some measure of harm to the integrity of the securities industry as a whole; or
- a fine alone would be insufficient or inappropriate.

The length of the suspension will also depend on these and other relevant factors.

Permanent Prohibition and Termination

Permanent prohibition of the authority of an Approved Person to conduct securities related business or termination of the membership of a Member are severe economic penalties and should generally be reserved for cases where any one or more of the following factors is present:

- the public itself has been abused;
- the Respondent is ungovernable or refuses to cooperate with regulatory bodies;
- the misconduct has an element of criminal or quasi-criminal activity;
- the likelihood of recurrence is high;
- the Respondent's conduct is such that it would undermine the public's confidence in the mutual fund industry or the MFDA's ability to regulate; or
- there is reason to believe that the Respondent could not be trusted to act in an honest and fair manner when dealing with the public, clients and other participants in the securities industry.

Other Penalties

To address misconduct effectively in any given case, a Hearing Panel may also impose any one or more of the following penalties:

- a reprimand;
- conditions on the authority of an Approved Person to conduct securities related business (e.g. rewrite appropriate industry course);
- terms and conditions on the membership of a Member;
- the appointment of a monitor to oversee and/or report on the Member's activities; or
- directions for the orderly transfer of client accounts from the Member.

Settlement Agreements

The agreement as to facts and the admission of wrongdoing that are requirements of any settlement under s. 24.4 of By-law No. 1 are usually considered to be mitigating factors since they save the MFDA and affected clients from a lengthy, complicated or expensive hearing.

In considering a settlement agreement, a Hearing Panel may accept an agreement that contains requirements to be fulfilled by the Respondent that are in addition to the penalties that a Hearing Panel could impose under s. 24 of MFDA By-law No. 1.

MFDA PENALTY GUIDELINES – PART II

The penalty types and ranges stated in the Guidelines are not mandatory. The Guidelines suggest the types and ranges of penalties that would be appropriate for particular case types. The Guidelines are intended to provide a basis upon which discretion can be exercised consistently and fairly in like circumstances but are not binding on a Hearing Panel.

<u>BOOKS AND RECORDS</u>	
<p>Every Member shall keep such books and records and other documents as are necessary for the proper recording of its business transactions and financial affairs and the transactions that it executes on behalf of others. The books and records to be kept are set out in MFDA Rule 5.1.</p>	
SPECIFIC FACTORS TO CONSIDER	PENALTY TYPES & RANGES
<ol style="list-style-type: none"> 1. The nature of the inaccurate or missing information. 2. The materiality of the inaccurate or missing information. 3. The extent of any client losses. 4. Whether there was an intentional disregard for the requirements or if the failure was due to carelessness or inadvertence. 	<p>Member:</p> <ul style="list-style-type: none"> • Fine: Minimum of \$15,000. • Interim order pursuant to s. 24.3 of MFDA By-law No. 1. • Suspension. • Termination in egregious cases. <p>Approved Person:</p> <ul style="list-style-type: none"> • Fine: Minimum of \$5,000. • Write or rewrite an appropriate industry course (e.g. IFIC Officers', Partners' and Directors' Course or Canadian Investment Funds Course). • Suspension. • Permanent prohibition in egregious cases.

COMPLAINT HANDLING

Every Member shall maintain a log of client complaints and shall establish written policies and procedures for dealing with client complaints that ensure that such complaints are dealt with promptly and fairly, in accordance with MFDA Rule 2.11. Members and Approved Persons must also ensure that all client complaints are handled in accordance with MFDA Policy No. 3. Under Policy No. 3, an Approved Person is required, among other things, to ensure that all complaints and pending legal actions are made known to the compliance officer at head office. Policy No. 3 also prohibits an Approved Person from entering into a settlement with a client without the prior written consent of the Member and from imposing confidentiality restrictions on a client as part of the resolution of a dispute.

SPECIFIC FACTORS TO CONSIDER	PENALTY TYPES & RANGES
<ol style="list-style-type: none"> 1. The number and nature of complaints. 2. The duration of the period during which complaints were not properly recorded or dealt with. 3. The delay in responding to complaints. 4. The extent of any client losses. 5. Whether there was an intentional disregard for the requirements or if the failure was due to carelessness or inadvertence. 6. Whether the Respondent misled or deceived the complainant as to the validity of the complaint. 	<p>Member:</p> <ul style="list-style-type: none"> • Fine: Minimum of \$10,000. <p>Approved Person:</p> <ul style="list-style-type: none"> • Fine: Minimum of \$5,000. • Write or rewrite an appropriate industry course (e.g. IFIC Officers', Partners' and Directors' Course or Canadian Investment Funds Course). • Suspension. • Permanent prohibition in egregious cases.

CONFLICT OF INTEREST

MFDA Rule 2.1.4 requires that each Member and Approved Person 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. In the event that such a conflict or potential conflict of interest arises, the Approved Person must immediately bring the conflict or potential conflict of interest to the attention of the Member and the Member and the Approved Person must ensure that it is addressed by the exercise of responsible business judgment influenced only by the best interests of the client.

Responsible business judgment requires the use of reasonable care and diligence as necessary in the circumstances to address the conflict or potential conflict of interest in the best interests of the client. The exercise of responsible business judgment will vary depending on the nature of the conflict of interest and the client’s circumstances.

See also the sections in these Guidelines for the following specific types of conflict of interest: Personal Financial Dealings, Outside Business Activity, Churning and Referral Arrangements.

SPECIFIC FACTORS TO CONSIDER	PENALTY TYPES & RANGES
<ol style="list-style-type: none"> 1. Whether the activity was an isolated incident or part of a larger pattern of conduct involving multiple clients. 2. Whether the conflict of interest was adequately explained to the client. 3. Level of client sophistication: did the client understand the nature and significance of the conflict of interest? 4. Whether the conflict of interest was brought to the attention of the Member. 5. Whether the Respondent was aware of the prohibited nature of the activity. 6. Whether the Respondent concealed or attempted to conceal the activity from the client and/or the Member. 7. Whether the client was harmed by the activity and if so, to what extent. 	<p>Member:</p> <ul style="list-style-type: none"> • Fine: Minimum of \$25,000. • Suspension. • Termination in egregious cases. <p>Approved Person:</p> <ul style="list-style-type: none"> • Fine: Minimum of \$5,000. • Write or rewrite an appropriate industry course (e.g. IFIC Officers’, Partners’ and Directors’ Course or Canadian Investment Funds Course). • Suspension. • Permanent prohibition in egregious cases.

PERSONAL FINANCIAL DEALINGS

Personal financial dealings with a client should be avoided as they create a potential for the Approved Person to place his/her own interests above those of the client. Examples of personal financial dealings with clients include:

- 1) borrowing from clients;
- 2) lending to clients;
- 3) private investment schemes with clients;
- 4) involvement in outside business activities with clients; and
- 5) monetary or non-monetary benefits to or from clients.

Each Member must develop policies and procedures to ensure that it is aware in advance of any personal financial or business dealings between Approved Persons and clients.

See also the section in these Guidelines for Conflicts of Interest generally.

SPECIFIC FACTORS TO CONSIDER	PENALTY TYPES & RANGES
<ol style="list-style-type: none"> 1. Whether there were circumstances which may make the offensive activity less objectionable – pre-existing/family relationship between client and the Respondent. 2. Whether the activity was an isolated incident or part of a larger pattern of conduct involving multiple clients. 3. Whether the conflict of interest was explained to the client. 4. Whether the conflict of interest was disclosed to the Member and its consent obtained. 5. Whether the Respondent was aware of the prohibited nature of the activity. 6. Level of client sophistication: client’s ability to appreciate conflict of interest and provide informed consent. 7. Whether the Respondent concealed or attempted to conceal the activity from the client and/or the Member. 8. Whether the client was harmed by the activity and if so to what extent. 	<ul style="list-style-type: none"> • Fine: Minimum of \$10,000. • Write or rewrite an appropriate industry course (e.g. Canadian Investment Funds Course). • Period of increased supervision for 12 to 24 months. • Suspension. • Permanent prohibition in egregious cases.

CHURNING AND EXCESSIVE TRADING

Excessive trading, “churning” or “overtrading” is a practice whereby an Approved Person recommends a trade or multiple trades in a client’s account for the purpose of generating sales commissions, increasing trailer fees, extending DSC periods or otherwise creating a benefit for the Approved Person, where there is little or no rationale for the trade(s) or where the trade(s) will have little or no economic benefit for the client.

See also the section in these Guidelines for Conflicts of Interest generally.

SPECIFIC FACTORS TO CONSIDER	PENALTY TYPES AND RANGES
<ol style="list-style-type: none">1. Length of time churning took place.2. Extent of churning (i.e. number and value of trades).3. Number of clients subject to churning.4. Existence of any client losses.5. Whether the Respondent misled the client as to the reasons for the trade(s).6. Whether the Respondent concealed or attempted to conceal the activity from the client and/or the Member.	<ul style="list-style-type: none">• Fine: Minimum of \$10,000.• Write or rewrite an appropriate industry course (e.g. Canadian Investment Funds Course).• Minimum 12 months increased supervision.• Suspension.• Permanent prohibition in egregious cases.

FORGERY/FRAUD/THEFT/MISAPPROPRIATION/MISAPPLICATION

This category involves deceptive activities intended to deprive a person of property or rights.

Forgery is the creation of a false document with the intent that it be acted upon as the original or genuine document, where the victim is deprived of property or rights.

Fraud is generally defined as an act of deceiving and misrepresenting, more specifically an intentional distortion of truth in order to induce another to part with something of value or to surrender a legal right.

Theft is the taking of property, not rightfully in one’s possession, for personal use and exploitation.

Misappropriation is where a person has a right to be in possession of the property but puts it to his/her own benefit.

Misapplication of Funds is where funds in the rightful possession of an Approved Person or Member are put to an improper purpose for the benefit of a third party.

SPECIFIC FACTORS TO CONSIDER	PENALTY TYPES & RANGES
<ol style="list-style-type: none"> 1. Nature of circumstances and conduct. 2. Client knowledge/consent. 3. Loss to client (s). 4. The Respondent’s intent. 5. Whether the Respondent was unjustly enriched and obtained/attempted to obtain a financial benefit from the fraudulent conduct. 6. Whether the Respondent concealed or attempted to conceal the activity from the Member or the MFDA. 	<p>Member:</p> <ul style="list-style-type: none"> • Fine: Minimum of \$100,000. • Interim order pursuant to s. 24.3 of MFDA By-law No. 1. • In almost all cases termination of Membership will be sought. • Fine should include the amount of any financial benefit to the Respondent. <p>Approved Person:</p> <ul style="list-style-type: none"> • Fine: Minimum of \$25,000. • In almost all cases a permanent prohibition will be sought. • Fine should include the amount of any financial benefit to the Respondent.

FINANCIAL REQUIREMENTS

Members must operate in accordance with the financial and operations requirements set out in MFDA Rule 3. Rule 3 requirements are designed to enhance investor protection. Rule 3 requires Members, among other things, to:

- Have and maintain at all times risk adjusted capital greater than zero. If at any time the risk adjusted capital of a Member is, to the knowledge of such Member, less than zero, the Member must immediately notify the MFDA;
- Maintain minimum capital in the amounts required by the Rules;
- Hold client cash, securities or property separate and apart from the Member’s own property and in trust for the clients in accordance with Rule 3.3;
- Make monthly and annual filings in accordance with Rule 3.5.

Senior management of a Member is responsible for the continuous monitoring of the capital position of the Member to ensure that the risk adjusted capital is maintained as prescribed and must document such monitoring at least monthly. Senior management of the Member must take prompt action to avert or remedy any projected or actual capital deficiency and report any deficiency immediately to the appropriate regulators.

Rule 4 requires every Member to maintain Financial Insurance Bond or Bonds as insurance against losses arising in certain situations.

SPECIFIC FACTORS TO CONSIDER	PENALTY TYPES & RANGES
<ol style="list-style-type: none"> 1. Amount of capital deficiency relative to capital employed. 2. Duration of capital deficiency. 3. Length of time to correct deficiency. 4. Whether the deficiency was reported promptly by Member or discovered by the MFDA, external auditors or other party. 5. Cause of capital deficiency – careless or inadvertent error or intentional or reckless disregard for requirements. 6. Whether the Member concealed or attempted to conceal deficiencies or inaccuracies. 	<p>Member:</p> <ul style="list-style-type: none"> • Fine: Minimum of \$25,000. • Suspension (where deficiency is result of deliberate or reckless disregard for requirements). • Interim order pursuant to s. 24.3 of MFDA By-law No. 1. • Termination in egregious cases. <p>Approved Person:</p> <ul style="list-style-type: none"> • Fine: Minimum of \$10,000. • Write or rewrite an appropriate industry course (e.g. IFIC Officers’, Partners’ and Directors’ Course or Canadian Investment Funds Course). • Suspension. • Permanent prohibition in egregious cases.

OUTSIDE BUSINESS ACTIVITY

“Outside business activity” means any business carried on by an Approved Person other than business done on behalf of the Approved Person’s Member. Outside business activity may involve business activity that is securities related or non-securities related.

Securities related business. MFDA Rule 1.1.1 requires that all “securities related business” must be conducted through the Member, with exceptions for the sale of deposit instruments not on account of the Member and the activities of bank employees conducted in accordance with the *Bank Act*. “Securities related business” is defined in By-law No. 1 to mean any business or activity that constitutes trading or advising in securities for the purposes of applicable securities legislation in any jurisdiction in Canada. This includes securities sold pursuant to exemptions under applicable securities legislation.

Apart from the specific exceptions in Rule 1.1.1, Approved Persons are prohibited from selling or advising on any investments that would be considered securities under applicable legislation through any entity other than the Member (often referred to as “selling away” or “off book trading”).

Non-securities related business. Pursuant to MFDA Rule 1.2.1(d) an Approved Person can only be gainfully employed in a dual occupation provided that:

- the Approved Person is permitted by legislation to devote less than his or her full time to the business of the Member for which he or she acts on behalf of;
- the activity is not prohibited by a securities commission in the jurisdiction in which the Approved Person carries on business;
- the Member is aware of and has approved the outside activity;
- the Member has appropriate procedures to ensure continuous service to clients and to address potential conflicts of interest;
- the activity does not bring the MFDA, its Members, or the mutual fund industry into disrepute;
- clear disclosure is provided to clients that any activities related to such other gainful occupation are not business of the Member and are not the responsibility of the Member.

See also the section in these Guidelines for Conflicts of Interest generally.

SPECIFIC FACTORS TO CONSIDER	PENALTY TYPES & RANGES
<ol style="list-style-type: none"> 1. Magnitude (in size and value) of outside business activity. 2. Number of clients affected. 3. Magnitude of client losses. 4. Suitability of outside business activity if involving securities. 5. Compensation received by the Respondent. 6. Any personal interest of the 	<ul style="list-style-type: none"> • Fine: Minimum of \$10,000. • Write or rewrite an appropriate industry course (e.g. Canadian Investment Funds Course). • Period of increased supervision. • Suspension. • Permanent prohibition in egregious cases (e.g. undisclosed activity resulting in client loss).

<p>Respondent in outside business activity.</p> <ol style="list-style-type: none">7. Whether the Respondent had honest but mistaken belief that proper approval obtained.8. Legality of outside activity.9. Whether outside activity resulted directly or indirectly in injury to clients of the Member and, if so, the nature and extent of the injury.10. Whether the marketing and sale of the product or service could have created the impression that the Member had approved the product or service.11. Whether the Respondent misled the Member about the existence of the outside activity or otherwise concealed the activity from the Member.	
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POLICIES AND PROCEDURES

Rule 2.10 requires Members to establish and maintain written policies and procedures (that have been approved by senior management) for dealing with clients and ensuring compliance with the Rules, By-laws and Policies of the MFDA and applicable securities legislation.

In addition, Members must establish and maintain internal controls in accordance with the internal control policy statements in Policy No. 4. Internal control is defined as:

“Internal control consists of the policies and procedures established and maintained by management to assist in achieving its objective of ensuring, as far as practical, the orderly and efficient conduct of the entity’s business. The responsibility for ensuring adequate internal control is part of management’s overall responsibility for the ongoing activities of the entity.” (CICA Handbook, 5200.03)

Members must maintain a detailed written record containing the specific policies and procedures approved by senior management to comply with MFDA Internal Control Policy Statements. These policies and procedures must be reviewed and approved in writing by senior management at least annually for their adequacy and suitability. The establishment and maintenance of adequate internal controls is management’s responsibility.

Approved Persons must comply with the policies and procedures as well as the internal controls established by the Member.

SPECIFIC FACTORS TO CONSIDER	PENALTY TYPES & RANGES
<ol style="list-style-type: none"> 1. Extent and nature of internal control inadequacy (e.g. capital requirement control, insurance or client funds/securities segregation or safekeeping problem). 2. Intentional or reckless disregard for requirements, or whether due to carelessness or inadvertence. 	<p>Member:</p> <ul style="list-style-type: none"> • Fine: Minimum of \$25,000. • Suspension. • Termination in egregious cases. <p>Approved Person:</p> <ul style="list-style-type: none"> • Fine: Minimum of \$5,000. • Write or rewrite an appropriate industry course (e.g. IFIC Officers’, Partners’ and Directors’ Course or Canadian Investment Funds Course). • Suspension. • Permanent prohibition in egregious cases.

PROVINCIAL SECURITIES REQUIREMENTS
(LEGISLATION, ORDERS, TERMS AND CONDITIONS OF REGISTRATION)

Members and Approved Persons must ensure that their conduct is in accordance with the relevant *Securities Act(s)*, and any applicable Regulations, Policies, Interpretation Notes or Bulletins enacted thereto, as well as any Orders made against the Members and Approved Persons or any terms and conditions placed on their registrations. More generally, Members and Approved Persons have obligations to not knowingly participate in, nor assist in, any act in contravention of any applicable law, rule, or regulation of any government, governmental agency or regulatory agency governing his/her professional, financial or business activities. This conduct may cover a very wide range of offences and various principles and penalties may be appropriate.

SPECIFIC FACTORS TO CONSIDER	PENALTY TYPES & RANGES
<ol style="list-style-type: none"> 1. Seriousness of legislative breach. 2. Client(s) knowledge/consent. 3. Loss to client(s). 4. Respondent's intent. 5. Whether the Respondent was unjustly enriched and obtained/attempted to obtain a financial benefit. 6. Whether the Respondent concealed or attempted to conceal their conduct from the Member or the MFDA. 	<p>Member:</p> <ul style="list-style-type: none"> • Fine: Minimum of \$10,000. • Interim order pursuant to s. 24.3 of MFDA By-law No. 1. • Suspension. • Termination in egregious cases. <p>Approved Person:</p> <ul style="list-style-type: none"> • Fine: Minimum of \$5,000. • Write or rewrite an appropriate industry course (e.g. IFIC Officers', Partners' and Directors' Course or Canadian Investment Funds Course). • Suspension. • Permanent prohibition in egregious cases.

REFERRAL ARRANGEMENTS

A referral arrangement is “an arrangement whereby a Member is paid or pays a fee . . . for the referral of a client to or from another person”, but does not include payments made to third party service providers that do not deal directly with clients and are not engaged in securities related business. An Approved Person is not permitted to enter into a referral arrangement in respect of securities related business.

There is a potential conflict of interest in all paid referral arrangements because the individual that makes the referral has a financial interest in introducing the client to the other service provider. Clients must be given sufficient information to appreciate the extent of the conflict before the referral takes place. In addition, controls must be put in place to ensure that clients are not misled as to the nature of the relationship between the referring parties, or as to any licensing limitations of the parties to the arrangements.

Referrals of Specific Securities

Additional issues arise where a referral is tied to a specific security rather than a general service. In many cases, the specific securities in respect of the referrals are not securities that the Member is appropriately registered or licensed to sell directly. This may result in Members and Approved Persons giving advice and making recommendations with respect to the specific security without having the required licensing or proficiency to do so.

Conversely, where the Member is appropriately registered or licensed to sell the security directly, the Member should not be entering into a referral arrangement with another entity with respect to the security but should sell the security for the account of the Member and through the facilities of the Member.

SPECIFIC FACTORS TO CONSIDER	PENALTY TYPES & RANGES
<ol style="list-style-type: none"> 1. Magnitude (in size and value) of referrals. 2. Number of clients affected. 3. Magnitude of client losses (if any). 4. Suitability of referrals if involving securities. 5. Compensation received by the Respondent. 6. Any personal interest of the Respondent in referral. 7. Existence of client complaints. 8. Legality of referral. 	<p>Member:</p> <ul style="list-style-type: none"> • Fine: Minimum of \$25,000. • Suspension. • Termination in egregious cases. <p>Approved Person:</p> <ul style="list-style-type: none"> • Fine: Minimum of \$10,000. • Write or rewrite an appropriate industry course (e.g. IFIC Officers’, Partners’ and Directors’ Course or Canadian Investment Funds Course). • Suspension. • Permanent prohibition in egregious cases.

SALES COMMUNICATIONS

MFDA Rule 2.7.3 requires that all advertisements and sales communications be approved by a designated partner, director, officer, compliance officer or branch manager before they are issued. The definition of “advertisement” in Rule 2.7.1 includes television or radio commercials or commentaries, billboards, internet websites, newspapers and magazine advertisements or commentaries and any published material promoting the business of a Member and any other sales literature disseminated through the communications media.

The rationale for requiring approval prior to the distribution of advertisements or sales literature is to ensure that no misleading, inaccurate and otherwise prohibited information is provided to a client who may act upon such information in making investment decisions.

In addition, all client communications must be in accordance with National Instrument 81-105.

SPECIFIC FACTORS TO CONSIDER	PENALTY TYPES & RANGES
<ol style="list-style-type: none"> 1. Whether materials distributed would have received approval by Member. 2. Materiality of misrepresentations or prohibited information, if any, contained in materials. 3. Whether misrepresentations are likely to bring the mutual fund industry into disrepute. 4. Whether client(s) acted upon misrepresentations or prohibited information contained in materials. 5. Whether the Respondent had honest but mistaken belief that approval was obtained. 6. Number of clients in receipt of materials. 	<ul style="list-style-type: none"> • Fine: Minimum of \$2,500. • Period of increased supervision. • Suspension (where material misrepresentations and/or other prohibited information contained in materials.)

SUPERVISION

Supervision focuses on the prevention and detection of breaches of the standard of conduct and the statutory and regulatory obligations of Members and Approved Persons. Supervision encompasses the process of training Approved Persons, monitoring their performance and establishing policies, procedures and internal controls geared to ensuring that:

- The Member has hired appropriately qualified and trained compliance staff;
- The Member has adequately implemented its policies, procedures and internal controls to fulfill its statutory and regulatory training and supervision obligations;
- Approved Persons are aware of their statutory and regulatory obligations and the policies and procedures of the Member;
- A two tier supervision process has been implemented by the Member to monitor the conduct of Approved Persons and attempt to prevent and detect breaches of statutory and regulatory obligations and the policies and procedures of the Member;
- Sufficient records are being maintained by Approved Persons to facilitate supervision and demonstrate to the Member’s compliance staff and regulators that Approved Persons are fulfilling their statutory and regulatory obligations (e.g. NAAFs, LTAs, records of instructions, transaction records, etc.); and
- Sufficient records are being maintained by the Member and the Approved Persons responsible for supervision to demonstrate that their supervisory obligations are being fulfilled (e.g. evidence of trade reviews, new account approval, inquiries made, responses received and action taken).

In all cases where an Approved Person engages in misconduct, the MFDA will investigate to determine if a supervisory failure, whether in the form of an inadequacy in the procedures for supervision or in the actual supervision of others, permitted the misconduct to occur or was a contributing factor. Penalties may be imposed on the Member, senior management, compliance officers and supervisory personnel where such failures are found.

SPECIFIC FACTORS TO CONSIDER	PENALTY TYPES & RANGES
<ol style="list-style-type: none"> 1. Extent of inadequacy in the procedures for supervision or the actual supervision of employee(s). 2. Extent of employee(s) misconduct. 3. Amount of losses or compensation for which the Member is liable as a result of the employee(s) misconduct. 4. “Red flag” warnings that should have been caught by a proper system of 	<p>Member:</p> <ul style="list-style-type: none"> • Fine: Minimum of \$25,000. • Condition that Member demonstrate that its supervisory practices meet MFDA standards; additional monthly fine until the MFDA is satisfied. • Appointment of a monitor to oversee and report on Member’s activities.

<p>supervision or follow-up.</p> <p>5. Corrective measures taken since discovery of problem.</p> <p>6. Intentional or reckless disregard for requirements, or whether due to carelessness or inadvertence.</p>	<ul style="list-style-type: none"> • Terms and Conditions on Member. • Suspension. • Termination in egregious cases. <p>Approved Person:</p> <ul style="list-style-type: none"> • Fine: Minimum of \$10,000. • Write or rewrite an appropriate industry course (e.g. IFIC Officers', Partners' and Directors' Course). • Conditions on Approved Person. • Suspension. • Permanent prohibition in egregious cases.
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SUITABILITY & KNOW YOUR CLIENT

Members and Approved Persons are required 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. Know-Your-Client requirements are a fundamental part of meeting basic suitability obligations.

The “Know-Your-Client” obligation is the obligation to learn about and appropriately document the client’s personal financial situation, financial sophistication and investment experience, investment objectives and risk tolerance. The “suitability” obligation includes the obligation to determine whether an investment is appropriate for a particular client at the time the recommendation is made or remains appropriate when the account is transferred to a different Member or to a different Approved Person at the same Member. Both the Approved Person and the Member must meet the “know your client” and “suitability” obligations.

The requirement to update a NAAF is a corollary to the Know-Your-Client rule. All material information about a client should be reflected in the client’s account documentation. The account documentation should be updated to reflect any material changes to the client’s status in order to assure the suitability of investment recommendations.

The suitability obligation also includes the requirement to make clients aware of the risks associated with a specific product or investment strategy, including the use of leverage.

SPECIFIC FACTORS TO CONSIDER	PENALTY TYPES & RANGES
<p>Suitability</p> <ol style="list-style-type: none"> 1. Extent of research conducted by the Approved Person with respect to the recommended security. 2. Magnitude of losses directly attributable to the unsuitable recommendations. 3. The number of clients affected. 4. The level of sophistication of the clients. 5. The existence of any pattern of making unsuitable recommendations. 6. Presence of any ulterior motive (i.e. financial gain to the Respondent). 7. Evidence that client was misled as to the suitability of the investment. 8. Evidence that Approved Person attempted to cover-up or conceal unsuitable investments. <p>Know Your Client</p>	<ul style="list-style-type: none"> • Fine: Minimum of \$10,000. • Write or rewrite an appropriate industry course (e.g. Canadian Investment Funds Course). • Period of increased supervision. • Suspension. • Termination in egregious cases. • Permanent prohibition in egregious cases.

<ul style="list-style-type: none">9. Nature and extent of failure to know your client.10. Magnitude of losses directly attributable to the failure to know your client.11. The level of sophistication of the client.12. Extent of due diligence conducted to determine the essential facts of the client.	
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PRODUCT SELECTION/DUE DILIGENCE

Members must perform a reasonable level of due diligence on products prior to their approval for sale by Approved Persons. Members must have written policies and procedures in place that describe in detail the steps to be followed in the due diligence process.

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. The approval process must be independent and objective. The Member must maintain records sufficient to demonstrate that it followed its due diligence process on each product.

SPECIFIC FACTORS TO CONSIDER	PENALTY TYPES & RANGES
<ol style="list-style-type: none"> 1. Extent of due diligence conducted with respect to the security. 2. Magnitude of losses directly attributable to the security. 3. The number of clients affected. 4. Presence of any ulterior motive (i.e. financial gain to the Respondent). 	<p>Member:</p> <ul style="list-style-type: none"> • Fine: Minimum of \$25,000. • Condition that Member demonstrate that its procedures and practices meet MFDA standards; additional monthly fine until the MFDA is satisfied. • Suspension or termination in egregious cases. <p>Approved Person:</p> <ul style="list-style-type: none"> • Fine: Minimum of \$10,000. • Write or rewrite an appropriate industry course (e.g. IFIC Officers', Partners' and Directors' Course or Canadian Investment Funds Course). • Suspension. • Permanent prohibition in egregious cases.

FAILURE TO COOPERATE

Section 22.1 of By-law No. 1 provides that for the purpose of an examination or investigation conducted by the MFDA, a Member, Approved Person or other person under the jurisdiction of the MFDA may be required to:

1. submit a report concerning the matters under investigation;
2. to produce relevant books records and accounts;
3. to attend and give information respecting the matter under investigation; and
4. to make the above available through any directors, officers, employees, agents and other persons under the jurisdiction of the MFDA.

Failure to cooperate with an MFDA investigation, whether by a Member or an Approved Person, is serious misconduct because it subverts the MFDA’s ability to perform its regulatory function. This category of misconduct is broad enough to include the following:

- failure to cooperate or respond in a timely manner;
- failure to respond truthfully;
- failure to cooperate or respond completely; and
- misleading the MFDA during an investigation.

SPECIFIC FACTORS TO CONSIDER	PENALTY TYPES AND RANGES
<ol style="list-style-type: none"> 1. Whether the contravention was intentional or inadvertent. 2. Whether there was complete or only partial non-compliance. 3. The impact that the non-compliance had on the investigation. 4. Whether the Respondent can demonstrate that the refusal to cooperate was based on reasonable reliance on competent legal advice. 	<ul style="list-style-type: none"> • Fine: Minimum of \$50,000. • Termination of Member or permanent prohibition of an Approved Person. • Interim order pursuant to s. 24.3 of MFDA By-law No. 1.

DISCRETIONARY/UNAUTHORIZED TRADING

Unauthorized Trading is the practice whereby a Member or Approved Person makes trades without the client’s knowledge or approval.

Discretionary Trading is the practice whereby a Member or Approved Person is granted authority by the client to make a trade without obtaining specific instructions from the client prior to the execution of the trade concerning one or more of the elements of the trade: the selection of the security to be purchased or sold, the amount of the security to be purchased or sold and the timing of the trade.

Under the terms of their registration, Members and Approved Persons are not permitted to engage in unauthorized trading or discretionary trading.

SPECIFIC FACTORS TO CONSIDER	PENALTY TYPES AND RANGES
<ol style="list-style-type: none">1. Number of trades.2. Whether client provided verbal authority to engage in discretionary trading.3. Underlying reason for engaging in trading. (e.g. For personal financial gain).4. The number of clients affected.5. Period of time over which the trading took place.6. Suitability of trades.7. Magnitude of client losses.	<ul style="list-style-type: none">• Fine: Minimum of \$5,000.• Period of increased supervision.• Write or rewrite an appropriate industry course (e.g. Canadian Investment Funds Course).• Suspension.• Permanent prohibition in egregious cases.

STANDARD OF CONDUCT

Rule 2.1.1 provides that Members and Approved Persons shall comply with a general standard of conduct. In accordance with the Rule, each Member and each Approved Person of a Member shall;

- (a) deal fairly, honestly and in good faith with its clients;
- (b) observe high standards of ethics and conduct in the transaction of business;
- (c) not engage in any business conduct or practice which is unbecoming or detrimental to the public interest; and
- (d) be of such character and business repute and have such experience and training as is consistent with the standards described in this Rule 2.1.1, or as may be prescribed by the Corporation.

The standard of conduct rule has a broad application. It provides for a standard that is able to encompass misconduct that is not directly captured in the Rules. It is applicable in situations where there is no specific rule that prohibits the misconduct or where there is a specific rule breach but the conduct is also below the standard expected in the industry. In egregious cases, this may include a failure to service clients in a prompt and reasonable manner.

SPECIFIC FACTORS TO CONSIDER	PENALTY TYPES & RANGES
<ol style="list-style-type: none"> 1. Nature of the circumstances and conduct. 2. Number of individuals affected. 3. Whether the conduct is likely to bring the individual, the Member or the mutual fund industry into disrepute. 	<p>Member:</p> <ul style="list-style-type: none"> • Fine: Minimum of \$5,000. • Interim order pursuant to s. 24.3 of MFDA By-law No. 1. • Suspension. • Termination in egregious cases. <p>Approved Person:</p> <ul style="list-style-type: none"> • Fine: Minimum of \$5,000. • Write or rewrite an appropriate industry course (e.g. IFIC Officers', Partners' and Directors' Course or Canadian Investment Funds Course). • Suspension. • Permanent prohibition in egregious cases.