Mutual Fund Dealers Association of Canada
Association canadienne des courtiers de fonds mutuels

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CASE SUMMARY # 201115
January 16, 2013

MFDA Case Summary

Enforcement

This case summary was prepared by Staff of the MFDA.

Hearing Panel imposes permanent prohibition and $500,000 fine on Thomas G. Arseneau

Nature of Proceeding

A Hearing Panel of the Atlantic Regional Council of the Mutual Fund Dealers Association of Canada ("MFDA") has imposed disciplinary penalties on Thomas G. Arseneau ("Arseneau"), a former Approved Person of the MFDA.

By-Laws, Rules, Policies Violated

Following a hearing on June 26 and 27, and July 31, 2012, the Hearing Panel found that:

(a) in about May 2007, Arseneau failed to observe high standards of ethics and conduct in the transaction of business and be of such character and business repute as is consistent with the standards prescribed by MFDA Rule 2.1.1 when he falsely reported on a loan application, which he submitted to a lender, that client KA owned a cottage property which she did not in fact own in order to increase the likelihood that the lender would provide an investment loan to client KA;

(b) between 2004 and 2007, Arseneau misrepresented, or failed to fully and adequately explain, the risks and benefits of leveraged investment recommendations that he made to at least 20 clients, thereby failing to ensure that the leveraged investment recommendations were suitable and appropriate for clients and in keeping with their investment objectives, contrary to MFDA Rules 2.2.1 and 2.1.1;

(c) between 2004 and 2007, Arseneau failed to ensure that his leveraged investment recommendations were suitable and appropriate for the clients and in keeping with their investment objectives, contrary to MFDA Rules 2.2.1 and 2.1.1, when he made leveraged investment recommendations to: (i) at least 12 clients which were not suitable and appropriate having regard to the relevant "Know Your Client" factors including, but not limited to, the clients' ability to afford the costs associated with the investment loans; and (ii) at least 12 clients which were not suitable and appropriate having regard to the requirements regarding the use of leveraging set out in the Member's policies and procedures; and

(d) between 2004 and 2008, Arseneau relied upon the lender's decision to approve the investment loans for 120 clients as the determination that the leveraging recommendations were suitable for those clients, without performing his own assessment of the suitability of the leveraging recommendations that he made to the clients, contrary to MFDA Rules 2.2.1, 2.5.1 and 2.1.1.

MFDA Rule 2.1.1 states:

Standard of Conduct. 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.

MFDA Rule 2.2.1 states, in part:

"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;
(c) to ensure that each order accepted or recommendation made for any account of a client is suitable for the client based on the essential facts relative to the client and any investments within the account;
(d) to ensure that, notwithstanding the provisions of paragraph (c), where a transaction proposed by a client is not suitable for the client based on the essential facts relative to the client and the investments in the account, the Member or Approved Person has so advised the client before execution thereof and the Member or Approved Person has maintained evidence of

such advice; …

MFDA Rule 2.5.1 states:

> **Member Responsibilities.** Each Member is responsible for establishing, implementing and maintaining policies and procedures to ensure the handling of its business is in accordance with the By-laws, Rules and Policies and with applicable securities legislation.

Penalty

The Hearing Panel imposed the following penalties and costs: (a) a permanent prohibition; (b) a fine of $500,000; and (c) costs of $20,000.

Summary of Facts

Registration History

From May 2005 to December 2009, Arseneau was registered in New Brunswick, Nova Scotia, Ontario, and Quebec as a mutual fund salesperson with Investia Financial Services Inc. ("Investia"). Arseneau was terminated by Investia on December 21, 2009. He is not currently registered in the securities industry.

Allegation #1 – Falsification of an Asset on a Loan Application

On May 31, 2007, Arseneau prepared a loan application for client KA in which client KA applied for a $25,000 investment loan (the "Loan Application"). In the assets section of the Loan Application, Arseneau reported that client KA owned a cottage property worth $63,000. Arseneau submitted the Loan Application to a lender. The lender approved the loan and the funds were used to purchase mutual funds for client KA's account.

Client KA did not own the cottage property listed in the assets section of the Loan Application. Arseneau added the asset to the Loan Application to increase client KA's net worth so that she could qualify for the loan. In addition, Arseneau submitted a Borrowing to Invest – Suitability Analysis Form to Investia, which falsely reported that client KA met Investia's net worth requirement regarding the use of borrowed monies to invest.

Allegation #2 – Misrepresentations and Failure to Explain the Risks and Benefits of Leveraging

Between 2004 and 2007, Arseneau recommended a leveraged investment strategy (the "Leveraged Investment Strategy") to 20 clients whereby the clients obtained investment loans in order to purchase return of capital ("ROC") mutual funds. The Leveraged Investment Strategy was based on the premise that the ROC mutual funds would generate proceeds each month which would pay the costs associated with the investment loans, and clients would therefore not incur any out-of-pocket expenses with respect to the strategy. To the extent that the proceeds generated by the ROC mutual funds exceeded the monthly costs associated with the investment loans, the excess amounts would be applied to the principal of the investment loans each month in order to pay them down faster. Based upon Arseneau's representations, the clients applied for, and obtained, investment loans totaling $2,150,000 in order to implement the Leveraged Investment Strategy.

In the course of recommending the Leveraged Investment Strategy, Arseneau misrepresented, or failed to explain the risks and benefits of, the strategy as set out below.

First, Arseneau told the clients that the ROC mutual funds pay distributions each month which would be sufficient to pay (or greater than) the costs associated with the investment loans, and the clients would therefore not incur any out-of-pocket expenses with respect to the strategy. Arseneau did not tell the clients that there were any risks that the mutual funds might reduce or suspend the payment of distributions in the event that the mutual funds failed to generate sufficient returns. Commencing in December 2008, the ROC mutual funds purchased by the clients reduced distributions by approximately 40-70 percent. In most instances, the proceeds from the ROC mutual funds were insufficient to pay the costs associated with the investment loans and clients were forced to incur out-of-pocket expenses.

Second, Arseneau told the clients that the investment loans would be paid off by the proceeds from the ROC mutual funds in approximately 7-12 years. The investment loans were, in fact, typically amortized over a period of 20 years. Arseneau did not explain to clients that a reduction or suspension in the payment of proceeds would prevent clients from repaying the loans faster than required or at all.

Third, Arseneau told the clients that the ROC mutual funds purchased with the investment loans would continue to grow in value over time and, once the investment loans were repaid, the clients would own the underlying investments which would continue to generate proceeds for use by the clients. Arseneau did not tell the clients about any risk that the ROC mutual funds might decline in value over time, particularly if the clients did not reinvest the proceeds paid to them. The ROC mutual funds purchased by the clients declined in value during the period at issue in this proceeding.

Fourth, Arseneau either told the clients that the Leveraged Investment Strategy was low risk or did not tell the clients that there were any risks associated with it. There were a number of risks associated with the Leveraged Investment Strategy which Arseneau did not disclose. These risks included: (a) the distributions paid by the ROC mutual funds could decline which could prevent the Leveraged Investment Strategy from paying for itself; (b) the value of the ROC mutual funds could decline over time; (c) the costs of borrowing may exceed the distributions generated by the ROC mutual funds and the clients could be forced to incur out-of-pocket expenses in order to sustain the Leveraged Investment Strategy; (d) as the clients' circumstances changed, the clients may not be able to afford the costs associated with the investment loans; and (e) leveraging can magnify the losses incurred by the clients.

Allegation #3 – Unsuitable Leveraging Recommendations

Between May 2005 and November 2008, Arseneau recommended to the 20 clients who submitted complaints to the MFDA that these clients apply for, and obtain, one or more investment loans in order to purchase mutual funds.

Twelve of the 20 clients were unable to afford the costs associated with the investment loans once the distributions generated by the ROC mutual funds were insufficient to pay for them. In addition, Arseneau's leveraging recommendations were not suitable for 12 of the 20 clients having regard to the requirements set out in Investia's policies and procedures.

Allegation #4 – Relying Upon the Lender to Determine Suitability

Between May 2005 and November 2008, 120 clients obtained investment loans based upon Arseneau's recommendations, which generated more than $10 million for the purchase of mutual funds.

Arseneau recommended the investment loans to clients without determining whether the clients satisfied the criteria identified in Investia's policies and procedures. Instead, Arseneau relied upon the lender's decision to approve the loans without performing his own assessment of the suitability of the leveraging recommendations.

Notwithstanding that Arseneau relied upon the lender's decision to approve the loans as a substitute for his own obligation to assess the suitability of the Leveraged Investment Strategy, he structured his leveraging recommendations and practices to avoid, or limit the scope of, the lenders' review of the client's circumstances. In particular, Arseneau recommended that clients apply for loans in increments of $50,000 or less to avoid scrutiny of the client's financial situation by the lenders, and thereby increase the likelihood that the lenders would approve the loans. At the time he recommended the loans, Arseneau was aware that loans of $50,000 or less were subject to an abbreviated review and approval process by the lenders.

For greater detail, see the Decision and Reasons, dated September 28, 2012, posted on the MFDA's website in the "Enforcement" section under "Completed Cases".

DM #324356