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

IN THE MATTER OF A DISCIPLINARY HEARING
PURSUANT TO SECTIONS 20 AND 24 OF BY-LAW NO. 1 OF
THE MUTUAL FUND DEALERS ASSOCIATION OF CANADA

Re: Muchoki Fungai Simba

Heard: February 6, 2012 in Toronto, Ontario
Decision and Reasons: February 20, 2012

DECISION AND REASONS

Hearing Panel of the Central Regional Council:

Martin L. Friedland, C.C., Q.C.	Chair
Robert J. Guilday	Industry Representative
Guenther W. K. Kleberg	Industry Representative

Appearances:

Michelle Pong	)	For the Mutual Fund Dealers Association of Canada
	)	
Muchoki Fungai Simba	)	Not in attendance personally or by counsel
	)	

Background

1. Muchoki Fungai Simba ("the Respondent") was a mutual fund and insurance salesperson with Canfin Magellan Investments Inc. ("Canfin" or "the Member") from 1998 to November 18, 2009. Canfin is a distributor of mutual funds and GICs. The Respondent's position as a salesperson was terminated on November 18, 2009, a few days after BS, a former client of Canfin, had informed Canfin that she had previously loaned $49,000 to the Respondent and that $43,400 of the loan remained outstanding.

2. On November 20, 2009, Canfin demanded that the Respondent return all client files, as he was required to do under the Canfin rules. The Respondent did not do so. The request was repeated on other occasions, but the files were never returned.

3. On November 30, 2009, Canfin informed the Mutual Fund Dealers Association ("MFDA") about the loan by BS. The MFDA commenced an investigation and interviewed the Respondent on September 21, 2010. The Respondent was not very forthcoming in the interview, forgetting many financial and other details, and refusing to divulge names of other clients who may have loaned him money.

4. The Respondent undertook to provide these details to the MFDA, as he was required to do under section 22 of MFDA By-law No. 1. He did not, however, provide the MFDA with this information, even after numerous requests from staff to do so and after the Respondent said on a number of occasions that he would send the documents. "I will act to get these to you pronto," he said in a typical e-mail on October 4, 2010. On November 2, 2010, he claimed to have tried to send the documents by e-mail, stating: "Tried to delivered docs but was returned." The MFDA replied: "Why don't you courier them to me instead?" On January 4, 2011, the Respondent e-mailed: "Got docs ready for courier. Fedex." They were never received by the MFDA.

The Allegations

5. On October 31, 2011 the MFDA commenced disciplinary proceedings against the Respondent. There were three allegations:

(a) Allegation #1: Between February 14, 2006 and November 18, 2009, the Respondent engaged in personal financial dealings with client BS by borrowing a total of $49,000 from client BS, of which amount the Respondent failed to repay or otherwise account for $43,400, contrary to MFDA Rules 2.1.4 and 2.1.1.

(b) Allegation #2: Commencing on or about November 20, 2009, the Respondent failed to return all client files and property of the Member and its affiliates to the Member, thereby:

i) failing to comply with MFDA Rules 1.1.2, 1.1.5(f) and 2.1.1
ii) failing to comply with the Member's policies and procedures, contrary to MFDA Rules 1.1.2, 2.5.1 and 2.1.1; and
iii) interfering with the Member's ability to comply with the requirements of MFDA Rule 5.1 to keep such books, records and documents as are necessary for the proper recording of its business transactions, financial affairs and the transactions it executes on behalf of others, contrary to MFDA Rules 1.1.2, 2.5.1 and 2.1.1.

(c) Allegation #3: Commencing on or about September 24, 2010, the Respondent failed to provide information and produce documentation requested by Staff of the MFDA ("MFDA Staff") during the course of an investigation, contrary to section 22.1 of MFDA By-law No. 1.

6. The MFDA rules provide that a Respondent must enter a reply within 20 days of service of the Notice of Hearing. There were repeated requests for a reply, but no reply was sent by the Respondent.

The Hearing

7. The Respondent did not participate at the set date hearing on December 7, 2011, although given notice of it. The present hearing was set for February 6, 2012. The Respondent was given repeated notices of this hearing, but did not attend in person or by counsel.

8. When a Respondent fails to deliver a reply, a hearing panel may "proceed with the hearing without further notice to and in the absence of the Respondent" or "accept the facts alleged and conclusions drawn by the Corporation in the Notice of Hearing as proved," or both.

9. We requested that counsel for the MFDA proceed with the hearing in the absence of the Respondent.

10. We are fully satisfied that all three allegations, with some slight modification to allegation 2, have been proved.

Borrowing Money from a Client

11. There is no doubt that the Respondent borrowed money from BS and failed to repay it. The funds were to be used to assist the Respondent in repairing a house in which the Respondent had an interest. He gave BS monthly payments until April 2007 and then stopped giving her payments.

12. Canfin was never informed of the loan and did not know about it until BS complained about the fact that money was still owing.

13. Borrowing money from clients is a clear conflict of interest under MFDA Rule 2.1.4, which states: "Each Member and Approved Person shall be aware of the possibility of conflicts of interest arising between the interests of the Member or Approved Person and the interests of the client. Where an Approved Person becomes aware of any conflict or potential conflict of interest, the Approved Person shall immediately disclose such conflict or potential conflict of interest to the Member."

14. The present case and many other MFDA cases show the danger of borrowing from clients. There are many such cases on the MFDA website. See, for example, some of those decided in 2011: *Carmel Toussaint* in September 2011; *James Woloshen* in June 2011; *Michael Ryan* in April 2011; and *Christopher Jones* in February 2011. As the panel stated in the *Ryan* case: "Borrowing money from a client has consistently been held by other panels to be a conflict of interest under Rule 2.1.4...even though borrowing is not specifically mentioned in the Rules."

15. The MFDA Member Regulation Notice 0047, dated October 3, 2005, takes a hard line on borrowing from clients, stating: "Borrowing from a client by either the Member or Approved Person raises a significant and direct conflict that in almost all cases will be impossible to resolve in favour of the client. While such activity is not explicitly prohibited under MFDA rules, MFDA staff are unaware of any circumstances where Members or Approved Persons proposing to enter into any such arrangements would be able to demonstrate that the conflict has been properly dealt with."

16. The Respondent admitted in his interview with the MFDA that he had borrowed the money from BS, that it was against the rules, and that he did not tell Canfin about the loan:

> Interviewer: "[S]o you borrowed the $49,000 from [BS] in 2006. Did you advise Canfin at the time that you were borrowing money from a client?"
>
> Mr. Simba: "No."
>
> Interviewer: "Did you know at the time, in 2006, that it was against the rules of Canfin?"
>
> Mr. Simba: "Yes."...
>
> Interviewer: "Okay. So you knew it was against the rules?"
>
> Mr. Simba: "I knew that there were a number of activities – like, even in terms of my involvement in other businesses that were against the rules of Canfin, let's say the code of ethics, yes."

17. During the interview the Respondent admitted that he had borrowed money from several other clients (MB and RT), but was unable to confirm the details of the loans or provide supporting documentation at the interview.

18. Borrowing from BS is in breach of Rule 2.14 and, in the circumstances of this case, all subsections of Rule 2.1.1. Those rules are as follows:

19. Rule 2.1.4 (a), as set out above, states under the heading "Conflicts of Interest": "Each Member and Approved Person shall be aware of the possibility of conflicts of interest arising

between the interests of the Member or Approved Person and the interests of the client. Where an Approved Person becomes aware of any conflict or potential conflict of interest, the Approved Person shall immediately disclose such conflict or potential conflict of interest to the Member."

20. Rule 2.1.1 states under the heading "Standards 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."

Failure to Return Canfin's Property

21. Canfin had demanded on several occasions that the Respondent return his files to Canfin. The Respondent did not do so. Section 1.1.5 (f) of the MFDA rules states that "all books and records prepared and maintained by the agent in respect of such business of the Member shall be in accordance with Rule 5 [the requirement for records] and applicable legislation, shall be the property of the Member and shall be available for review by and delivery to the Member during normal business hours."

22. The failure to allow Canfin to see the records is a breach of section 1.1.5 (f) and also section 2.1.1.

23. Allegation 2 (b) and (c) relating to allowing Canfin to see the records has caused us some difficulty because each subsection includes a reference to Rule 1.1.2, and appears to assume that section 1.1.2 deals with compliance with By-laws and Rules of the Member. Rule 1.1.2 states: "Each Approved Person who conducts or participates in any securities related business in respect of a Member...shall comply with the By-laws and Rules as they relate to the Member or such

Approved Person." We think that the words "By-laws and Rules" relate solely to those of the MFDA. The definition of those words in MFDA By-law No. 1 are consistent with our interpretation.

24. At our request, MFDA counsel examined whether any MFDA cases discuss Rule 1.1.2 in any depth. Although the combination of Rule 1.1.2 and Rule 2.5.1 has been used in recent years in many cases to cover breach of a member's policies, only one case has carefully explored Rule 1.1.2 – the *Laverdiere* case in 2010. There, a MFDA tribunal in B.C. stated (paragraph 10): "An Approved Person is required to comply with the supervisory policies and procedures established, implemented and maintained by a Member under Rule 2.5.1. The Respondent's failure to do so in this case was a breach of his obligation under MFDA Rule 1.1.2." As we said above, we have doubts about linking those two sections.

25. The *Laverdiere* tribunal, however, went on to state (paragraph 11): "Further, where an Approved Person fails to comply with the Member's Policies and Procedures, he engages in conduct which falls below the acceptable standard of conduct required of the Approved Person as prescribed by MFDA Rule 2.1.1(b)." That Rule, as set out above in paragraph 18, provides that each Member and each Approved Person of a Member shall "observe high standards of ethics and conduct in the transaction of business." It is not the breach of *any* Member rule that can be considered MFDA misconduct, but it is limited to conduct where the Respondent does not "observe high standards of ethics and conduct in the transaction of business."

26. We agree with the aspect of the *Laverdiere* decision discussed in paragraph 23 and therefore uphold the charges under (b) and (c) of Allegation 2 because a reference is made in each subsection to Rule 2.1.1. The references to Rule 1.1.2 are, in our opinion, unnecessary, and should not be included in our Order.

Failure to Cooperate with the MFDA

27. The failure to cooperate with the MFDA is in the circumstances of this case the most serious allegation. Non-cooperation made it very difficult for the MFDA to gather evidence on other persons who may have lent money to the Respondent and to uncover other matters of concern to the MFDA.

28. The interviewer asked about other persons who the Respondent had borrowed from that were clients of Canfin. The respondent gave a number of names. He said that he was unsure whether other persons who gave him money were clients who he borrowed from or who became clients after they gave him money.

> Mr. Simba: "I just want to make sure – I'm just trying to make sure the order of the activity, that's why."
>
> Interviewer: "Sure."
>
> Mr. Simba: "Because there could easily be about 90 people that I've done business with in that fashion over the years, right?..."
>
> Interviewer: "But would you agree what you were saying before, I'd asked you if they were Canfin clients first and then you borrowed money from them. So it's either life insurance or mutual funds."
>
> Mr. Simba: "That's what I'm trying to make sure, that the order, right?...You know, I'll endeavour to get...those names to you and I'll review the process...."
>
> Interviewer: "So agree to undertake to provide names and/or documents of Canfin clients that you borrowed money from?"
>
> Mr. Simba: "Yes."

29. As stated earlier, those names were never given to the MFDA or to Canfin. There were likely many people that he loaned money to or borrowed money from. At one point in the interview, the Respondent was asked about a specific loan and the Respondent replied: "Like I said, I can give you – if I give you every single solitary detail about all the – and name all the names, it will be – you could write in fine print and fill up this table, right?"

30. A particularly disturbing use of funds given to the Respondent by a number of people to invest on their behalf involved a very high risk endeavour operating out of Ohio in the United States, which is now the subject of a civil action in the State of Ohio by the U.S. Commodity Futures Trading Commission. (See *U.S. Commodity Futures Trading Commission v. Complete Developments LLC et al* on the Commission's website.) Mr. Simba received funds from a number of persons and invested on their behalf, although not in their names, in a foreign

exchange scheme, which the Commodity Futures Trading Commission alleges was a "Ponzi" scheme. Monthly interest payments of 12% *a month* were promised by the organizers for those who invested $50,000 or more. Eighty per cent of the capital was said to be "guaranteed."

31. Not surprisingly, this "too good to be true" scheme collapsed and everybody, including Mr. Simba and his father, appears to have lost their money. Whether they will get anything back in various class actions remains to be seen. The scheme was explored in some detail in the interview. Many persons likely invested in the Ohio scheme through Mr. Simba:

> Interviewer: "Okay. You said you invested and several other people invested in [the Ohio scheme]. Other than [Mr. T.] was there anybody else who gave you money?"
>
> Mr. Simba: "Yes, many."
>
> Interviewer: "Those other people, are they Canfin clients?"
>
> Mr. Simba: "No. That's why I said I wanted to make sure that I get that – previously when I indicated to you the names, I want to make sure."

32. The amount invested was likely considerable:

> Interviewer: "Was there any specific dollar amount that you might have participated in with [the Ohio scheme]? Like, either your money or anybody else's money?"
>
> Mr. Simba: "Through myself with my name documented, there may have been—there might be anywhere between 65 to $140,000; with other entities, it could be as high as $700,000."

33. The Respondent knew it was a high risk investment:

> Interviewer: "[G]oing back as a mutual fund agent, what level of risk would you give these investments?"
>
> Mr. Simba: "They were high – see, based upon the document indicating 80 percent guarantee, right, when you look at the history of the company and you look at that number, you tend to weigh the risk with the possibility of the reward. And thus, it

was a calculation that may have been made in sand, but – but it obviously sounded more sound than it proved to be, based upon the 80 percent guarantee, yes."

Interviewer: "So you would say it's a very high risk investment?"

Mr. Simba: "In hindsight, one would say yes. And the process when it's working and proving to be successful, it would say, well, okay, if they had paid out, let's say the 80 percent, it would have proven to be a low risk investment."

34. He was asked by counsel, who attended the interview, about his investigation of the Ohio scheme:

Counsel: "Okay. Now, back to [the Ohio scheme]...what type of due diligence did you conduct?"

Mr. Simba: "None."

Counsel: "None?"

Mr. Simba: "Yes."

Counsel: "So what made you decide to invest your money into [the Ohio scheme]?"

Mr. Simba: "When I let's say looked at [the Ohio scheme], my concern, obviously was the history and the effectiveness...I did not go through the process of trying to determine whether or not [the Ohio scheme] fit me or, you know, the – I didn't do that process. Because for me, what I – I saw what I liked, what motivated me and that's really what compelled me to take action."

35. Mr. Simba undertook to supply the names of Canfin clients. None was provided to the MFDA. We find that the Respondent has failed to provide information and produce documentation request by Staff of the MFDA, contrary to section 22.1 of MFDA By-law No. 1. Allegation 3 has therefore been proved.

Penalty

36. This is a clear case for a permanent prohibition on the Respondent conducting securities-related business in any capacity while in the employ of or associated with any Member of the

MFDA, pursuant to section 24.1.1 (e) of MFDA By-law No. 1. We therefore order such a prohibition.

37. We also agree with the MFDA counsel that costs in the amount of $7,500 attributable to conducting the investigation and hearing, should be imposed on the Respondent, pursuant to section 24.2 of MFDA By-law No. 1.

38. What should the fine be? The Respondent's conduct was egregious. He repeatedly borrowed money from clients, knowing that it was against Canfin's policy and against the MFDA Rules. He did not tell the Member what he was doing. Moreover, he refused to cooperate fully with the Member or the MFDA. He undertook to provide information to the MFDA, but did not do so. This resulted in the MFDA not being fully aware of the extent of his improper conduct. Some of the conduct involved investing clients' money in very high risk endeavours.

39. MFDA staff have suggested a fine of "at least $125,000." The fine in this case is likely symbolic and cannot be collected. But what if it could be? We think that the fine should be very substantial to indicate the seriousness of the conduct and have decided that a fine of $250,000 be imposed.

40. We would like to thank Ms. Michelle Pong for her clear and helpful presentation.

DATED this 20th day of February, 2012.

"Martin L. Friedland"
Martin L. Friedland, C.C., Q.C.,
Chair

"Robert J. Guilday"
Robert J. Guilday,
Industry Representative

"Guenther W. K. Kleberg"
Guenther W. K. Kleberg,
Industry Representative

Doc 280064