



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

**IN THE MATTER OF A SETTLEMENT HEARING  
PURSUANT TO SECTION 24.4 OF BY-LAW NO. 1 OF  
THE MUTUAL FUND DEALERS ASSOCIATION OF CANADA**

**Re: Worldsource Financial Management Inc**

Heard: July 14, 2010 in Toronto, Ontario  
Reasons for Decision: August 3, 2010

**REASONS FOR DECISION**

Hearing Panel of the Central Regional Council:

The Hon. Fred Kaufman, C.M., Q.C.  
Guenther Kleberg  
Brigitte Geisler

Chair  
Industry Representative  
Industry Representative

Appearances:

Shelly Feld )  
) For the Mutual Fund Dealers Association of  
) Canada

David Di Paolo )  
) For the Respondent (the Respondent's  
) president, Andrew Mitchell, and its Chief  
) Compliance Officer, Rick Kenney, also  
) appeared at the hearing)

## **FACTS**

1. As detailed in the Settlement Agreement produced at the hearing, the facts which gave rise to this case are as follows:

### **Registration History**

6. The Respondent is registered as a Mutual Fund Dealer in all 10 Canadian provinces and as an Exempt Market Dealer in the provinces of Ontario and Newfoundland and Labrador.

7. The Respondent became a Member of the MFDA on May 10, 2002.

### **The 2004 MFDA Compliance Examination**

8. In July 2004, the MFDA completed its first compliance examination of the Respondent (the “2004 Examination”) which included an assessment of compliance by the Respondent with MFDA By-laws, Rules and Policies for the period from February 1, 2003 to January 31, 2004. The 2004 Examination included a review of the Respondent’s head office as well as 3 branch locations. The findings of the 2004 Examination were reported to the Respondent in the MFDA Compliance Examination Report dated July 5, 2004 (the “2004 MFDA Report”).

9. The 2004 MFDA Report identified, among other things, deficiencies relating to the Respondent’s failure to establish and implement adequate procedures and controls in the following areas:

- (a) Approval of new accounts;
- (b) Completeness and approval of KYC information and amendments; and
- (c) Excessive trading or switching by Approved Persons in client accounts.

(these three deficiencies are collectively referred to below as the “Deficiencies”)

10. The MFDA required the Respondent to describe the steps it had taken, or intended to take, to address all of the deficiencies identified in the 2004 MFDA Report.

11. Between August 2004 and December 2004, the MFDA and the Respondent exchanged communications regarding the Respondent's plans to address the deficiencies in the 2004 MFDA Report.

12. The plans included changes to the Respondent's policies and procedures.

### **The 2006 Compliance Examination**

13. In January, 2006, the MFDA undertook a second compliance examination of the Respondent (the "2006 Examination") which included an assessment of compliance by the Respondent for the period from February 1, 2004 to December 31, 2005. The 2006 Examination included a review of the Respondent's head office as well as 3 branch locations. The findings of the 2006 Examination were reported to the Respondent in the MFDA Compliance Examination Report dated May 26, 2006 (the "2006 MFDA Report").

14. The 2006 MFDA Report identified, among other things, the Deficiencies that were previously identified in the 2004 MFDA Report which had not been fully remedied.

15. The 2006 MFDA Report also identified a pattern of excessive trading conducted by Leo O'Brien, an Approved Person who was subsequently the subject of an MFDA disciplinary proceeding.<sup>1</sup> Mr. O'Brien was terminated by the Respondent on September 1, 2006.

16. MFDA Compliance Staff referred the results of the 2006 MFDA Report to MFDA Enforcement Staff for possible disciplinary action.

### **Agreement and Undertaking**

17. On April 20, 2007, in consideration of the MFDA foregoing enforcement action, the Respondent signed an Agreement and Undertaking with the MFDA (the "2007 Agreement") in which the Respondent agreed to:

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<sup>1</sup> On May 15, 2008, the MFDA issued a Notice of Hearing against O'Brien. The allegations concerned excessive trading by O'Brien who had processed 166 switches in 22 client accounts over a 14 month period between April 2005 and June 2006 using limited trading authorizations without obtaining instructions from clients. By Order of the Hearing Panel dated November 25, 2008, O'Brien received a lifetime ban from the mutual fund industry and was ordered to pay a fine of \$60,000 and costs of \$5,000.

- (a) Develop and implement an action plan (the “Action Plan”) to remedy:
  - (i) the Deficiencies; and
  - (ii) certain other deficiencies that had been identified in the 2006 MFDA examination report such as the requirement to properly identify all leveraged accounts on the Respondent’s back office system and the obligation to ensure that each client who borrowed money to invest received a copy of an appropriately worded leverage disclosure document; and
- (b) Retain an independent consultant (the “Consultant”) at its own expense to test whether the deficiencies described in paragraph 17(a) above had been rectified, identify any new deficiencies and report its findings to the MFDA.

18. The Action Plan that the Respondent prepared to address the Deficiencies required the Respondent to produce certain reports and implement desk audit processes designed to enable the Respondent’s compliance staff, through a sampling process, to:

- (a) review for timely approval of new accounts and KYC amendments;
- (b) confirm that the KYC information including KYC amendments are accurately recorded on its back office system; and
- (c) identify possible patterns of excessive trading by its Approved Persons.

19. The Consultant retained by the Respondent completed testing in August 2007 and submitted a report to the MFDA dated September 28, 2007 (the “Consultant’s Report”) outlining its findings and recommendations.

20. The Consultant’s Report revealed that although the Respondent had implemented some new procedures in accordance with the Action Plan, the Respondent’s new procedures were insufficient to satisfactorily address the Deficiencies.

21. The Respondent did not initially request a copy of the Consultant’s Report. In November 2007, after the MFDA opened an investigation concerning the findings in the Consultant’s Report, the Respondent requested and obtained a copy of the report.

22. On March 25, 2008, during the course of its investigation, MFDA Enforcement Staff conducted an on-site examination of the Respondent to determine whether the Deficiencies were resolved during the four months following the end of the period examined by the Consultant. The examination covered the period from September 1, 2007 to December 31, 2007. MFDA Enforcement Staff did not report their findings to the Respondent following the examination. MFDA Staff identified the following issues during their testing:

- (a) Desk audits did not contain evidence of timely review, details of follow-up on issues identified, details of resolution of issues identified, or timely follow-up on information requested from Branch Managers/Approved Persons; and
- (b) The Respondent was not producing some of the reports that it had agreed in the Action Plan to produce to review for excessive trading.

#### **Bulk Transfer of Coast Capital Investments' Accounts**

23. On March 4, 2008, the MFDA received a request from Coast Capital Investments for approval to transfer its client accounts and Approved Persons to the Respondent.

24. By letter dated March 17, 2008, the MFDA provided written confirmation to the Respondent that the MFDA was not prepared to approve the proposed transaction as a result of outstanding compliance issues at the Respondent. The MFDA further advised that once the compliance issues had been satisfactorily addressed, it would reconsider the application.

25. In response, the Respondent informed the MFDA that the Respondent had implemented additional new procedures to address the Deficiencies. The Respondent revised the Action Plan to incorporate its additional new procedures and agreed to retain the Consultant to complete further testing and report to the MFDA.

26. On April 4, 2008, the Consultant completed further testing covering the period from January 1, 2008-February 28, 2008.

27. On April 6, 2008, the Consultant submitted a report to the MFDA (the "2008

Consultant's Report"). The Consultant's Report stated that since the Consultant's first examination, the Respondent had made marked improvements in its desk audit processes, tracking and follow-through. However, the Consultant's testing revealed that the Respondent had not sufficiently resolved the Deficiencies and had not complied fully with the requirements in the Action Plan in that:

- (a) Desk audit procedures, designed to review for:
  - (i) timely approval of new accounts and KYC amendments; and
  - (ii) completeness of KYC information and amendmentswere not being conducted bi-weekly in accordance with the requirements of the Action Plan which resulted in a backlog;
- (b) the Respondent had developed but not yet implemented all of the reports agreed to in the Action Plan to review for excessive trading; and
- (c) Desk audit procedures were not always performed at the same frequency or within the established sample sizes agreed to in the Action Plan.

#### **Letter from Officers Of The Respondent**

28. On April 28, 2008, senior officers of the Respondent signed a letter confirming that the issues described in the 2008 Consultant's Report had been resolved as follows:

- (a) The backlog in desk audits identified by the Consultant had been cleared;
- (b) The monitoring for excessive trading now included all of the reports described in the 2008 Consultant's Report; and
- (c) Desk audits were being conducted at the same frequency and within the established sample sizes agreed to in the Action Plan.

29. In consideration of the representations in the April 28, 2008 letter from the Respondent's senior officers stating that issues raised in the 2008 Consultant's Report had been resolved, the MFDA approved the Coast Capital transaction subject to terms and conditions.

## **The 2009 Compliance Examination**

30. In January 2009, the MFDA undertook a third compliance examination of the Respondent (the “2009 Examination”) which included an assessment of compliance by the Respondent for the period from February 1, 2006 to November 30, 2008. The 2009 Examination included a review of the Respondent’s head office as well as 4 branch locations. The findings of the 2009 Examination were reported to the Respondent in the MFDA Compliance Examination Report dated May 25, 2009 (the “2009 MFDA Report”).

31. The 2009 MFDA Report identified, among other things, that:

- (a) although the Respondent had implemented many of the procedures that were described in the Action Plan, the Respondent:
  - (i) had not sufficiently resolved the Deficiencies that were previously identified in the 2004 and 2006 MFDA Reports;
  - (ii) was not producing one of the three reports that were agreed to in the Action Plan and described in the 2008 Consultant’s Report to identify cases of excessive trading; and
  - (iii) was not taking sufficient follow-up action to ensure that cases of non-compliance with regulatory requirements that were identified by means of the desk audits were not repeated;
- (b) the Respondent was not maintaining sufficient evidence of its head office or branch level trade supervision activities for the duration of the period examined; and
- (c) Staff had discovered additional patterns of possible excessive trading by certain Approved Persons of the Respondent.

32. The cases of possible excessive trading identified in the 2009 MFDA Report would have appeared on reports that the Action Plan required the Respondent to produce to monitor for excessive trading if all of those reports had been developed and implemented in accordance with the Action Plan. These cases should have also been reviewed and queried by the Respondent to determine whether such trading patterns did

constitute excessive trading.

### **Additional Facts**

33. The Respondent has cooperated with the MFDA's investigation of the matters that form the subject-matter of this Settlement Agreement.

34. Following discussions with MFDA Staff upon the completion of the 2009 Compliance Examination, the Respondent acknowledged its failure to rectify the Deficiencies. Prior to the commencement of enforcement action by the MFDA, the Respondent took the following additional steps to try to rectify the Deficiencies:

- (i) the Respondent voluntarily retained PricewaterhouseCoopers LLP ("PwC") in April, 2009 to assist it with rectifying the remaining Deficiencies at a cost to date of \$225,000;
- (ii) the Respondent undertook an independent review of its compliance structure and resources; and
- (iii) the Respondent developed and implemented additional changes to its systems and controls.

### **CONTRAVENTIONS**

2. Based upon the facts set out above, the Respondent admitted to having committed the following violations (again, as set out in the Settlement Agreement):

35. The Respondent admits that it failed to fully carry out the terms of the 2007 Agreement, thereby engaging the authority of the Hearing Panel to impose a penalty on the Respondent pursuant to section 24.1.2(i) of MFDA By-law No. 1.

36. The Respondent admits that between February 1, 2003 and November 30, 2008, it failed to establish, implement and maintain adequate policies and procedures to address the Deficiencies by:

- (a) ensuring the accuracy, completeness and approval of all KYC information and amendments; contrary to MFDA Rules 2.2.1, 2.2.4, 2.5.3(b), 2.5.4 and



MFDA Policy No. 2;

- (b) ensuring that appropriate supervisory staff were completing the timely review and approval of the opening of all new client accounts, contrary to MFDA Rules 2.2.3, 2.5.2(b), 2.5.3(b), 2.5.4 and MFDA Policy No. 2; and
- (c) detecting and preventing patterns of excessive trading and switching in client accounts, contrary to MFDA Policy No. 2.

37. The Respondent admits that between January 1, 2006 and November 30, 2008, the Respondent failed to maintain adequate records of trade supervision that was conducted at both the branch and head office level, including trades reviewed and records of inquiries made, responses received and resolutions achieved, contrary to MFDA Rules 2.2.1, 2.5.1, 2.5.4 and MFDA Policy No. 2.

### **PENALTIES**

3. The penalties agreed upon by the parties, as stated in the Settlement Agreement, are as follows:

38. The Respondent agrees to the following terms of settlement:

- (a) The Respondent shall pay a fine in the amount of \$50,000, pursuant to section 24.1.2(b);
- (b) The Respondent shall retain PwC as an independent monitor at the Respondent's expense and in accordance with the terms set out in Schedule "B" [to the Settlement Agreement] to resolve:
  - (i) the Deficiencies;
  - (ii) all other compliance deficiencies identified in the 2009 MFDA Report; and
  - (iii) any deficiencies that the independent monitor identifies during its review;pursuant to section 24.1.2(g) of MFDA By-law No. 1;
- (c) The Respondent shall pay the costs of this investigation and proceeding in

the amount of \$25,000, pursuant to section 24.2 of MFDA By-law No. 1.

39. In accordance with s. 24.4.2(b) of MFDA By-law No. 1, the Respondent acknowledges its obligations to comply with all MFDA By-laws, Rules and Policies, and all applicable securities legislation and regulations made thereunder and to carry out the terms of agreements with the MFDA in the future and in particular the obligation to implement sufficient compliance procedures and controls to ensure compliance with MFDA Rules 2.2, 2.5 and MFDA Policy No. 2.

## **DISCUSSION**

4. It is well settled that hearing panels should not interfere lightly in negotiated settlements as long as the penalties proposed are within a reasonable range of appropriateness given the conduct of the Respondent. As was said by the British Columbia Court of Appeal in *B.C. Securities Commission v. Seifert*, 2007 BCCA 484,

Settlements assist the Commission that its overriding objective, the protection of the public, is met ... They provide the means of reaching a flexible remedy that is tailored to address the interests of both the Commission and the person under investigation.

5. This approach is equally applicable to disciplinary actions undertaken by the MFDA. The compliance deficiencies noted by MFDA examiners were serious and, despite assurances that they would be addressed, the Respondent failed to do so in a timely manner. While there is no evidence that clients were actually harmed, failure to follow the rules and regulations of the industry put clients at risks which can, and must be, avoided. It is, therefore, important that the penalties imposed stress the gravity of the offences committed by the Respondent.

6. On the other hand, there are mitigating factors in this case. This is the Respondent's first offence, and once the investigation began, the Respondent's officers and staff co-operated fully with the MFDA. It must also be noted that in April 2009, prior to the commencement of the enforcement action, the Respondent voluntarily retained PricewaterhouseCoopers LLP as a consultant to assist it in correcting the remaining deficiencies at a cost (up to this point) of \$225,000. And finally, we acknowledge that by entering into a Settlement Agreement, the Respondent has avoided a potentially lengthy, and no doubt costly, hearing.

7. The penalties agreed upon by the parties meet the accepted criteria. They are reasonable and proportionate, and hopefully they will serve as a warning to others whose compliance practices fall short of the required standards.

8. It is for these reasons that, at the conclusion of the hearing, after deliberating on the matter, we accepted the Settlement Agreement reached by the parties.

**DATED** this 3<sup>rd</sup> day of August, 2010.

“Fred Kaufman”

The Hon. Fred Kaufman, C.M., Q.C,  
Chair

“Guenther Kleberg”

Guenther Kleberg,  
Industry Representative

“Brigitte Geisler”

Brigitte Geisler,  
Industry Representative