Summary of Public Comments Respecting Proposed MFDA Sanction Guidelines

On May 23, 2018, the MFDA published Proposed MFDA Sanction Guidelines for a 90-day public comment period that expired on August 20, 2018.

Five submissions were received during the comment period:

1. The Canadian Advocacy Council for Canadian CFA Institute Societies
2. Canadian Foundation for Advancement of Investor Rights
3. The Investor Advisory Panel
4. Kenmar Associates
5. PFSL Investments Canada Ltd.

Copies of comment submissions may be viewed on the MFDA's website at: www.mfda.ca.

The following is a summary of the comments received, together with the MFDA's responses. Factors #7 and #8 have been renumbered as Factors #12 and #13, and this summary reflects that renumbering.

I. General Comments

Most commenters expressed general support for the intent of the proposed Sanction Guidelines and the move to a principle-based approach to sanctioning.

One investor advocate questioned whether the Sanction Guidelines, without dollar ranges, can lead to consistent application by Hearing Panels and expressed the view that it would be useful if the MFDA provided detail as to why the current sanction system requires change. In addition, this commenter expressed the view that the proposal does not identify the risks that could result from a conversion to principles-based sanctions, which include: variability in fines in time or by region; and the inability of stakeholders, including investors, to benchmark the appropriateness of fines and sanctions.

One investor advocate questioned whether the Guidelines applied to both individual and Member Respondents.

MFDA Response

The move to a principled-based approach to sanctioning is consistent with the prevailing practice of Canadian securities regulators and self-regulatory organizations ("SROs"). There is a significant body of decided cases which provide ample guidance to Hearing Panels with respect to the appropriate quantum of sanction. This will assist in ensuring consistency of fines, and it will allow stakeholders to benchmark the appropriateness of sanctions.

The MFDA Sanction Guidelines apply to both individual and Member Respondents and wording in Factor #3 has been amended in that regard.

II. Key Factors

1. General and specific deterrence

Investor advocates expressed the view that the expectations of the investing public should be included as an important consideration to achieve deterrence.

MFDA Response

This comment has been addressed in the amended Factor #2 – Public confidence.

2. Industry expectations

Investor advocates expressed the view that the expectations of the investing public should also be included in the Guidelines.

MFDA Response

This comment has been addressed in the amended Factor #2 – Public confidence.

3. The seriousness of the allegations proved against the Respondent

Investor advocates recommended suggestions that include:

- a firmer distinction should be drawn between inadvertent wrongdoing and intentional misconduct
- undue influence on vulnerable investors exerted by a Respondent should be an explicit aggravating factor
- the definition of vulnerable investor should not depend upon the existence of a unique or special relationship with a Respondent
- concealment of misconduct by a Respondent should be an aggravating factor, and
- the seriousness of the allegations proven against the Respondent should not be limited to MFDA requirements and should extend to violations of securities regulations.

MFDA Response

Factor #3 clearly makes a distinction between inadvertent wrongdoing and intentional misconduct. The importance of the distinction in any particular case is within the discretion of the Hearing Panel.

The suggestion to include undue influence on vulnerable investors as an aggravating factor is addressed by this factor under "Vulnerable Investors". Undue influence is one example of the manner in which an investor can be vulnerable to a Respondent's conduct.

Staff agrees with the comment suggesting that the definition of vulnerable investor should not depend upon the existence of a unique or special relationship with a Respondent. Staff has amended the factor accordingly.

Concealment of misconduct by a Respondent is already addressed in this factor under "Deception".

This factor has been amended to reflect that these principles apply to all violations for which a Respondent may be disciplined.

4. Whether the Respondent recognizes the seriousness of the misconduct

Specific comments were not made on this factor.

5. The benefits received by the Respondent as a result of the misconduct

The industry association and one investor advocate suggested that this factor should be expanded to include that disciplinary action must ensure that a net negative financial outcome results for the Respondent. Alternatively, it was suggested that this addition could be a separate factor, as noted in the IIROC Sanction Guidelines where it is a fundamental tenet that wrong-doers should not benefit from their wrong-doing.

MFDA Response

This factor has been amended to include reference to the general principle that wrong-doers should not benefit from their wrong-doing, and that in cases where the Respondent benefited financially from the misconduct, the sanction should, if possible, account for the extent to which the Respondent obtained or attempted to achieve a financial or other benefit from the misconduct, whether directly or indirectly.

6. The harm suffered by investors as a result of the Respondent's misconduct

One investor advocate expressed the view that the risk of losses to investors should also be considered and even though a risk may not have resulted in actual investor losses, the risk itself should be considered a factor.

The MFDA Member commenter expressed the view that where a Respondent's actions were done solely to convenience the client and not for financial gain to the individual, that should be considered a mitigating factor. This commenter also agreed that it is important to recognize emotional and mental harm, but was of the view that a tempered approach should be applied when factoring these unquantifiable determinants.

MFDA Response

This factor has been amended to clarify that the risk of harm to which the client was exposed may be a relevant factor, even if actual harm did not result.

MFDA Hearing Panels have treated the issue of client convenience in various ways, particularly in signature falsification cases, and it would not be possible to state as a general principle that client convenience is a mitigating factor. We have however clarified in the "Purpose" section of the Sanction Guidelines that the list of factors is not exhaustive and that parties are free to argue additional principles before the Hearing Panels.

This factor has been amended to clarify that harm may be measured reasonably [*emphasis added*] *using subjective factors, such as the emotional and mental impact of the misconduct on the investor.*

7. The Respondent's past conduct, including prior sanctions

The industry association and one investor advocate expressed the view that this factor should be revised to contemplate whether the Respondent engaged in the misconduct over an extended period. Additionally, the investor advocate suggested that a history of client complaints, including OBSI decisions, should be considered.

MFDA Response

Cases where Respondents engaged in misconduct over an extended period of time are addressed in Factor #3.

The existence of a client complaint on its own is not evidence of a violation. Only a proven violation arising from such a complaint would be relevant. OBSI decisions are confidential under its Terms of Reference and in any event do not constitute evidence of a violation.

8. Whether a sanction was imposed on the Respondent for the same misconduct by the Member or other regulator

One investor advocate was of the view that the MFDA should take internal disciplinary action into consideration, but expressed the view that internal Member discipline should not take the place of the public enforcement process since sanctions imposed by a Member are not transparent to the public.

MFDA Response

The Sanction Guidelines provide that internal Member discipline is a factor to be considered in relation to MFDA public disciplinary proceedings.

9. Previous decisions made in similar circumstances

One investor advocate suggested that when Hearing Panels deviate substantially from jurisprudence, the reasoning for this decision should be articulated in the Decision.

MFDA Response

This falls under the general principle that Hearing Panels should identify the basis for the sanction imposed in the Reasons for Decision, which appears in the "Purpose" section of the Sanction Guidelines.

10. For multiple violations, the total or cumulative sanction should appropriately reflect the totality of the misconduct

Two investor advocates expressed the view that the application of the totality principle should depend on individual circumstances as should the existence of multiple or similar violations being used as an aggravating factor. One of these commenters further suggested that the totality principle is more suitable in situations where breaches were unintentional, there was no harm to investors and the problem that caused the breach has been addressed so it will not reoccur.

MFDA Response

Factor #10 takes into account individual circumstances, and it makes clear that the totality principle does not apply in every case. The application of the principle in any particular case is an issue for the Hearing Panel to determine.

11. Ability to pay is a consideration when imposing an appropriate monetary sanction

The investor advocates expressed concern with a Respondent's ability to pay as a factor and suggested this should only be considered relevant when:

- setting a payment plan
- the firm has paid compensation to those harmed by the misconduct, and
- it would result in serious financial hardship, which must be objectively proven.

One investor advocate expressed concern that it would require considerable MFDA staff time, effort and expertise to credibly validate a Respondent's inability to pay.

Some commenters suggested that there should be consideration to requiring the firm to be held accountable to pay for the individual Respondent's misconduct.

The industry association commenter advised that the IIROC Sanction Guidelines state that while the inability to pay is a relevant consideration in determining appropriate financial sanctions, this should not be considered a predominant factor.

MFDA Response

Case law acknowledges the principle that ability to pay may be a relevant consideration when considering the quantum of a fine to be imposed. There is no principle that ability to pay can only be considered when a client has been compensated, although that may be a factor on a case by case basis.

In response to the concern that ability to pay should only be considered relevant when it would result in serious financial hardship and is objectively proven, Factor #11 states that the burden is on the Respondent to raise the issue and provide evidence of a bona fide inability to pay. Currently, MFDA staff is able to assess the adequacy of such evidence if it is presented.

The consideration of whether it would be appropriate to require a Member to be held accountable to pay for the individual Respondent's misconduct is beyond the scope of the MFDA Sanction Guidelines. Where a Member has engaged in misconduct, as for example with a failure to conduct reasonable supervision, a disciplinary proceeding may be brought against the Member.

Staff agrees that ability to pay is only one of the factors to be weighed in relation to all other applicable factors including general and specific deterrence and the need to ensure public confidence in the MFDA's disciplinary processes. We have amended Factor #11 on this point.

12. Whether the Respondent voluntarily implemented corrective measures after the misconduct

One investor advocate recommended that corrective measures taken by either the individual or the MFDA Member should only be a mitigating factor if taken prior to detection and intervention by the MFDA or other regulator.

MFDA Response

Case law acknowledges the principle that voluntary implementation of corrective measures is a mitigating factor and there is no restriction that the measures must be taken by the Respondent prior to detection and intervention by the regulatory body. If corrective measures are taken by the Respondent after detection and intervention by the MFDA or other regulator, it may be a less significant mitigating factor.

13. Whether the Respondent made voluntary acts of compensation, restitution or disgorgement to remedy the misconduct

Two investor advocates suggested that full compensation or restitution to investors for their losses should be a mitigating factor and that under-compensating should be an aggravating factor. Another suggestion included considering whether an individual Respondent's firm paid the compensation or restitution.

Two investor advocates suggested that disgorgement payments should be separated from the amount of a fine. Further, one investor advocate suggested that to do otherwise places the Respondent in the position they were in before the misconduct, which suggests inadequate deterrence. Further, it was suggested that the amount disgorged should be the total amount wrongfully earned because of the misconduct and not just that portion received by the Respondent.

MFDA Response

Payment of an amount of compensation or restitution to investors is a mitigating factor, the significance of which is to be determined on a case by case basis. In a case where a particular amount is owed under applicable regulatory requirements and is not fully paid, the breach of applicable requirements may be addressed as an allegation in disciplinary proceedings.

MFDA Hearing Panels do not have a specific disgorgement power.

14. The Respondent's proactive and exceptional assistance to the MFDA

One investor advocate expressed the view that proactive assistance by a Respondent should only be a mitigating factor if accompanied by full compensation of those harmed by the misconduct. Another investor advocate similarly noted that anything short of complete and unequivocal cooperation should be an aggravating factor.

MFDA Response

Proactive assistance and client compensation are different issues under applicable case law.

The Guidelines state that this factor only provides as a mitigating factor if the Respondent's assistance <u>exceeds</u> [*emphasis added*] *regulatory requirements to cooperate, and conversely, failure to comply with the duty to cooperate is a violation.*

III. Types of Sanctions

<u>Suspension and Permanent Ban</u>

The industry association noted that the MFDA's proposed Sanction Guidelines do not specify the conditions under which a suspension or a permanent ban should be considered, as do IIROC's Sanction Guidelines.

MFDA Response

It is not possible to provide an exhaustive list of circumstances that warrant suspensions and prohibitions in contested and settled cases. The Reasons for Decision in previously-decided MFDA cases provide guidance on when suspensions and permanent prohibitions are appropriate in particular situations.

<u>Additional Type of Sanction - Publishing Respondent's Name</u>

The Member commenter suggested that publishing a Respondent's name on the MFDA's website should be considered as a sanction and that Hearing Panels should have the discretion to decide the length of time the decision is posted. Additionally, it was recommended that only the most egregious cases that involve financial harm, personal gain and repeat offenders should be publicly named and that minor offenses that do not show mal intent or personal enrichment

should not be permanently posted. This commenter also recommended that consideration should be given to the potential harm caused to the Respondent for the reputational damage caused by publishing their name. Lastly, this commenter suggested that the MFDA should have a mechanism by which Respondents can apply to have their names removed from the website.

MFDA Response

Under the Recognition Orders of the recognizing regulators, the MFDA is required to maintain a public register of the disposition of any disciplinary action or settlement, including any discipline imposed. The MFDA also participates in the CSA Disciplined List, which is dependent upon discipline records of all participating securities regulators and SROs being available on their respective websites.

IV. Additional Comments

One investor advocate recommended that if the proposed Sanction Guidelines are approved, they should be accompanied by robust user guidance.

The industry association commenter recommended that the MFDA should include a factor to consider whether at the time of the contravention, the Respondent received adequate training and education from their sponsoring firm.

One investor advocate recommended that there should be a training course for Hearing Panel members.

One investor advocate recommended that there should be a historical database of sanctions imposed, which should allow for searches by type of infraction and sanction imposed, allowing for consistency of sanction application.

MFDA Response

Further guidance on sanction principles is found in the Reasons for Decision of previously-decided MFDA cases.

The issue of whether the Respondent was in compliance with a Member's policies and procedures, as well as whether they received and followed training and education from their sponsoring firm, has been considered variously as a violation or as an aggravating or mitigating factor in particular cases. Respondents are able to raise these issues before the Hearing Panels, as the factors in the Guidelines are not exhaustive.

Hearing Panel members receive training through the Director of Regional Councils.

MFDA decisions are searchable on CanLii, which is a public database, and Quicklaw. They are also provided on the MFDA website.