MFDA

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Suitability Infractions By Mutual Fund Advisor

Leveraged Investments

As a result of a contested hearing, an MFDA registrant was permanently prohibited from conducting any securities-related business in MFDA jurisdiction and subject to a $750,000 fine with $20,000 in costs for recommending unsuitable leverage investments in return of capital ("ROC") and conventional mutual funds to 18 clients.

The clients took out loans to invest in mutual funds and segregated funds. The Panel considered the cost of carrying loans for segregated investments was considered relative to the client's total debt obligations. The Respondent sold insurance to some clients. Those insurance costs were also considered relevant by the Panel in determining the client's total monthly debt obligation.

With one exception, the clients did not have prior experience in borrowing to invest.

Although the client signed risk disclosure documents, the panel held and found relevant that the Respondent did not discuss the contents of the disclosure document s with them.

The Panel found that a suitability analysis involved 3 stages:

- Know the product and the client.
- Sound judgment to determining suitability.
- Disclosure of negative aspects of proposed investments.

The analysis of the harm to client included "quantifiable harm" (their losses) and "incalculable harm", which was defined as the need to make up the shortfall to service the loans when the distributions declined.

Another mutual fund advisor was fined $40,000, plus costs of $10,000 for recommending unsuitable leveraged strategies to 25 clients. The advisor would refer the client to a mortgage broker who would determine the clients' "available equity" based on an amount equal to at least 75% of the value of the client's home less any debt owed on the home. In many instances clients used a 2:1 or 3:1 investment loan as

secured by their home. All borrowed monies were used to purchase ROC mutual funds. The advisor recommended the use of distributions to make monthly and accelerated payments on their debt. The advisor also recommended they purchase a life insurance policy from him. Once the loans were paid with the ROC funds, he advised he could continue to use them for other purposes and the insurance would repay any outstanding amounts upon death.

The advisor agreed he overstated income and assets and understated liabilities on some account openings and loan applications. He agreed his clients were misinformed the investment strategy was low risk and had limited investment knowledge and time horizons due to age, health issues and liquidity needs.

Failure to Supervise for Suitability: By Branch Manager

A branch manager received a one-year suspension and other restrictions, including the completion of an IFSE MFDA Compliance course, a prohibition on acting in a supervisory capacity for 7 years, and 6 months of close supervision. The Branch Manager either sold or was responsible for the supervision of mutual fund advisors who sold certain prospectus exempt-debentures. The Branch Manager did not use a "portfolio approach" to review the debentures' suitability for a client's account. With incorrect direction form the dealer, he did not conduct a detailed review to determine whether the investors were accredited and considered non-financial assets for the purposes of accredited qualification. The Respondent sold the debentures to 40 clients who had indicated a risk tolerance of less than high on their KYC (or no risk tolerance) and supervised 4 mutual fund advisors who sold the debentures to 31 clients in similar circumstances. He was paid a salary and received no additional compensation as a result of the sales. The dealer was separately disciplined for its deficiencies. Read the full settlement agreement here.

Note: MFDA enforcement activity regarding pre-signed and/or altered forms has been voluminous. Some settlements were previously reported to you in our other publications of 2015. These settlements have continued.

By

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Expertise

Securities Disputes

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