

November 4, 2013

IN THE MATTER OF: THE SECURITIES ACT

- and -

IN THE MATTER OF: KENNETH WAYNE MUZIK

**REASONS FOR DECISION
OF THE DIRECTOR OF
THE MANITOBA SECURITIES COMMISSION**

Background

Kenneth Wayne Muzik (“Muzik”) made application under The Securities Act (the “Act”) for registration as a dealing representative with Sterling Mutuals Inc. (“Sterling”), a Mutual Fund Dealer headquartered in Windsor, Ontario with offices in various locations including Winnipeg. The original application for registration was made to the Commission by way of a submission dated June 10, 2013.

Muzik was first registered under the Act as a mutual fund salesman, originally with Summit Securities Ltd. starting May 8, 1990. Muzik has more or less been continually registered until November 6, 2012 when a termination notice was filed by his most recent sponsoring dealer, National Bank Financial Ltd. (“National”). Muzik has not been registered under the Act since November 6, 2012.

The authority of the Director to grant an application for registration is contained in Section 7 of the Act.

Registration by Director

7(1) The Director shall grant registration or renewal of registration to an applicant where in the opinion of the Director the applicant is suitable for registration and the proposed registration is not objectionable.

Refusal of registration

7(2) The Director shall not refuse to grant or refuse to renew registration without giving the applicant an opportunity to be heard.

Director’s authority to impose terms on registration

7(3) The Director may, either at the time of registration or afterward,

- (a) Restrict or expand a registration with or without terms and conditions, including, but not limited to, the condition that the registration is restricted to trades in certain securities or a certain class of securities; or
- (b) Restrict or expand the duration of a registration.

As a result of questions and concerns arising from the review of the application, the Director provided Muzik and Sterling an opportunity to be heard on the application. Attending at the opportunity to be heard was Muzik as well as two representatives of Sterling, Nelson Cheng (Chief Executive Officer) and Zaid B. Mohammed who works out of the Winnipeg office of Sterling. Commission staff also assembled a history of Muzik’s registration under the Act which was provided to Muzik and Sterling prior to the opportunity to be heard which was held on September 23, 2013.

Following the opportunity to be heard there were a small number of follow-up items which required further response by Commission staff and Muzik. Those steps have now been completed and what follows is the Decision of the Director

with respect to the application and whether Muzik is suitable for registration and whether the proposed registration is not objectionable.

Registration History

Significant portions of Muzik's registration history do not raise a concern. From Muzik's initial registration in May of 1990 until approximately the year 2000, although his sponsoring dealer did change, the changes in dealer were more as a result of amalgamations and business restructuring of the dealer and were not related to Muzik's conduct.

In September of 2001 Muzik's registration as a mutual fund salesperson (the terminology changed to Dealing Representative with the enactment of National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* in 2009) was sponsored by Assante Financial Management Ltd. ("Assante").

The grounds stated by Assante for its termination of their sponsorship of Muzik's registration on May 7, 2004 included the following:

1. Muzik issued a personal cheque to a client on the understanding the client would pay him back once a rebate had been proceeded through the dealer. The dealer was unaware of the payment. When questioned whether this was an isolated incident at the time Muzik could not specifically remember other incidents occurring although he acknowledged that it could be possible.
2. Muzik had clients sign blank forms.

In addition, the Assante termination notice also stated Muzik was having unlicensed assistants conduct trading activity as well as Muzik providing a personal loan of \$1,000.00 to a client. Muzik disputes these additional allegations. He denies he was aware of unlicensed assistants conducting trading activity and also advised that the \$1,000.00 loan was to a father of a client who required the funds to pay for a car repair. The cheque repaying the loan was mailed to Assante's office and brought to the attention of Assante compliance personnel. While he acknowledges the loan was made, it did not relate to trading in a client's account.

After identifying these matters, and before terminating Muzik's employment, Assante proposed placing Muzik on heightened supervision. Muzik acknowledged during his opportunity to be heard that some, although not all, of the matters identified by Assante were not disputed. While Muzik did not specifically have an objection to heightened supervision being placed on his activities, a dispute arose between Muzik and Assante with respect to how

Assante intended to implement heightened supervision, and whether in fact Assante was effectively changing the terms of his contract with Assante.

For the purposes of the review of this application it is not necessary to determine the validity of Muzik's assertion that the terms of his employment contract would have been changed by Assante in a manner that was prejudicial to his interest. What is important for the purposes of the current application for registration is that Muzik confirms that Assante was accurate in its identification of both personal financial dealings with respect to a client as well as Muzik's use of pre-signed blank forms (items 1 and 2 above). It is also acknowledged by Muzik that it was appropriate for Assante to propose additional supervision of his activities and he acknowledged that the use of blank pre-signed forms was not an acceptable business practice.

The Commission entered into a Settlement Agreement with Muzik which is reflected in Commission Order No. 6435 dated December 15, 2011. The Settlement outlines Muzik's dealings with four clients for a period ending in approximately 2002. In the Settlement Agreement Muzik acknowledged that he acted contrary to the public interest in that:

- a) He recommended investments in mutual funds some of which were outside the risk tolerance of clients;
- b) He recommended leveraging which was outside the risk tolerance of a client; and
- c) He made recommendations to clients at times when completed Know Your Client Forms were not on the clients' files, pursuant to which recommendations transactions were permitted by his employing brokers.....

On April 23, 2004 the Director imposed additional terms and conditions on Muzik's registration requiring strict supervision of his activities by his sponsoring dealer. These terms and conditions were not imposed as a result of a regulatory finding by the Commission, but as a result of complaints being made by a small number of clients about Muzik, as well as the matters raised by Assante at the time it ended its sponsorship of Muzik's registration.

It is important to note that at this time the imposition of terms and conditions was not as a result of a regulatory action by the Commission. The Director can apply terms and conditions to a registration in order to monitor the activities of a registrant pending a review and investigation of matters involving that registrant's conduct. This type of precautionary term and condition is routinely imposed by the Director to provide additional protection to the public and to permit the Commission and/or a self-regulatory organization to conduct whatever review or investigation is necessary to determine if there is a question with respect to the

conduct of a registrant. A registrant does have the right to challenge the imposition of terms and conditions by way of an appeal of the Director's decision. In this case Muzik did not appeal the imposition of the terms and conditions requiring increased supervision of his activities by his sponsoring dealer. The decision not to appeal the imposition of terms and conditions did not prejudice Muzik's right to defend his position in any future hearing held to review his suitability for registration.

Muzik became registered as a dealing representative with Wellington West Financial Services Inc. ("Wellington") on May 14, 2004. This registration continued until April 9, 2012. During this time Muzik's activities were subject to the terms and conditions imposed by the Director requiring Wellington to conduct increased supervision of his activities. Monthly supervision reports were filed with the Director throughout this time period. Although most of the reports did not disclose any concerns about Muzik's conduct there were three exceptions:

1. February, 2009 - Wellington found a blank signed form on a client file. An undated signed form was found on a second file.
2. March, 2009 – Further review by Wellington compliance found a trade ticket and two transfer forms signed by client and Muzik, but not dated.
3. April, 2009 – Wellington compliance found conversation/switch form signed by client and Muzik, but not dated.

It is important to note that the terms and conditions imposed on Muzik included a prohibition from him having unlimited trading authority. In other words he was not in a position to exercise discretion with respect to trading on a client's account. Each and every trade had to be subject to specific instructions from the client, with those instructions being documented at the time they were given. Undated forms in effect operate not only in violation of the terms and conditions imposed on Muzik's registration, but operate as a form of limited trading authority permitting Muzik to carry out a trade without having to contact the client at the time a date is added to the signed form and the trade is entered. While during the opportunity to be heard Muzik questioned whether the unsigned forms referred to in the April, 2009 supervision were not the same forms identified in the February, 2009 supervision reports, he did not deny the overall finding in the supervision reports that client files contained incomplete undated documents.

Muzik did confirm an understanding of the terms and conditions on his registration and that these forms were in violation of those terms and conditions.

Muzik resigned from Wellington effective April 9, 2012.

Muzik stated that his resignation from Wellington in April of 2012 was precipitated by his attempts to move to an IIROC member firm where he could continue to conduct mutual fund activity. Muzik advised that he had been trying to move for several years but that Charlie Spiring had been blocking his move.

Muzik was subsequently approved as a dealer representative with National effective July 27, 2012. The terms and conditions that had been previously imposed by the Director were continued at this time.

It was also during this period between Muzik's resignation in April of 2012 and July of 2012 that there was increased attention and publicity to Mr. Muzik's activities. This included media reports generated by former clients of Muzik. Muzik was also of the view that he was not receiving full information from National with respect to how they were dealing with the attention generated by media reports, other complaints that had been made by former clients as well as the general handling of Muzik client accounts. In Muzik's view he felt that National was positioning itself to obtain his client accounts and suspend his registration.

Also during this time Muzik was named as a defendant in two Statements of Claim filed by former clients. Additional complaints were received by the Commission, the Mutual Fund Dealers Association and the Investment Industry Regulatory Organization of Canada about Muzik at this time.

For the purpose of the review of the application for registration, while it is important to consider the fact that Muzik was named in various complaints and court actions to put Muzik's situation into context, it is also important not to prejudge the validity of any complaint or court action Muzik was involved in at that time. The existence of a complaint or court action, in the absence of other compelling evidence of obvious misconduct, does not in itself lead to the conclusion an individual is unsuitable for registration or that registration is objectionable. However, these matters do illustrate the complexity of the situation faced by Muzik and National at that time.

National terminated sponsorship of Muzik's registration effective November 6, 2012. The termination notice National filed with the Commission disclosed an uncompleted form related to Know Your Client information as reason for termination. During the opportunity to be heard, while not denying there was an uncompleted form, Muzik took the position that a single piece of information on the form had been inadvertently missed and that the remainder of the form had been completed. In effect, Muzik took the position the missing piece of information on the form was not sufficient to justify his termination by National.

Staff obtained the New Account Application Form in question. The form includes an annual income amount but blank disclosure about assets and no estimated total net worth. Bank reference is blank, although a series of yes or no questions that form part of the Account Holder Profile are completed. While other parts of the form are completed the certification of Politically Exposed Foreign Persons is not. The most significant omission is the entire section of Investment Objectives and Risk Tolerance. In other words, there is no disclosure of what risk level or

asset mix should be in the account. Finally, it should also be noted that the form is signed but undated.

What is clear is the omissions on this form represent more than a minor mistake or error. For a registrant with the experience and background of Muzik to allow a form to be signed which failed to disclose the most basic elements of investment objectives and risk tolerance is clearly unacceptable. The information contained in these forms establish key elements of how the interaction between client and dealer will be conducted. The forms also provide evidence to protect the client, dealer and dealer representative in the case of a dispute. Finally, the information in the forms is critical to the ability of a dealer to supervise the activities of a dealing representative and carry out its obligations to clients. By allowing a form to be signed before it is completed, even if it could be argued the information was to be added later based on other sources, places the client at risk. The validity of all of the information contained in the form can come into question once it is shown the client has signed a form that was not properly completed.

Muzik also took the view that the individuals at Assante at that time were also the same individuals who were involved with his termination by National Bank in 2012, implying his termination from National was not justified.

The repetitive conduct of Mr. Muzik is clear. He was aware of the necessity to complete forms prior to conducting trading activity on behalf of clients. Even if he was not aware of the general requirements in this area, the terms and conditions included on his registration would have focused his attention on this requirement. Each monthly supervision report that Muzik signed would have also been a reminder of his obligations. Each termination of his employment as a result of loss of sponsorship by his dealer should have emphasized the seriousness of these requirements. When questioned of these repeated instances of what he acknowledged to be unacceptable conduct Muzik could provide no insight into his conduct except that it was a mistake and in some instances done for some perceived benefit to the client.

Activities while not registered

Muzik has not been registered to trade or advise in the trading of securities since November 6, 2012. He is currently involved in various civil actions in Court, both filed and contemplated. However, it was apparent that while he understands that he cannot trade or advise in the trading of securities without registration, Muzik has in fact conducted himself in a manner since the loss of his registration that arguably does involve unregistered advising in the trading of securities.

In an email to Jason Roy, Senior Investigator of the Commission dated August 22, 2013 under the subject heading "Unsatisfied clients of National Bank" Muzik refers to speaking with people about their investments. The email refers to changes made to these client accounts after he left National and questions

whether those changes were appropriate under the circumstances. Muzik states "I have been able to gather a significant amount of information concerning this matter....".

In addition to this email Commission staff have noticed a pattern in the complaints made by former clients of Muzik. Each of these complaints contain essentially the same wording. In a limited sampling conducted by Commission staff it appears that in at least some instances it is clear that the complainant has relied on a third party to assist in the preparation of the complaint.

Mr. Muzik confirmed he has continued to have contact with former clients. While Muzik states he told the former clients he was no longer registered to trade in securities, he also stated he reviewed those client's investments and has pointed out to those clients where in his view the changes made to their investment portfolios following his departure from National were not appropriate. When asked if he assisted these individuals in writing their complaints to National, Mr. Muzik somewhat hedged his answer by saying he provided assistance to these former clients who had approached him. Muzik was of the view these clients had no other recourse or source to receive information about their accounts.

This continued conduct by Muzik following the loss of his registration calls into question his suitability for registration for a number of reasons. First, in spite of a history of failing to comply with terms and conditions of registration, and promises that he will comply with the requirements of registration in the future if his current application is granted, Muzik was of the view that he was the only person who could provide advice to these former clients on the suitability of the trades made in their accounts following his department from National. Secondly, he put himself in this position at a time no dealer was supervising his activities, and without advising his new potential dealer (Sterling) that he was conducting these activities. Thirdly, he has quite possibly damaged the chances of at least some of these clients to make a successful complaint to National about the handling of their accounts. If the information and evidence provided from these former clients in their complaints has been inadvertently tainted by Muzik there is a risk that the credibility of that evidence will be weakened. Muzik may very well have damaged the very clients he claims he needed to help.

It is difficult not to conclude that these actions by Muzik were motivated out of self interest. He alone determined no one else had the ability to assist these clients. No doubt his dispute with National over his termination motivated Muzik to have these individuals make complaints with respect to the handling of their accounts, complaints that in many cases were similar in nature. This could only assist Muzik in having those clients agree to return to him if he became registered with Sterling. Such self serving conduct at a time when Muzik ought to have known questions would be posed with respect to his suitability for registration demonstrates that he is not suitable for registration and that registration would be objectionable.

Sterling Mutuals Inc.

As stated previously, representatives of Sterling attended at the opportunity to be heard. In particular, Nelson Cheng, Chief Executive Officer provided information with respect to supervisory systems in place at Sterling. There is no evidence to suggest those systems are deficient.

However, although supervisory systems are in place, in order to properly determine whether the registration should be granted, it is necessary to look at all the circumstances surrounding both the application as well as the dealer's conduct with respect to that application.

No individual can be registered without being sponsored by a dealer. The application filed for registration is in effect a joint application by both the dealer and the individual. The dealer assumes significant responsibilities with respect to the conduct of each individual registered by the dealer, and incurs serious reputational and regulatory risks in the event an individual were to act in a manner that is damaging to the business of that dealer and its clients.

It is a clear expectation of the securities law and rules that a dealer that proposes to sponsor a registrant does background checks in order to ensure that the individual which they are sponsoring for registration is in fact fit to be registered. The dealer performs a gatekeeper function in order to reduce the possibility of an unsuitable individual becoming registered.

What was acknowledged by Sterling at the end of the opportunity to be heard was that much of the information that had been provided in written materials assembled by staff, as well as during the review by the Director, was not known to Sterling. Whether this lack of knowledge was caused by a lack of due diligence on the part of Sterling, or by a failure of Muzik to fully disclose all of the information related to his registration does not need to be decided. In either situation the lack of knowledge and/or due diligence by a sponsoring dealer calls into question whether the proposed registration should be granted, as well as whether any concerns with the proposed registration can be alleviated by additional supervision being conducted by the dealer.

The initial plan for supervision of Muzik was based on Muzik being located in an office separate from the existing Winnipeg office of the dealer. Given Muzik's past conduct and numerous instances of problems with files and documentation, it is difficult to understand why the dealer would feel that such an arrangement where Muzik could in effect work independently out of a separate location would in any way be acceptable under the circumstances.

Following the opportunity to be heard Sterling sent an email to the Director proposing an additional level of supervision of Muzik's activities which would

involve more direct supervision. The list of additional permanent terms and conditions suggested were the following:

- No Outside Business Activities (other than Insurance)
- Only Sterling approved referral arrangements
- No trade names
- Mr. Muzik must maintain written notes of each client meeting
- Within five business days of each meeting, Mr. Muzik must provide a copy of those notes to the client
- No leveraged investing for any clients over the age of 50
- No Limited Authorization Forms. He must obtain signatures for all activities

In the view of the Director terms and conditions have already been applied to Muzik's registration and have failed. These additional conditions do not provide an increased level of supervision which would lead to the conclusion that Muzik is suitable for registration. The proposed registration would be objectionable.

During the opportunity to be heard Sterling also acknowledged that it was not aware that Muzik no longer had his insurance license. In addition, Sterling was unaware of the activities of Muzik in providing advice to a multiple number of clients after he was no longer registered. This calls into question whether Sterling conducted proper due diligence with respect to the application for registration, or whether information was not provided to Sterling during its due diligence process.

Conclusion

For these reasons I find that Muzik is not suitable for registration and the proposed registration is objectionable and that the application for registration should be refused.

"D.R. Brown"

Douglas R. Brown
Director