

February 1, 2012

IN THE MATTER OF: THE SECURITIES ACT

- and -

IN THE MATTER OF: WFG SECURITIES OF CANADA INC.

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

Panel:

Panel Chair:	Mr. D.G. Murray
Member:	Mr. J.W. Hedley
Member:	Mr. G.J. Lillies

Appearances:

Mr. S. Gingera)	Counsel for the Commission
Mr. N. Campbell)	Counsel for the Respondent
Mr. R. Morris		

This matter was heard over parts of a five day period from October 17th through October 21st, 2011. The Statement of Allegations as amended sets out allegations against WFG Securities of Canada Inc. (WFG) a mutual fund dealer with offices in several Canadian provinces, that it, as a dealer, and through the actions of its employees registered through WFG, breached duties to clients with leveraged accounts. Without repeating the allegations they include unsuitability of leveraging as a strategy, failure to adequately supervise managers and salespersons, failure to act fairly, honestly and in good faith toward leveraged clients and generally conducting itself in a manner contrary to the public interest. The Statement of Allegations seeks sanctions ranging from a reprimand to cancellation of registration, orders of compensation for financial loss and costs.

The proceedings were preliminary in nature, intended to deal with the admissibility of certain reports. The reports were prepared under the direction of Ms. Kim Maggiasco by Compliance Alliance, a company she founded. Under her direction Compliance Alliance provides compliance and expert witness and litigation support for investment and mutual fund dealers and other securities industry participants.

Ms. Maggiasco is acknowledged by both parties to be an expert in the area of investment industry compliance. She was responsible for the compilation of the report and testified at the hearing. It was agreed by both parties that it was unnecessary to qualify her as an expert.

The reports are reviews of the leveraging activities of WFG both before and after April 2008. The report filed as Exhibit 32 is dated October 4, 2010. It is referred to in these proceedings as the National Report. It is a compilation of leverage reviews done in every branch office of WFG in Canada including Manitoba. Ms. Maggiasco's firm was commissioned to prepare this report in the fall of 2009. The date of April 2008 is noted in evidence and argument as the date that MR-0069 was put into place by the Mutual Fund Dealers Association (MFDA). MR-0069 is an MFDA Rule that sets out suitability guidelines for leveraged accounts. Obviously these guidelines were not in place prior to April 2008. There is further discussion on this matter subsequently in these Reasons for Decision.

The Statement of Allegations indicates that:

- a) MSC staff members became concerned about the number of leveraged accounts in two WFG branch offices in Winnipeg arising out of a limited review;
- b) MSC staff concerns were then communicated to the MFDA which organization arranged for reviews of the WFG head office and branch offices in Manitoba and elsewhere in Canada. These resulted eventually in the preparation of the Compliance Alliance Reports entered as Exhibit 32 (the "National Report") and Exhibit 39 (the "Manitoba Report");
- c) MSC staff also initiated an investigation and reviewed Leveraged Accounts at several WFG Winnipeg branch offices between November, 2008 and June, 2009.

Prior to the commissioning of the National Report, WFG voluntarily ceased leveraging in its Winnipeg branch offices. As such only those leveraging activities predating this time were reviewed in the Manitoba branch offices of WFG by

Compliance Alliance. This timeframe would include the leveraging activities contemplated by the Statement of Allegations which based on evidence received at the hearing and the information set out in the Statement of Allegations, appears to have primarily occurred prior to April, 2007.

The National Report was the first to be commissioned by the MFDA, however, during its compilation the MFDA and WFG also agreed to the preparation of the Manitoba Report. The Manitoba Report was specific to activities occurring in the branch offices in this province and included separate reports (Exhibits 33 through 38) on the branch offices in Manitoba. The final versions of the reports provided at the hearing are dated October 4, 2010 (National Report) and December 31, 2010 (Manitoba Report). While the reports were provided to MSC staff, their parameters were determined by the MFDA and WFG. According to the evidence of Kim Maggiacomo, the review on leveraging suitability was intended to serve largely as a guideline to identify any remedial actions required by WFG to bring their leveraged accounts in line with what were then current standards set by the MFDA. With respect to the National Report another, and perhaps secondary, intent was for the review to provide a possible basis for disciplinary action against WFG and/or its employees.

On the last day of the hearing both counsel advised that there is no question that the Manitoba Report (and by implication the separate branch office reports) are admissible at the hearing of this matter. It was agreed by counsel that the primary consideration for admissibility of the reports is relevance. Although he seriously questions the weight, if any, that should be afforded the Manitoba Report, counsel for WFG acknowledges that it is relevant as it deals specifically with the activities of WFG and its employees within the Province of Manitoba.

The testimony of Ms. Maggiacomo given at the hearing was not with respect to the specific content of client files but on the intent and scope of the National Report for the purpose of determining admissibility. The National Report deals with a selected review of the leveraged accounts of certain WFG salespersons, referred to as Approved Persons ("APs") across the country, including some of those in Winnipeg branch offices. The reviews, however, are not against the suitability parameters that were in place in the industry in 2007 and earlier. The review is specifically against the more recent (April 2008) parameters for suitability in leveraged transactions set out in MR-0069. In addition, the reviews done by Compliance Alliance were largely intended to highlight areas where the leveraging activities of APs were not compliant with MR-0069 and where remedial action was required to bring the leveraged accounts into compliance, if possible. The review was largely intended to set a path going forward as opposed to being an in-depth determination of the suitability of leveraging as a strategy in specific past transactions.

Ms. Maggiacomo testified that the April 2008 parameters for suitability as set out in MR-0069 were not the same as those in place earlier in the industry. She advised that the review done was not intended to be an in-depth study of the suitability of leveraging of individual client accounts against industry standards prior to April 2008. While the National Report applied the term "unsuitable" to a number of leveraged client accounts operated by APs in Manitoba, Ms. Maggiacomo testified that the use of the term was "unfortunate" in hindsight. She acknowledged that the review taken as against the parameters of MR-0069 would be part of a suitability review as understood in the industry, but that additional steps would have to be taken

concerning individual accounts in order to qualify as a full suitability review with respect to leveraged accounts. As such, the National Report does not answer the specific question of whether any WFG APs in Manitoba had made use of a leveraging strategy that was unsuitable for individual Manitoba clients according to standards in place before April 2008.

As the National Report is not intended to answer the question of leveraging as a suitable strategy for pre April 2008 activities, counsel for WFG takes the position that it has no relevance to the current proceedings. In addition, he argues that the National Report should not be admitted into these public proceedings because while it deals with a number of Manitoba APs and leveraged accounts of Manitoba investors, it deals with many more accounts and transactions occurring outside of Manitoba which are not matters within the jurisdiction of the Commission.

He argues further that admitting such extra-provincial material into evidence could well be prejudicial to WFG, its business and its employees as well as presenting an unnecessary and possibly harmful exposure of confidential information and privacy concerns of non involved WFG employees and clients.

Commission staff counsel argues that the National Report is relevant to these proceedings. He notes the National Report makes findings that there were "macro" issues in the WFG operations and that problems found in the Manitoba offices were also found in other Canadian jurisdictions. He argued that this is a relevant consideration for the panel. He also argued that the public interest jurisdiction of a Securities Commission should be given a wide scope and that it is common for an administrative tribunal like a Securities Commission, which is not bound by the rules of evidence, to admit evidence and deal with its probative value by an assessment of weight.

The 1997 Federal Court Decision of *Canada Post v. Public Service Alliance of Canada* quotes Chief Justice Dickson in the case of *R. v. Corbett*, 1988 Decision of the Supreme Court of Canada:

".....basic principles of law of evidence embody an inclusionary policy which would permit into evidence everything logically probative of some fact in issue, subject to the recognized rules of exclusion and exceptions thereto. Thereafter the question is one of weight. The evidence may carry much weight, little weight or no weight at all. If error is to be made it should be on the side of inclusion rather than exclusion and our efforts in my opinion, consistent with the ever increasing openness of our society, should be toward admissibility unless a very clear ground of policy or law indicates exclusion."

The *Canada Post* case also cites *R. v. Zeolkoski*, a 1989 Supreme Court of Canada Decision:

"The meaning of all relevant evidence was the principle basis upon which the majority of the Court of Appeal rested its decision. In my opinion, this expression means all facts which are logically probative of the issue. The general rule of evidence is that all relevant evidence is admissible. Frailties in the evidence are a matter of weight."

The Court in *Canada Post* went on to note that the two cited cases were criminal cases where the standards of admissibility are notably higher and more stringent than in administrative law cases.

The panel was provided with excerpts from legal text “Administrative Law in Canada” which notes:

“Relevance is determined by the purpose and subject matter of the proceeding described in the notice of hearing or written allegations. Any evidence relevant to those matters is admissible. If the failure to admit relevant evidence affects the fairness of the proceeding, the decision may be quashed. Accordingly, when in doubt as to relevance, it may be advisable to admit the evidence and decide later whether it has any importance to the matters to be decided.” (page 58)

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“Relevant expert evidence is admissible. Any frailties in the facts or hypotheses upon which an opinion is based, or in the qualifications of the expert, affect the weight of the evidence but not its admissibility.” (page 60)

The panel is of the opinion that the National Report is relevant to these proceedings and is therefore admissible.

While the National Report does not make a specific finding on suitability as a strategy in individual cases of Manitoba investors, that is not the only matter raised in the Statement of Allegations that is at issue. The allegations include that WFG failed to properly supervise its Manitoba APs and branch managers concerning leveraged accounts. There is a specific finding in the National Report (page 83 of Exhibit 32) on this point:

“Based on the finding of our review concerning supervision, we have concluded that WFG did not have adequate mechanisms or controls in place to supervise the leverage business conducted at WFG prior to April 2008, before MFDA MR-0069.”

Ms. Maggiacomo in evidence acknowledged this finding applied to several Manitoba offices of WFG. The opinion applies specifically to the pre-MR-0069 period during which the activities set out in the Statement of Allegations occurred. The National Report included in its review the leveraging activities of a Manitoba AP named Dennis Villarin. Evidence of two WFG clients (complainants) brought into question the leveraging activities of the same Dennis Villarin. The panel believes that an expert opinion on leveraging supervision is relevant to these proceedings.

It should also be noted that Ms. Maggiacomo testified that the Manitoba Report did not include a review of supervision as this had already been completed as part of the National Report. The National Report is the proper report on which to base expert evidence in this area.

In addition, the National Report didn't confine itself to a determination of whether leveraging was a suitable strategy used by APs according to the parameters of MR-

0069. On page 7 of the National Report (Exhibit 32) the stated purpose of the review (paragraph 4) is to determine whether WFG and its approved clients conducted business:

- “Within the bounds of good business practice”;
- “Fairly, honestly and in good faith with clients”;
- “With high standards of ethics and conduct”;
- “In compliance with regulatory requirements and in particular MFDA requirements with respect to leverage including:
 - MFDA Rule 2, Business Conduct.”

The Report makes reference as well to several other policies and rules in addition to MR-0069 against which the conduct of APs was assessed and which were in place prior to MR-0069.

In evidence Ms. Maggiacomo stated (at pages 21 and 22 - Evidence):

- A. “So, what I have included here in the National Report is MFDA Rule 2.1 and 2.2.1 which is Business Conduct and Know Your Client. So, to assess whether WFG and its approved persons conducted business within the bounds of good business practice, which is from, which is from the KYC Rule. Fairly, honestly and in good faith is the business conduct rule, and with high standard of ethics and conduct from the business conduct rule”.

As such, Compliance Alliance, in drafting the National Report, reviewed the activities of WFG APs against the Rules then in place to determine whether they acted fairly, honestly and in good faith with their clients.

The Statement of Allegations alleges that WFG in fact had failed to act fairly, honestly and in good faith toward Manitoba clients where leveraged accounts were opened. As such the panel considers the evidence of Ms. Maggiacomo, based on the reviews done in compiling the National Report to be a relevant consideration.

Ms. Maggiacomo testified that in preparing the National Report a document was created for every leveraged client of an AP under review. This included Manitoba APs under review such as Dennis Villarin. The panel notes that the creation of a document for each leveraged client was not made easy by WFG. By the time that Compliance Alliance started its review for the National Report, from and after the fall of 2009, several of the APs that had set up leveraged client accounts had been terminated by WFG. This included the aforesaid Dennis Villarin and other Manitoba based APs. When the audit staff of Compliance Alliance requested the client files of these APs they were advised that they were not available. They apparently had not been retained. It is noted in the National Report that, because of this, Compliance Alliance had to “pull together” other documents still available in the records of WFG in order to allow the creation of client documents for the review. In addition to making the job of Compliance Alliance staff more difficult, Ms. Maggiacomo testified that the failure to keep the client files represented a breach by WFG of the MFDA Books & Records Requirements:

- A. "It is against books, and records requirements. You have to have your records retained for seven years for reasons of supervision, and cases of disputes, so the books and records could not be produced. That is a serious problem."

The purpose of the Manitoba Report (Exhibit 39) is stated at page 6:

"The purpose of this review was to conduct leveraged account assessments to determine if any WFG leveraged client accounts in Manitoba required action to remedy deficiencies or discrepancies."

The purpose of the Manitoba Report was to review the leveraged account files of WFG to see if any remedial actions were required to set the account right according to the requirements of MR-0069. This is different than the stated purpose of the National Report which included assessing the conduct of APs against industry rules in place at the time.

The assessment in the Manitoba Report is of the status of client files both against the suitability standards in MR-0069 as well as Bulletin 431 which is complimentary to MR-0069 and was put in place subsequently. MR-0069 sets the parameters for suitability for a leveraged account from and after April 2008. Bulletin 431 sets out the methodology to apply to a suitability review. Neither standard was in place prior to April 2008 when the leveraging activity complained of took place in Manitoba. The Manitoba Report was not intended to and does not assess the past activities of the APs of WFG for possible misconduct. That restriction, according to Ms. Maggiacomo (page 198 and 199 – Evidence) did not apply to the National Report which included the possibility of providing a basis for disciplinary enforcement action by the MFDA.

In addition, while the National Report's goal was to assess suitability according to the standards of MR-0069, the subsequently drafted Bulletin 431 was not available when the review was being done. When leveraging activity was being reviewed and in some cases leveraged accounts were referred to as "unsuitable" in the National Report, the new parameters in Bulletin 431 were not yet available. According to Ms. Maggiacomo, the reviewers instead used their own judgment in determining whether the activities around a leveraged file appeared to be unreasonable or high risk and as such presented a "flag" or appeared as an irregularity to the reviewer. It was the presence of these flags or irregularities surrounding an account's operation that resulted in it being referred to as "unsuitable". The flags or irregularities were, according to Ms. Maggiacomo a result of separate tests outside of the parameters of MR-0069. As such, while the term "unsuitable" does not suggest a full suitability review had taken place, it does imply the exercise of judgment by a Compliance Alliance operative to the effect that there appeared to be irregularities in a leveraged account.

The purpose of expert evidence is to receive the opinion and benefit of the exercise of judgment of an expert. The panel considers evidence based on the National Report to be relevant in determining whether, on the facts and against the rules in place, a strategy of leveraging should be considered unsuitable in individual cases.

While helpful, the panel doesn't need the opinion of an expert to answer the specific question of whether a strategy was suitable for an individual client. The panel can make that assessment based on the evidence and the rules in place at the time of the transaction. The opinion evidence of an expert, however, in the application of his/her judgment as to problems or irregularities in the activities of an AP is relevant in making such an assessment.

Finally, the two reports appear to combine and make a whole with respect to leveraged accounts of Manitoba investors. Although they contain the same attached documents created for a specific client, these reports have to be considered together to tell the entire story. Ms. Maggiacomo also testified that the methodologies applied in both reports were determined as part of the review leading up to the National Report. In the opinion of the panel, the National Report and the evidence based upon it is relevant to these proceedings. As counsel for WFG noted, the expert evidence is not the Report itself but the evidence given by the expert at a hearing. Ms. Maggiacomo's testimony will determine the weight, if any, which will be given the evidence. The National Report is admissible as evidence in these proceedings.

Counsel for WFG made reference to *R. v. Mohan*, a 1994 Decision of the Supreme Court of Canada which raises the position that evidence that is otherwise legally relevant may be nonetheless excluded if its probative value is "overborne" by its prejudicial effect. He argued that the possible prejudicial effects of a report that deals with the national as opposed to the strictly Manitoba operations of WFG would be greater than the probative value offered. In addition he noted that the confidentiality and privacy deserved by non-Manitoba APs and non-involved WFG clients were factors mitigating against admitting the National Report.

While acknowledging the principles stated in *R. v. Mohan* (which again is a criminal case) in the opinion of the panel, privacy or confidentiality should not be an issue for WFG and its APs and branch managers. Ms. Maggiacomo testified that in the preparation of the review that WFG and its employees were given no expectations of confidentiality. As far as privacy of clients is concerned, what is currently before the panel and will form part of the record is the 99 page National Report that was provided at the hearing. There are, the panel is informed, in electronic form as attachments, records and documents concerning specific clients that would fill boxes and boxes. We would expect that no attachment will be printed and filed in this hearing as part of Exhibit 32 that does not apply to a complainant. Any other

documents that may be considered necessary and that may make reference to a client, not a complainant, can be modified as necessary to maintain privacy. It seems to the panel this could be agreed upon between counsel, however, we are prepared to hear from counsel if an agreement cannot be reached in this area.

"D.G. Murray"

D.G. Murray
Panel Chair

"J.W. Hedley"

J.W. Hedley
Member

"G.J. Lillies"

G.J. Lillies
Member