IN THE MATTER OF THE *SECURITIES ACT*,
S.N.B. 2004, c. S-5.5

-and-

IN THE MATTER OF

JAMES EDWARD SELLARS

-and-

IN THE MATTER OF

KEYBASE FINANCIAL GROUP INC., and
STAFF OF THE NEW BRUNSWICK SECURITIES COMMISSION

REASONS FOR DECISION ON HEARING AND REVIEW

Date of Hearing: 16, 17 and 18 January 2012

Date of Reasons for Decision: 28 June 2012

Panel:

Denise A. LeBlanc, Q.C., Panel Chair

Céline Trifts, Panel Member

Appearances:

Mark McElman	For Staff of the New Brunswick Securities Commission
André G. Richard and Josie Marks Stewart McKelvey	For James Edward Sellars

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A. OVERVIEW

1. History of the Proceedings

[1] In December 2009, Enforcement Staff ("Staff") of the New Brunswick Securities Commission (the "Commission") filed an Application dated 7 December 2009 (the "Application") with the Executive Director of the Commission (the "Executive Director") seeking restrictions on the registration of Keybase Financial Group Inc. ("Keybase") and James Edward Sellars ("Mr. Sellars"). In its Application, Staff was seeking terms and conditions that Keybase and Mr. Sellars not act in furtherance of trades involving the borrowing of money to invest. More specifically, the relief sought by Staff was framed as follows:

> *"That the Executive Director of the Commission restrict the registration of Keybase Financial Group Inc. ("Keybase") and James Edward Sellars ("Sellars"),*

by imposing terms and conditions on their respective registrations pursuant to subsection 48(2) of the Securities Act, S.N.B. 2004, c.S-5.5, as amended (the "Securities Act"), including a term and condition that they may not recommend or act in furtherance of trades involving the borrowing of money to invest."

[2] Keybase and Mr. Sellars, with their respective counsels, exercised their opportunity to be heard before the Executive Director, as set out in subsection 48(4) of the *Securities Act ("Act")* in relation to Staff's Application. Following this opportunity to be heard, the Executive Director issued an Order on 6 August 2010 imposing terms and conditions on the registration of both Keybase and Mr. Sellars (the "Executive Director's Order"). Reasons for the decision were issued 18 August 2010. By letter dated 8 December 2010, the Executive Director varied portions of his Order.

[3] On 7 September 2010, Mr. Sellars filed a Request for Hearing and Review of the Executive Director's decision pursuant to section 193 of the *Act*. Counsel for Keybase confirmed that they would not be participating in the Hearing and Review.

[4] The Hearing and Review of the Executive Director's decision pursuant to the provisions of section 193 was conducted over three (3) days in January 2012. At its conclusion, Staff and counsel for Mr. Sellars agreed to file post-hearing written submissions, which were received on 2 February 2012 and 15 February 2012.

[5] Prior to the commencement of the hearing, Mr. Sellars filed a Notice of Motion with an Affidavit in support thereof, seeking a stay of the Executive Director's Order pending final disposition of the Hearing and Review of this matter or, in the alternative, a partial stay of the Executive Director's Order. The Panel heard arguments on the motion at the conclusion of the hearing, and on 19 January 2012, the Commission granted Mr. Sellars' request for a partial stay.

2. Mr. Sellars' Approved Person status

[6] Section 38(1) of the *Act* enables a recognized self-regulatory organization to regulate the operations, standards and conduct of its members in accordance with its bylaws, regulatory instruments, practices and policies.

[7] Pursuant to a recognition order issued by the Commission on 23 July 2007, the Mutual Fund Dealers Association of Canada (the "MFDA") was recognized as a self-regulatory organization under section 35(1)(b) of the *Act*. This recognition order requires the MFDA to have its members confirm that their "Approved Persons" comply with applicable securities legislation and that they are properly registered.

[8] Keybase is registered as a mutual fund dealer in the Province of New Brunswick since 5 September 2001. As a registered mutual fund dealer, Keybase is required to be a member of the MFDA and to abide by its bylaws, rules and policies.

[9] Mr. Sellars has been registered as a Dealing Representative in New Brunswick under Keybase since September 2009. Mr. Sellars has been registered as a Mutual Fund Salesperson in New Brunswick since 24 September 2001 and was registered as the Keybase Branch Manager of the Moncton office since 23 October 2003. Mr. Sellars is an "Approved Person" at Keybase and with the MFDA.

[10] MFDA Rule 1.2 requires members to ensure that any Approved Person who conducts business on behalf of the MFDA Member commits to be bound by the bylaws and rules of the MFDA.

[11] Section 180 of the *Act* makes it an offence for any member or employee of a member of a recognized self-regulatory organization to contravene or fail to comply with any bylaw, regulatory instrument, practice or policy of the self-regulatory organization.

[12] It is not contested that Mr. Sellars, at all times material to this matter, was subject to compliance with securities legislation, as well as the MFDA bylaws, rules and policies.

B. THE ALLEGATIONS AND THE POSITION OF THE PARTIES

[13] As previously mentioned, Staff, in its Application to the Executive Director, was seeking terms and conditions that Keybase and Mr. Sellars not act in furtherance of trades involving the borrowing of money to invest. The practice of "leveraging" is a

practice whereby an investor uses borrowed funds to invest. The investment industry has recognized that this type of investment is not suitable for all investors and, Mr. Sellars, in making such recommendations to clients had an obligation to ensure that all leveraging recommendations were suitable to a particular client, in keeping with the client's current "Know Your Client" ("KYC") information.

[14] At all times material to this matter, the provisions of section 54 of the *Act* read as follows:

> **Standards of business conduct**
>
> **54** A registrant shall:
>
> *(a)* Act fairly, honestly, in good faith and in the best interest of a client of the registrant,
> *(b)* Exercise the degree of care, diligence and skill that a reasonably prudent person would exercise in the circumstances,
> *(c)* Not engage in conduct that would bring the reputation of the capital market into disrepute,
> *(d)* Take all reasonable steps to learn the essential facts about the identity, reputation and financial circumstances of each of the clients of the registrant and to keep current the registrant's knowledge of those essential facts, and
> *(e)* Ensure that the recommendations made to a client of the registrant are appropriate to the general investment needs and objectives of the client and the client's risk tolerance level.

[15] It warrants noting, as counsel for Sellars indicated in their post-hearing submissions, that section 54(e) was repealed on 28 September 2009.

[16] In addition, MFDA Rule 2.2.1 placed upon Sellars a duty of '"suitability":

> 2.2.1 **"Know-Your-Client"**. Each Member and Approved Person shall use due diligence:
>
> (a) to learn the essential facts relative to each client and to each order or account accepted;
> (b) to ensure that the acceptance of any order for any account is within the bounds of good business practice;
> (c) to ensure that each order accepted or recommendation made for any account of a client is suitable for the client and in keeping with the client's investment objectives; and

(d) to ensure that notwithstanding the provisions of paragraph (c), where a transaction proposed by a client is not suitable for the client and in keeping with the client's investment objectives, the Member has so advised the client before execution thereof and the Member or Approved Person has maintained evidence of such advice;
(e) to ensure that the suitability of the investments within each client's account is assessed:
    (i) whenever the client transfers assets into an account at the Member;
    (ii) whenever the Member or Approved Person becomes aware of a material change in client information, as defined in Rule 2.2.4; or
    (iii) by the Approved Person where there has been a change in the Approved Person responsible for the client's account at the Member; and
(f) to ensure that, where investments in a client's account are determined to be unsuitable, the Member or Approved Person so advises the client and makes recommendations to address any inconsistencies between investments in the account and the essential facts relative to the client and the Member or Approved Person maintains evidence of such advice and recommendations.

[17] Staff also rely on Member Regulation Notice MR-0069 – Suitability Guidelines ("MR-0069"), published by the MFDA on 14 April 2008 in their assertion (set out in their Pre-Hearing Submission dated 14 July 2011) that the failure of Sellars "*to exhibit any restraint in recommending leverage to his clients, combined with his multiple breaches of internal and external leverage guidelines, requires that he be prohibited from engaging in leveraged transactions on behalf of his clients in the public interest*".

[18] Staff allege that Mr. Sellars has breached his duty under section 54(e) of the *Act* to ensure that recommendations made to clients were appropriate to their "general needs, objectives and risk tolerance", thereby breaching the "suitability obligation". In their Application, Staff referenced six (6) of Mr. Sellars' client accounts (representing 11 individual clients) and how each account exceeded the leverage-to-net-worth guidelines imposed by MR-0069 and also raised other allegations of improprieties with respect to such accounts. In their Application, Staff summarized their position by stating that Mr. Sellars had been recommending and/or approving the use of leverage in client accounts without regard to his obligation of suitability and for the purpose of increasing his own commissions, contrary to the public interest.

[19] The position taken by Mr. Sellars is that there is a lack of any evidence, whatsoever, regarding the needs, investment objectives and risk tolerance of particular clients of his and that consequently there is absolutely no evidence to support Staff's contention that he breached the suitability obligation. Mr. Sellars suggests that Staff is erroneously relying upon the leverage-to-net-worth guidelines imposed by MR-0069, in most cases retroactively, and erroneously relying on non-client specific factors, such as Mr. Sellars' level of commissions or the percentage of clients of Mr. Sellars who were leveraged.

C. THE ISSUES

[20] The issues which must be decided by the Panel are the following:

(a) Whether Mr. Sellars recommended use of leveraged investments without regard to the suitability of this strategy for particular clients; and

(b) If (a) is answered in the affirmative, what terms and conditions should be imposed upon Mr. Sellars' registration.

D. THE LAW

1. Hearing de Novo and the Commission's Public Interest Jurisdiction

[21] The Hearing and Review of the Executive Director's decision is before this Panel pursuant to the provisions of section 193 of the *Act*. The relevant subsections of section 193 state:

Review of decision

193*(1) Any person directly affected by a decision of the Executive Director may, by notice in writing sent by registered mail to or personally served on the Commission within 30 days after the date of the decision, request and be entitled to a hearing and review by the Commission of the decision.*
[. . .]

193*(6) The Commission may by order confirm, vary or rescind the whole or any part of the decision under review or make such other decision as the Commission considers proper.*

[22] Prior to the commencement of the Hearing and Review, Staff and counsel for Mr. Sellars agreed that the hearing would proceed by way of a hearing *de novo*. This procedure has been considered and adopted by the Ontario Securities Commission ("OSC"), note particularly the OSC's decision in ***Re Triax Growth Fund Inc.,*** 2005 CarswellOnt 7518, and most recently by the Nova Scotia Securities Commission (NSSC) in ***Re Turnpointe Wealth Management Inc. and Frederick Saturley***, released 19 August 2010.

[23] The Panel therefore considered Staff's Application on a *de novo* basis, involving, as noted by the OSC in ***Re Michalik*****,** 2007 CarswellOnt 4742,

> *"a fresh consideration of the matter, as if it had not been heard before and no decision had been previously rendered"*.

[24] In their post-hearing submissions, Staff have suggested that the Application should be decided as if it had been filed under section 184(1) of the *Act*, which pertains to the Commission's jurisdiction to make orders in the public interest and that what this Panel ultimately has to decide is whether it is in the public interest to place terms and conditions on Sellars' registration.

[25] Mr. Sellars contests any suggestion that because the Hearing and Review proceeded as a hearing *de novo*, the Application no longer defines the issues. Counsel for Mr. Sellars contends that it is the case as defined in the Application that Staff must prove and that Sellars must defend.

[26] As previously noted, the Panel, pursuant to the provisions of section 193 (1), undertook a fresh consideration of the matter, based on the evidence presented by the parties during the course of the three days, as if it had not been heard before and no decision had been previously rendered. Section 193(6) of the *Act* confers upon the Commission the power to confirm, vary or rescind the whole or any part of the decision under review or make such other decision as the Commission considers proper. While we agree with counsel for Sellars that it is the case as defined in the Application which

Staff must prove and that Sellars must defend, there is nothing precluding the Panel from the exercise of its public interest jurisdiction if the Panel receives evidence which would warrant the exercise of such jurisdiction by the Panel.

[27] The Panel, when exercising its jurisdiction under section 193, is required to act in the public interest "*with due regard to its mandate/purpose under the Act*" (see ***Re Michalik***, 2007 CarswellOnt 4742, 30 O.S.C.B. 6717). In ***Re Michalik***, supra, the Ontario Securities Commission wrote:

> *46 As previously mentioned in paragraph 44 above, one of the paramount objectives of the Act is to protect the public (Gregory & Co. v. Quebec (Commission des valeurs mobilières), [1961] S.C.R. 584 (S.C.C.) at para. 11). The Commission exercises its discretion in the public interest prospectively to protect the public and the integrity of the capital markets to prevent future harm. This was clearly articulated in Mithras Management Ltd., Re ("Mithras"), where the Commission stated that:*
>
> > *[...] the role of this Commission is to protect the public interest by removing from the capital markets — wholly or partially, permanently or temporarily, as the circumstances may warrant — those whose conduct in the past leads us to conclude that their conduct in the future may well be detrimental to the integrity of those capital markets. We are not here to punish past conduct; that is the role of the courts, particularly under section 118 of the Act. We are here to restrain, as best we can, future conduct that is likely to be prejudicial to the public interest in having capital markets that are both fair and efficient. In so doing we must, of necessity, look to past conduct as a guide to what we believe a person's future conduct might reasonably be expected to be; we are not prescient, after all. [Emphasis added] (Mithras Management Ltd., Re (1990), 13 O.S.C.B. 1600 (Ont. Securities Comm.) at 1610 and 1611)*
>
> *47 The principle enunciated in Mithras Management Ltd., Re, that the Commission has the mandate to restrain future harmful conduct in the capital markets was also emphasized and cited in Belteco Holdings Inc., Re (1998), 21 O.S.C.B. 7743 (Ont. Securities Comm.) (at para 23).*
>
> *48 In pursuing the purposes of the Act, including protecting the investing public, the Commission is required to have regard to certain fundamental principles, such as the requirements to maintain high standards of fitness and business conduct to ensure honest and reputable conduct by registrants. Registrants have a very important function in the capital markets and they are also in a position where they may potentially harm the public. Regulating conduct of registrants is a matter of public interest. Consequently, proficiency requirements have been put in place by the Commission to ensure that the*

public deal with qualified registrants.

49 Proficiency requirements for registrants support, promote and enhance these objectives. In the case of an ICPM [Investment Counsel and Portfolio Manager]*, that proficiency includes both expertise in securities trading and also in the analysis that is required to manage a securities portfolio for others on a discretionary basis. Proficiency requirements also contribute to ensure regulatory compliance and enhance the efficiency of the capital markets.*

50 Strict adherence to defined proficiency requirements, subject to well articulated exceptions, are necessary and desirable: they permit both applicants and members of the investing public to know precisely and with certainty that registrants will meet reasonable, well-defined standards, which will be consistently applied. As stated in Oxford Investments Holdings Inc., Re, 2007 ABASC 150 (Alta. Securities Comm.): "[t]he advisor registration requirements are intended to ensure that investors receive sound investment advice by setting education and conduct standards for registered advisors and by providing ongoing monitoring and compliance obligations" (Oxford Investments Holdings Inc., Re, supra at para. 57). The well-defined proficiency standards are mandatory (subject to clearly articulated exceptions). We are of the view that it is in the public interest that they be strictly and consistently construed.

[28] A hearing *de novo* involves not only fresh consideration of the evidence which was put before the Executive Director but may also involve consideration of any new evidence brought forward by the parties. There is and can be nothing to curtail the exercise of the Commission's public interest jurisdiction based on the evidence which is put before it during the course of a hearing *de novo*.

2. The Standard of Proof

[29] Both parties have raised the issue of the standard of proof in their respective post-hearing written submissions. Staff submits that the standard of proof is that of the balance of probabilities. Sellars' counsel submit that Staff must discharge the burden of providing "clear and convincing proof based upon cogent evidence".

[30] That proceedings before Securities Commissions are administrative and civil in nature is well established (see ***British Columbia Securities Commission v. Branch*** [1995], 2 S.C.R. 3; ***Re Boock*** (2010), 33 O.S.C.B 1589 and this Commission's decision in ***Mallett et al.*** released 12 April 2012) and there can be no doubt that the civil standard of proof is

the applicable standard in proceedings before this Commission. This being said, we are mindful of the serious nature of the allegations made against individuals appearing before this Commission and the consequences flowing therefrom for the individual against whom such allegations are made.

[31] While the parties may appear at odds with regard to the applicable standard of proof, they are not. In this matter, Staff bears the onus of proving its allegations on a balance of probabilities, the civil standard of proof. Because of the serious allegations made against Sellars and the potential consequences thereof for Sellars, Staff must provide clear, convincing and cogent evidence for the allegations to be proven (see ***Re George***, 1999 CarswellOnt 236; ***Re Daubney*** (2008) 31 OSCB 4817).

3. The Guidelines

[32] Much has been said and argued about the "guidelines" governing leveraged investing during these proceedings.

[33] It warrants noting that prior to 2008 the MFDA did not have guidelines regarding leveraged investing. Keybase issued Leverage Evaluation Guidelines in 2007, with updates in September 2008 and January 2009. The Keybase guidelines identified various parameters for determining the suitability of a client for leveraging. Each updated version of the guideline provided a more comprehensive approach to determining eligibility.

[34] The MFDA issued MR-0069 on 14 April 2008. It provided MFDA Members and Approved Persons with guidance on their suitability obligation. Part 4 of MR-0069 describes the responsibilities of Members and Approved Persons with respect to leveraged transactions along with guidance on a wide range of suitability issues with respect to leveraged investments including investment knowledge, risk tolerance, age, investment time horizon, net worth and income.

4. The Obligations: Know-Your-Client and Suitability

[35] As there has been no judicial consideration in New Brunswick of the provisions of section 54(e) of the *Act*, it is appropriate to turn to the decisions issued by securities commissions in other provinces which have considered equivalent legislative provisions with regard to the proper approach to be taken in determining whether Sellars has breached his obligations.

[36] In ***Re Marc Lamoureux*** (2001) ABSECCOM 813127, the Alberta Securities Commission ("ASC") described the Know-Your-Client and Suitability obligations in the following terms at page 10:

> *The "know your client" and "suitability" obligations are conceptually distinct but, in practice, they are so closely connected and interwoven that the terms are sometimes used interchangeably.*
>
> *The "know your client" obligation is the obligation to learn about the client, their personal financial situation, financial sophistication and investment experience, investment objectives and risk tolerance.*
>
> *The "suitability" obligation is the obligation of a registrant to determine whether an investment is appropriate for a particular client. Assessment of suitability requires both that the registrant understands the investment product and knows enough about the client to assess whether the product and client are a match.*
> *.....*

[37] The Alberta Securities Commission also set out in the ***Lamoureux*** matter, supra, a three-stage process for the assessment of suitability by a registrant. The process is described as follows at pages 14 and 15 of the decision:

> *Suitability is to be assessed prior to any investment recommendation by the registrant to a client. The process that culminates in a registrant's investment recommendation to a client has three components phases or stages that must occur in sequence.*
>
> *The first stage involves the "due diligence" steps undertaken by the registrant to "know the client" and to "know the product". Knowing the product involves carefully reviewing and understanding the attributes, including associated risks, of the securities that they are considering recommending to their clients ....*

Only after the "due diligence" of the first stage is completed can the registrant move to the second stage in which they fulfil their obligation to determine whether specific trades or investments, solicited or unsolicited, are suitable for that client.

Suitability determinations ... will always be fact specific. A proper assessment of suitability will generally require consideration of such factors as a client's income, net worth, risk tolerance, liquid assets and investment objectives, as well as an understanding of particular investment products. The registrant must apply sound professional judgement to the information elicited from the know your client inquiries. If, based on the due diligence and professional assessment the registrant reasonably concludes that an investment in a particular security in a particular amount would be suitable for a particular client, it is then appropriate to the registrant to recommend the investment to that client.

By recommending the investment to a client, the registrant enters the third stage of the process. ... ..At this stage, when making the client aware of a potential investment, the registrant is obligated to make the client aware of the negative material factors involved in the transaction, as well as the positive factors.

... It should be emphasized that such disclosure cannot ameliorate deficiencies in either of the first two stages of the process. ... . The registrants failure may have been the result of not knowing the client, or not knowing the securities, or an error in the suitability determination but, once the improper recommendation has been made, it does not matter whether or how the registrant discloses the material negative factors, or whether the client claims to understand and accept the risks involved in the investment. The registrant has failed in their obligations.
[the underlining is ours]

And at pages 16 and 17 of the decision:

The obligation to ensure that recommendations are suitable or appropriate for the client rests solely with the registrant. This responsibility cannot be substituted, avoided or transferred to the client, even by obtaining from the client an acknowledgment that they are aware of the negative material factors or risks associated with the particular investment.

The obligation on a registrant to ensure that each investment recommended to a client is suitable is a particularly important protection for those clients whose investment experience and sophistication may be insufficient to enable them to fully recognize or assess the risks inherent in an investment. As noted below, disclosure to the client of the negative material factors of an investment, however important, is not necessarily relevant to a suitability determination and cannot replace a registrant's obligation to assess suitability. Acknowledgment on the part of an investor of awareness of the material

negative factors or risk does not convert an unsuitable investment into a suitable one.

...

The suitability of an investment product for any prospective investor will be determined to a large measure by comparison of the risks associated with the investment product with the risk profile of the investor. This comparison is probably the most critical element in the registrant's suitability obligation.

...

> *[A] registrant's obligation is to "know his client" and to ensure that any recommendations made by [him] are appropriate for the client based on the factors, both negative and positive, reasonably known to a diligent registrant at the time the investment is contemplated. Only those factors that are reasonably foreseeable at the time the investment is contemplated are relevant to the suitability determination. If a suitable investment actually fails due to some unforeseeable circumstance, that does not retroactively make it an unsuitable investment. If an unsuitable investment is recommended by a registrant, the fact that the investment is in fact proven to be successful does not retroactively make it suitable. It would be improper and unreasonable to assess a registrant's performance of his duties, which arise at the outset, in light of subsequent unforeseeable events.*

The Respondent Lamoureux's appeal to the Alberta Court of Appeal was dismissed (see [2002] A.J. No. 1300).

[38] Knowing the client means that a registrant must learn a client's "essential facts and characteristics", including the client's age, income, assets, investment knowledge and a host of other information. In ***Re Daubney*** (2008), 31 OSCB 4817, the OSC, citing ***Re Lamoureux***, *supra*, listed the essential facts and characteristics with which a registrant must familiarize him or herself in order to meet and discharge the obligation to "know your client" and the obligation of suitability:

> *[17] Knowing the client involves learning the client's "essential facts and characteristics", including the client's:*
>
> - *age;*
> - *assets, both liquid and illiquid;*
> - *income;*
> - *investment knowledge;*
> - *investment objectives, including plans for retirement; and*

• risk tolerance.

(Re Lamoureux, supra at 12-13.)

[19] In addition, we consider that other essential facts and characteristics would include the client's:

• net worth;
• employment status; and
• investment time horizon.

[20] In this case, where Daubney provided financial planning advice, it is particularly important that all of the above facts and characteristics be considered in addition to the client's cash flow requirements and tax position.

[21] This is commonly done by way of a "Know Your Client" ("KYC") form. The KYC form must be amended whenever the client's circumstances, investment objectives, and risk tolerance change. (Re Bilinski, 2002 BCSECCOM 102 at para. 330.)

[22] However, completion of the form is not, by itself, sufficient to ensure that suitability requirements are met. The registrant must make detailed enquiries as to the client's circumstances to ensure that suitable investments are recommended and to assess the client's likely reliance on the registrant's advice and recommendations. (Re Lamoureux, supra at 12-14.)

[23] Knowing the product "involves carefully reviewing and understanding the attributes, including associated risks, of the securities that they are considering recommending to their clients" (Re Lamoureux, supra at 14).

[24] With respect to "knowing the product," we agree that a particular investment approach, such as the leveraging strategy recommended by Daubney, is part of the "product."

[25] Where a registrant recommends leveraging, i.e. borrowing money to invest in a recommended product, the registrant is obliged to assess whether the client's circumstances are such that they have the ability to meet debt obligations and tolerate losses under different market scenarios. Because leveraging can magnify losses, it is critical that the registrant ensures the client understands the risks of borrowing to invest, in particular the risks of using collateral, including investments made with monies borrowed, as security for loans.

[39] In ***Re Foresight Capital Corp***., 2007 BCSECCOM 101, the British Columbia Securities Commission ("BCSC") summarized the three stage process for assessment of

suitability prior to making an investment recommendation by a registrant to a client in the following terms:

> *52 We would summarize this three stage process as the obligations of a registrant to:*
>
> *1. know the client and the product*
> *2. apply sound professional judgement in establishing the suitability of a proposed investment*
> *3. disclose the negative as well as the positive aspects of the proposed investment*

[40] It is difficult to imagine how one could make a determination as to suitability other than by engaging in a fact specific exercise. Individuals will necessarily have different levels of wealth, income and assets and beyond and within these specific differences, they will necessarily have different levels of risk tolerance and investment objectives and investment knowledge. Individual A may perfectly understand and wish to enter into an investment transaction, in full cognizance of the potential gains and losses which the transaction entails whereas individual B, may consider the same transaction a foolhardy and risky venture of which he or she wants no part. We agree with the reasoning of the ASC in ***Re Lamoureux*** and that of the OSC in ***Re Daubney***, *supra*, that a financial adviser's determination of suitability will always be fact specific and will necessarily involve consideration of factors such as the client's income, net worth, risk tolerance, liquid assets, investment objectives and the client's knowledge of investing and the particular investment product.

[41] It is against this background that the Panel must determine whether, in light of the evidence received during the Hearing and Review, Mr. Sellars breached the know-your-client and suitability obligations and whether there should be terms and conditions attached to his registration.

E. EVIDENCE AND ANALYSIS

1. Overview

[42] The Panel received the evidence from three (3) witnesses.

[43] Staff's evidence was led through two (2) witnesses, Mr. Ed LeBlanc, a senior investigator with the Commission ("Mr. LeBlanc") and one investor, identified herein as "A.A".

[44] Mr. Sellars testified on his own behalf. His counsel did not call any other witnesses.

2. Staff's Evidence

[45] Staff presented direct testimony from A.A., who testified about her investment experience with Mr. Sellars.

[46] A.A. is currently 31 years old. She is university educated and currently employed by the City of Moncton. She owns a house, which she purchased in April of 2004 for the sum of $100,000.00. Her purchase was financed through a mortgage, the amount of which was close to $100,000.00.

[47] Mr. Sellars was formally introduced to A.A. in 2002, through A.A.'s father. Mr. Sellars was her father's financial advisor and had, through the years, assisted the family with income tax issues.

[48] In 2002, A.A. was a 22 year old casual employee. She wanted to start investing by putting aside $100 per month as a retirement fund by means of opening a RSP account and began doing this through Mr. Sellars in the Fall of 2002. In the Summer of 2006, A.A. ceased the $100 per month investment and embarked into leveraged investing with Mr. Sellars. A.A. was 26 years old at the time.

[49] A.A. testified that in June or July of 2006, she received a call from Mr. Sellars asking if she owned a house and advising her of an exciting opportunity for homeowners to attend a seminar. She attended a seminar in July 2006 where she learned about the "Smith Manoeuvre". According to her, she did not understand the

Smith Manoeuvre very well but understood that it had something to do with one's mortgage.

[50] A.A. testified that a few days after the seminar, Mr. Sellars had followed up with her and described the opportunity as very exciting. She was explained that with a $100,000.00 loan, she could purchase investments and that the loan would be paid off with the dividends received through the investments and that eventually, in the years to come, she would have a $100,000.00 investment that had paid for itself. A.A. believes that the time frame which she was given for this to occur was 20-25 years.

[51] She testified that she did not believe that she had participated in a Smith Manoeuvre. She stated that she did borrow money for the purpose of investing but that it had nothing to do with her house or mortgage. When A.A. was asked if she had had any questions about the strategy at the time, she said "*not too many*" and that she was "*very naive and very new to investments*." She stated that she did have questions about how you could get out if you wanted to and how it would kind of affect you otherwise. According to A.A., Mr. Sellars made it sound like it was very easy to get out of any time you wanted to and the loan and the investments would just cancel each other out.

[52] Through Mr. Sellars, A.A. contracted a $100,000.00 loan from AGF Trust. The AGF Trust investment loan application dated 10 July 2006 was introduced as evidence Exhibit 1. On the loan application, A.A.'s house was listed as having a value of $130,000.00 even though she had purchased it 2 years and 2 months prior for the sum of $100,000.00. A.A. testified that Mr. Sellars had asked her how much she thought her house was worth and she said $130,000.00 because "someone" had made a comment that they thought it was worth $130,000.00. A pension of $10,000.00 was also listed on the document and A.A. was unable to explain why this would be indicated on the document and believes it is just an "estimate" which Mr. Sellars indicated on the form. A.A. testified that the investment loan application form was filled out by Mr. Sellars and that she signed it. She does not recall Mr. Sellars reviewing the document with her.

[53] With the proceeds of the investment loan, A.A. purchased $100,000.00 worth of mutual funds with Stone Co. Flagship and Growth Fund (the "Stone Fund"). She does not remember whether this was a cash or an RRSP account but recalls the monthly payments were $645.00. The dividends she was receiving from the fund were approximately $1,000.00 per month and the payments were automatically withdrawn out of her account.

[54] A.A. testified that the monthly statements she received showed that the investment was going down rapidly whereas the loan amount remained the same. She stated that this made her anxious and concerned because she had been told, and she had understood, that "*it would be something not to really worry about and it would stay the same*." She spoke to Mr. Sellars about this in January 2007, approximately, and was told not to worry and that she shouldn't pay attention to the statements because it would take a long time to work itself out.

[55] Around mid-2008, A.A.'s investment was down by about $20,000.00 and she spoke with Mr. Sellars again. A.A. testified that at that point, Mr. Sellars asked whether she had $20,000.00 to get out of it and when she replied in the negative, Mr. Sellars told her that she would have to stay in it for the long term and not to worry about it or pay attention to the statements.

[56] At the end of 2009, A.A. received a letter stating that the monthly distribution from the Stone Fund would be decreasing from $1,000.00 per month to $360.00 per month. At that time, her loan payment was approximately $795.00 per month. She testified that her monthly payment had increased from $645.00 to $795.00 per month because in late 2008 she had retained the services of another financial adviser and the new adviser had counselled her that it was in her best interest to apply the full monthly dividend to the investment loan to pay off the loan as rapidly as possible rather than re-investing some of the distribution with the fund provider through a systematic investment plan.

[57] When asked how she made up the difference between the $795.00 monthly payment and the $360.00 monthly distribution, A.A. stated that she was making up the difference out of pocket. When asked if Mr. Sellars had ever explained to her that this was a possible scenario, she replied in the negative.

[58] Staff, through A.A.'s testimony, also introduced in evidence Exhibit 3, being a Letter of Assignment of Mutual Funds, dated 18 July 2006. A.A. testified that although this document was purportedly signed by her, she did not recognize the signature on this document and has no recollection of meeting with Mr. Sellars on that date. A.A. produced a page out of her workplace's daily log which indicates that she worked from 8 a.m. to 4 p.m. with a 20 minute lunch break between 12:00 and 12:20 p.m. She testified that she had never met with Mr. Sellars before commencing work and that she had not met with him during her 20 minute lunch break.

[59] On cross-examination, A.A. testified that when she obtained a mortgage in 2004, she had understood that the interest would be payable for a period of five years at the rate that she had contracted for and if, after 5 years, the rates went up or down she would have to adjust payments accordingly. She understood that regardless of the value of her home, the amount owed to the bank was a definite amount.

[60] A.A. testified that she had attended the entire presentation on the Smith Manoeuvre at the seminar and had been given the opportunity to ask questions. She also acknowledged that at the seminar, she and others had been provided with a book on the Smith Manoeuvre, written by Fraser Smith. She stated that she had tried to read it but did not really understand most of what was in it.

[61] When counsel for Mr. Sellars suggested to A.A. that when she met with Mr. Sellars at no time did she advise him that there were aspects of what was being proposed to her that she did not understand. Her answer was "*No. He would have known. No. He knew*."

[62] A.A. stated that she did recall ceasing the monthly $100 investment in her RRSP. She recalls that in 2006 she stopped investing the $100 in her RRSP and when questioned by counsel for Mr. Sellars as to whether the purpose of this was to apply the $100 against her mortgage, A.A. stated that she had ceased this investment because it seemed kind of "simple" to be doing that given the fact that she was engaging in a grander scale investment. When asked if she recalled having a conversation with Mr. Sellars during which he recommended that the $100 a month should be applied against her mortgage rather than going towards an RRSP, A.A. stated that she recalled the conversation but does not remember Mr. Sellars framing the issue as a recommendation. A.A. stated that she understood that the interest on the investment loan was tax deductible and that the idea was that the refund she would obtain from Revenue Canada would be used to pay down her mortgage but that she had not done that.

[63] A.A. also acknowledged that she had filed complaints against Mr. Sellars with Keybase, the Commission, the MFDA and the Ombudsman; most of these complaints were resolved. The MFDA was still investigating.

[64] As their final witness, Staff presented Mr. LeBlanc. Mr. LeBlanc testified that he had been employed with the New Brunswick Securities Branch since 1990 and employed with the Commission since 2004, and currently holds the position of Senior Investigator.

[65] The direct evidence of Mr. LeBlanc was limited to his testimony that he did not personally conduct an investigation but that he is aware that the MFDA conducted an investigation into Mr. Sellars' leveraging strategies; and to the introduction into evidence of an Affidavit sworn by him on 7 December 2009.

[66] Mr. LeBlanc was cross-examined by counsel for Mr. Sellars and acknowledged the following:

- He reports to the Commission's director of enforcement.
- The Commission employs two investigators, but he was the sole investigator assigned to the Sellars and Keybase matter.

- He became involved in the matter in the Fall of 2009.

[67] Mr. LeBlanc never received a verbal or a written mandate in relation to this matter. He stated that he had never conducted his own investigation into the matter and that he had simply reviewed documents and correspondence which had been directed to the enforcement division of the Commission by the MFDA. He stated that he had never received any documents directly from the MFDA.

[68] At paragraph 6 of his Affidavit, Mr. LeBlanc states:

> *"I have reviewed certain of the information produced as a result of the MFDA investigation into the leveraging practices of Sellars, which includes certain information regarding another approved person named K.A. I am concerned with the leveraging practices indicated in the documents provided by the MFDA, as well as Keybase's lack of supervision over the accounts in question*."

[69] Counsel for Mr. Sellars questioned Mr. LeBlanc regarding the contents of his Affidavit. When questioned as to how he had formed the conclusions expressed in his Affidavit, Mr. LeBlanc stated that his process had consisted of reviewing the emails, letters and documents which the enforcement division had received from the MFDA and sent to him and concluding that he shared the MFDA's concerns. He stated that he had not followed up with the MFDA for clarifications nor had he asked for or obtained any additional documents.

[70] In paragraph 7 of his Affidavit, Mr. LeBlanc states the following:

> *"I have compared Keybase's internal guidelines with respect to leverage to the guidelines set by the MFDA. Attached hereto and marked as Exhibit "2" are Keybase's internal guidelines with respect to leverage for the years 2007, 2008 and 2009. Staff of the Enforcement division requested these documents from Nadia Dedic, an investigator with the Enforcement Department of the MFDA ("Ms. Dedic"), on 15 October 2009. Ms. Dedic provided the documents in PDF format by email that same day*."

[71] When questioned as to how he had conducted his comparison of such guidelines, Mr. LeBlanc stated that he had gone through the documents and compared each paragraph to the MFDA document and paragraphs. He

acknowledged that the MFDA guidelines were published only on 14 April 2008 and when asked as to what purpose was served by comparing the Keybase 2007 guidelines to the MFDA 2008 guidelines, Mr. LeBlanc agreed that the MFDA 2008 guidelines could not be imposed retroactively.

[72] In paragraph 10 of Mr. LeBlanc's Affidavit, there is reference to an email from Ms. Nadia Dedic, an investigator with the MFDA, to Enforcement Staff. To this email there is an attachment consisting of a letter dated 15 August 2008 from B.B., the chief compliance officer at Keybase, to Ms. Nadia Dedic, providing information regarding specific leveraged accounts as well as Keybase's general approach to supervising leverage. In this letter of August 2008, B.B. wrote that a revision of the guidelines was in progress and would be implemented in September and she references a draft version of such guidelines being attached to the letter for Ms. Dedic's review. The attachment, although referenced in the letter, was not attached. When asked whether he had followed up with either of B.B. or Mr. Sellars, or with the MFDA, as to what exactly had been sent to the MFDA, Mr. LeBlanc replied in the negative. He also acknowledged that:

(a) he had not communicated with Ms. Dedic as to whether the MFDA had responded positively or negatively with regard to what was sent to the MFDA by Keybase on 15 August 2008; and
(b) he had not communicated with anyone at Keybase to obtain further information concerning the guidelines.

[73] As evidenced by the email from Ms. Dedic to Enforcement Staff, the letter from B.B. to Nadia Dedic, dated 15 August 2008, was provided to Enforcement Staff on 21 October 2008, at least 1 year before Staff filed its Application in December 2009. When Mr. LeBlanc was questioned as to whether he or Staff had obtained the various appendices which are referenced in the letter, including the draft version of the September 2008 Keybase guidelines, Mr. LeBlanc answered in the negative and stated that he was not aware that Staff had followed up with the MFDA regarding this letter.

[74] Finally, Mr. LeBlanc's Affidavit contains a list of what purports to be clients of Mr. Sellars. In addition, there are attachments to Mr. LeBlanc's Affidavit which are a sampling of six sets of Mr. Sellars' client accounts, which contain information on 11 individual clients in particular. Counsel for Staff confirmed at the hearing that he was the one who had requested from the MFDA the leverage documentation regarding the sampling of the six sets of accounts. When questioned as to whether he had reviewed any of the client accounts listed in his affidavit, Mr. LeBlanc stated that he had reviewed some of these but not others and that he had not had any personal contact with any one of the clients, including A.A. He also added that he had not conducted any investigation into the complaints made by A.A. Mr. LeBlanc also stated that he was not aware whether anyone from the MFDA had communicated with or contacted the clients.

[75] Mr. LeBlanc testified that he had not prepared any reports nor did he report any irregularities regarding the six sets of client accounts which are highlighted in his Affidavit nor was he asked to follow up with Mr. Sellars to obtain any clarification of any information obtained or to obtain more information from these clients.

[76] Mr. LeBlanc confirmed as well that during the course of his review of documents regarding the Sellars and Keybase matter, he had never prepared any internal notes or reports to the Enforcement Division. He confirmed as well that he had not taken any action to ascertain the accuracy of any information relating to the amount of the commissions purportedly earned by Mr. Sellars.

[77] When asked by counsel for Mr. Sellars whether he had any contacts with the office of the Superintendent of Insurance for the Province of New Brunswick, either verbal or written, with respect to Mr. Sellars, Mr. LeBlanc responded that he had not.

[78] When questioned on re-direct, Mr. LeBlanc testified that he had not conducted his own investigation into the Keybase and Sellars matter because the MFDA was conducting their own investigation.

3. Evidence of Mr. Sellars

[79] Mr. Sellars testified on his own behalf. His Affidavit, sworn on 25 January 2010 was entered into evidence as Exhibit 6.

[80] Mr. Sellars holds a bachelors degree in arts and economics. He has completed the courses towards the certified general accountant designation but did not complete the program. He successfully completed the Canadian Securities Course, has earned the Chartered Financial Planner designation and is licensed to sell mutual funds and (up until January 2012) life insurance.

[81] Mr. Sellars started working as a financial planner at Heritage Financial Services in 1993. He worked with this company until the Fall of 2001 at which time he started working with Canadian Investment Consultants. In the early winter of 2003, this company was purchased by Keybase Financial Group and he has been working with Keybase ever since.

[82] Mr. Sellars worked alone when he started working with Keybase in 2003. In 2007 or 2008, a junior financial adviser joined his office for a short period. Mr. Sellars is currently the only financial adviser in his Moncton office. Mr. Sellars stated that at all times there would have been a person acting as a secretary/ receptionist in his office and that since 2006, these duties were performed by his wife. He testified that he was appointed a branch manager within a few years of starting to work with Keybase. As a branch manager, there was no one in New Brunswick supervising his transactions and the oversight of his work was done by the chief compliance officer for Keybase, who was working out of Keybase headquarters in Toronto.

[83] Mr. Sellars has been a licensed mutual fund dealer since 1993. He explained that he also has a tax practice and from 1996 also held a licence allowing him to sell life, health and disability insurance, a license which he no longer holds since January 2012.

[84] Mr. Sellars is an Approved Person of Keybase. Keybase is a registered dealer and member of the MFDA. Mr. Sellars' status within the MFDA is that of an Approved Person

of a registered dealer. His role within Keybase is to develop relationships with clients in the area where he is licensed, to provide such clients with guidance in terms of their investment objectives, their goals and to maintain an office.

[85] He currently serves 256 clients, which he considers his clients and not those of Keybase. He described his relationship with his clients as being one where he has a fiduciary obligation to ensure that they are well cared for and well informed.

[86] Mr. Sellars' relationship with Keybase is that of an independent contractor. He explained that the process of how is he compensated for his work is that once he sells investments to a client, a commission is triggered by the mutual fund vendor from whom the investment is purchased. The mutual fund vendor sends a cheque to Keybase and Mr. Sellars gets a percentage of that amount. He explained that on a deferred service charge contract in a mutual fund, Keybase receives 5% of the gross purchase amount being made by the client. From that 5%, Mr. Sellars receives 80% and Keybase receives 20%. Mr. Sellars is paid only after the money is received by Keybase.

[87] Mr. Sellars testified that he would also have discussions with his clients regarding deferred services charges, which are service charges deferred over a period of time. A schedule sets out the fees payable by the client if the investments are extracted from the fund at different points in time. He explained that if a client purchased an RRSP with the objective of not drawing from it for 10 years and knowing that the deferred service charge schedule is 5 to 6 years out, it would make perfect sense to adopt a deferred service charge and not pay any fee at all. He confirmed that in the case of a deferred service charge the fund provider pays the fee rather than the client paying the fee. Mr. Sellars stated that he recommended this mechanism to his clients because if they kept the investment long enough they ended up paying no service charges.

[88] Mr. Sellars was asked who within Keybase developed guidelines and policies. He explained that these functions would belong to the staff of Keybase. He was unsure whether the Keybase compliance department played a role in the development of

policies but was certain that the compliance department monitored the policies and ensured compliance with same.

[89] During his testimony, Mr. Sellars explained the steps involved with the processing of a client transaction. He explained that he would have to complete and then send on to Keybase a number of documents related to the transaction. Depending on the nature of the transaction, the documentation could include a new account application form ("NAAF") and a purchase agreement with a mutual fund company and, in the case of certain kinds of registered products, a registered document as well, along with proper identification documents relating to the particular client. This package of documents, once received by Keybase, would have to be reviewed, stamped for approval and sent on to the industry for completion of the transaction.

[90] Mr. Sellars was questioned as to his knowledge, understanding and practices as they related to the Know Your Client and the suitability obligations. He stated that his understanding of suitability is that the *Act* dictates that all investments need to be made suitable to the goals and objectives of the client and that his obligation is to ensure, to the best of his ability, that the investments are suitable to his clients' goals and objectives. The process through which he meets this obligation of suitability is by doing with the client a detailed data gathering exercise to determine who the client is as well as the client's goals and objectives, and then using the KYC form to add relevant information to best define the client's goals and objectives.

[91] Mr. Sellars explained that part of the NAAF was the KYC questionnaire. Mr. Sellars went through this questionnaire and pointed out the questions relating to the client's employer, nature of the business, type of occupation, client income, household net worth, investment knowledge and investment objectives, risk tolerance and liquidity. He explained that in each case he would discuss these issues with the client and hopefully there would be notes documenting such discussions. He also stated that he would often have detailed discussions about goals and objectives that were not necessarily captured by the items listed in the KYC questionnaire, such as discussions on whether their main concern was investments which provide nothing but safety or

whether they were interested in investments that had more potential for growth. He explained that he would also have conversations about risk tolerance and liquidity and at what point they expected to need to draw down this investment, discussions about whether any other person had trading authority on this account, discussions about banking information and discussions relating to consent to electronic delivery of documents.

[92] Mr. Sellars also referenced and went through that part of the NAAF which relates to leverage disclosure. He explained that this is where the risks associated with borrowing for the purpose of investing are described. Mr. Sellars testified that the NAAF, and in particular the KYC forms, have evolved over time. He produced the current Keybase NAAF, which was last modified in 2011 (Exhibit 7). He explained that the main changes made to the Keybase NAAF between 2008 and 2011 were the leverage disclosure provisions, the simplified information as to how financial advisers get paid and the addition of a summary of the Keybase complaint handling procedure.

[93] With respect to his leveraging practices, Mr. Sellars testified in detail with respect to his knowledge and use of the "Smith Manoeuvre", which was also referenced by A.A. in her testimony. Mr. Sellars testified that he became acquainted with the Smith Manoeuvre when he attended a seminar in Truro, NS in 2003 at which the guest speaker was Fraser Smith. Mr. Smith gave a speech about the opportunity to convert a client's mortgage debt into tax deductible debt. Mr. Sellars stated that although he had listened to the speech and taken home a book authored by Fraser Smith about the Smith Manoeuvre, he was unable to fully understand the manoeuvre so he did not pursue this concept at the time. In 2005, he attended a convention in Niagara Falls where Fraser Smith was again a guest speaker. Mr. Sellars had the opportunity to further discuss the concept with Mr. Smith and another individual, and they were able to explain to him the part which had caused him difficulty. He stated that as he now understood the concept, he returned to Moncton and began telling people what he had discovered.

[94] As explained by Mr. Sellars, Fraser Smith's materials suggest that if the equity in a person's home could be converted to a line of credit and the available equity used to purchase investments, over time there would occur a transfer of your debt from a debt that was primarily focused on that person's real estate to a debt that was actually focused on investments. And, by virtue of the fact that it was now a debt associated with investments, the interest costs would be deductible on your tax return. Mr. Sellars explained that the basic objective of the Smith Manoeuvre is to build wealth and the methodology by which one can do this is to create an investment portfolio and pay off your mortgage and your debts. According to Mr. Sellars this is accomplished by creating an investment portfolio that triggers a monthly distribution. The monthly distribution is used to reduce the amount owed on the mortgage and as that debt is reduced, there becomes more credit available to the homeowner which can be used to service the investment loans. Over time, and if you make regular payments, you accelerate the reduction on that loan on which the interest is not deductible and what you are left with is a home which is free of debt, an investment portfolio and an investment debt, the interest of which is deductible.

[95] Mr. Sellars also testified that there was as well a strategy known as the "enhanced Smith Manoeuvre" which consists of optimizing the amount of the loans to create a larger portfolio that would pay larger monthly distributions and accelerate the reduction of the debt. He testified that it was necessary to have considerable equity in your home, considerable net worth and considerable income to be able to justify this sort of investment strategy but in the proper circumstances it could be a positive idea for the clients.

[96] Mr. Sellars started introducing the Smith Manoeuvre or the enhanced Smith Manoeuvre in Moncton in early July of 2005. In 2005, neither Keybase nor the MFDA had guidelines dealing with leveraging.

[97] In order to introduce this concept of the Smith Manoeuvre and to guide his clients, Mr. Sellars used seminars, a marketing tool which he had used for a number of years for tax planning. At one point in time he was conducting 2-3 seminars per week.

The seminars consisted of a 45-minute Power Point presentation with himself as primary speaker. He testified that on some occasions there would be bankers or tax specialists in attendance who would also speak about leveraged investing. There would as well be a question and answer period during which the attendees could ask questions. Everyone who attended a seminar was given, free of charge, the book entitled "Is your Mortgage Tax Deductible" - The Smith Manoeuvre, written by Fraser Smith, and urged to read it. A copy of this book was introduced into evidence.

[98] Mr. Sellars testified that he understood that it was important for the clients to be really well informed and that he would have face to face meetings with anyone interested in engaging in leveraged investing to discuss with them the "variables" involved, the fees, the risks, the possibilities of future changes and so on. He would also discuss risk management with his clients. Mr. Sellars testified that the investments he recommended were mutual funds that were very secure, blue chip, dividend bearing, and primarily focused on Canadian banks with a very strict management style; and he recommended no margin loans, because in the event that the investment declined, the client would not get demands to make up the difference. He explained that over a period of 20 years or so, he believed that this represented a relatively manageable level of risk but nonetheless still explained to the clients in great detail that there remained risks. He stated that there is risk in all investing and no one could assert that there could never be a situation that could cause investments to go down.

[99] Mr. Sellars' evidence is that his recommendations to his clients in terms of reducing and paying off the debt strayed from the strict traditional Smith Manoeuvre. He testified that Fraser Smith espoused the view that a debt with a tax-deductible component should never be paid off and that any proceeds or cash derived from the investments should be used to purchase additional investments, whereas his own view was that there was value to and some form of empowerment for clients when they were able to become debt free.

[100] Mr. Sellars' evidence is that it was very difficult and only happened in rare instances that people who did not own a home with equity or did not have a job could

engage in the Smith Manoeuvre or any kind of leveraged investing. He testified that once he determined that an individual could be an appropriate candidate for leveraged investing, he would fill out the NAAF and in so doing, would complete the KYC questionnaire.

[101] Mr. Sellars also testified that in 2005 or the Spring or Summer of 2006 he had developed a form, which he referred to as a Memorandum of Understanding ("MOU") (found at tab 11 of Exhibit 6) to help him ensure that the clients who engaged in leveraged investing understood the steps involved in this strategy. It was his evidence as well that when Keybase became aware of his MOU, they used his document as a template to develop their own MOU regarding leveraged investing (found at tab 5 of Exhibit 6). During his testimony at the hearing, Mr. Sellars read through every paragraph of the MOU and stated that the process he adopted with every one of his clients was to read every paragraph and then ask the client whether they had any questions. He added that with some clients "you knew explicitly that they understood".

[102] Mr. Sellars testified that as he went through this information gathering process with his clients, he was also assessing client suitability as he has always understood that the investment needed to be appropriate and suitable to the client's goals and objectives. He stated that there would be discussions about suitability in every case and that as the process evolved, Keybase elevated its compliance and the compliance department would call him and ask questions about why he thought certain investments were suitable to certain clients, whether he had discussed certain information with certain clients, and whether the client understood what had been discussed.

[103] In terms of processing transactions, Mr. Sellars testified that once the loan applications were made, the client's credit worthiness was ascertained by way of a credit check completed by the lender. He stated that the lender would then communicate to him whether the information provided to him by the client was true. When asked what guarantees were being requested from the clients by the lenders, Mr. Sellars stated that the lenders wanted the interest costs on a monthly basis as well as

an assignment of the investment purchased with the proceeds of the loan, thereby ensuring that the investment could not be sold without their knowledge. Mr. Sellars' counsel asked him to explain why in a lot of cases, clients were contracting two loans with two lending institutions. Mr. Sellars' explanation was that "they", (presumably the lenders), made him aware that it was their preferred way of doing business, that they were mitigating the risk by splitting a global amount into two loans. He stated that the lenders, or at least AGF and B2B, being the lenders with which he dealt, were fully aware of the structure being followed and never voiced any problems with this way of proceeding. The two investment funds which he recommended to his clients were the Clarington Canadian dividend fund (the "Clarington Fund") and the Stone Fund because notwithstanding the fact that they were equity funds, they were promoted as being a purely Canadian blue chip dividend bearing investment, and were closely managed funds which were very stable and safe. Mr. Sellars testified that once he had gathered what he believed was a "complete package", the documents would be sent to Keybase compliance by courier.

[104] Mr. Sellars testified that as a result of the downturn in the economy in 2008 and 2009, he consulted with every one of his leveraged clients and formed a "very defensive stance from thereon". He called in wholesalers for both the Stone Fund and the Clarington Fund at separate events and asked all his clients to attend to get information about the change that had occurred. He explained it to them as the earth having moved under their feet and upsetting the notion with which they had originally adopted this strategy. He told his clients that they had to retract, be cautious and approach the situation with a view to "weather a storm". There were two such information events in the Fall of 2008 and he then started a complete campaign during the Winter and Summer of 2009 where he held seminars titled "Bear Strategies", to which he invited all clients who had engaged in the Smith Manoeuvre to come in and review their strategy. He stated that his recommendation to the clients at that time was to vacate the Stone Fund, as they had communicated to the group at the 2008 meetings that they had fixed payout cents per share whereas the Clarington Fund representatives had told the group that they were going to change the distribution in order to protect the asset values of the fund, to ensure that the investment did not

erode to zero. As a result of this, most of his clients moved either half or entirely away from the Stone Fund. Mr. Sellars testified that the decision to move away from or to remain with the Stone Fund was the client's decision. They needed to be informed as to what options were available to them and how those options worked. Mr. Sellars stated that as he was dealing with different individuals, there were different responses.

[105] Mr. Sellars then moved his testimony to his earnings. In Mr. LeBlanc's Affidavit (Exhibit 5), and more particularly at tab 8 thereof, there is a letter from the MFDA to Enforcement Staff where, on page 2, the amount of commissions earned by Mr. Sellars between 2004 and 2008 are set out. The numbers show a significant increase from 2004 to 2005, large increases in 2006 and 2007 and a decrease in 2008, although the total amount earned is still significant. Mr. Sellars confirmed the amounts. He explained that in 2003, there was a major market crash, and that 2004 was the precipitant out from that correction, which explained the increase from 2003 to 2004. He stated that in 2005, the markets were on the upswing and that his existing business would organically expand when the markets were growing. He explained that his income fluctuates with market performance. He stated that his income decreased in 2008 and that there were no restrictions on his license at that time. He also added that prior to Staff's Application, no one had ever questioned him about his income.

[106] With respect to A.A., during cross-examination by Staff, Mr. Sellars acknowledged that in 2002, A.A. was investing $100 per month in an RRSP account and when she adopted a different strategy in 2006 by entering into a leveraged investment of $100,000, he received 80 times the amount of the commission he would have received had A.A. maintained her initial investment strategy.

[107] Mr. Sellars was questioned by his counsel in relation to Keybase Leverage Evaluation Guidelines for 2007, 2008 and 2009 (tab 2 of Exhibit 5). On the Keybase Leverage Evaluation Guidelines for 2007 the "posted date" is indicated as 16 April 2007. Mr. Sellars stated his belief is that this guideline was put into place by Keybase when it was posted on their website. Although he didn't recall specific discussions, he acknowledged that there would surely have been discussions between him and

Keybase in relation to this document. In the 2007 guidelines, one of the parameters was the client's total assets-to-net worth and there were 2 criteria: i) 50% of client's total assets; or ii) 70% of the client's net worth. Mr. Sellars explained that this was one of the parameters which was to be considered and that it was a threshold. He also explained that one had to look at other parameters as well, such as that the client investment horizon must be long term, the client investment knowledge must be good or excellent as well as other parameters.

[108] Mr. Sellars explained that in September 2008, the Keybase Leverage Evaluation Guidelines were revised and client risk tolerance was added as a parameter. He explained that they had also provided for exceptions. He stated that while there were certain thresholds and when one considered net worth as a focus, the discussion might lead to a conclusion that the client would not have enough net worth to engage in leveraging, there could be exceptions. For example, where the client was a recent university graduate with a large income and a big career ahead of him, even though the client does not meet the threshold in terms of net worth, an exception to the standard could be made. Mr. Sellars testified that he was not involved in any exchanges between the MFDA and Keybase with regard to these guidelines nor was he involved in the development of the 2008 Keybase Leverage Evaluation Guidelines.

[109] Mr. Sellars testified that he only became aware of MR-0069 in the Fall of 2009 but acknowledged that the MFDA issued MR-0069 on 14 April 2008. He added that it was possible that he had heard someone mention that the MFDA came out with a new guideline in the spring or summer of 2009.

[110] A spreadsheet containing data relating to various individuals was introduced into evidence as Exhibit 9. Mr. Sellars acknowledged that the individuals referenced in this document are his clients but that the document was prepared by KPMG at the request of the MFDA, and that he was never consulted in the preparation of that document. He surmised that the data contained in this document must be the data contained in the clients' files and that this data was gathered from the files and put on

a spreadsheet by KPMG. He testified that he did not know whether the data contained in the document was captured from his own files or those of Keybase.

[111] When asked whether, strictly based on the information contained in the spreadsheet, it was possible to fully assess whether the investments and leveraging strategies proposed to the clients were appropriate, Mr. Sellars replied in the negative. He stated that there was no means to gather that information because the data in the spreadsheet does not speak to the goals and objectives of the clients in any meaningful way, nor does it speak to the conversations he had with his clients and the nuances of those conversations. He stated that while the spreadsheet did record a lot of data, the main component in the whole of the document was reliance on ratios, in terms of loans and net worth in particular. He stated that when KPMG audited his files, he was told that he had not captured the data related to net worth but that net worth is a very "complex" calculation and needs to include "everything", and he never had the "data capture" that accomplished this. He also stated that in terms of evaluating the overall performance or well being of a particular client, the data contained in the spreadsheet did not enable one to do this because it did not address anything in terms of reduction in mortgage debt, tax savings and other issues which should be addressed in order to do a proper assessment of a client's financial well-being.

[112] During cross-examination, Mr. Sellars did not dispute that the worst part of the 2008 financial crisis was the 2 month period between mid-September and mid-November but added that the situation "got really bad in December 2008 to March 2009". Staff spent considerable time questioning Mr. Sellars about the data relating to several clients. Mr. Sellars acknowledged that:

- client 20[1] entered into a leveraged loan of $63,000 on 31 October 2008, a second leveraged loan of $40,000 on 5 November 2008 and made a cash investment of $20,000 during this time period;
- client 23 entered into a leveraged loan of $150,000 on 19 September 2008, a second leveraged loan of $70,000 on 9 October 2008 and made a cash investment of $35,000 during this time period;

[1] Clients in paragraph 112 identified using the client numbers set out in the spreadsheet contained at Tab 8 of Exhibit 5 (Affidavit of Ed LeBlanc)

- client 29 entered into a leveraged loan of $86,800 in November and December of 2008;
- client 30 leveraged an amount of $375,000, combined with a cash investment of $125,000 in November and December of 2008;
- client 46 leveraged an amount of $160,000, combined with a cash investment of $30,000 in October 2008; and
- client 71 leveraged an amount of $232,500 in October and November of 2008.

[113] Mr. Sellars did not dispute that the data in the spreadsheet was inputted by the Keybase chief compliance officer but expressed concerns about the data associated with net worth. He suggested that the net worth data was captured during a timeframe which might not be appropriate to the spreadsheet. He stated that in 2005 and 2006, and years prior to this period, there was virtually no net worth calculation and what data capture there was, was to meet the requirements of the lender and consequently there was possibly undocumented data which was used to establish the net worth calculation. He stated that based on this, he would dispute, for example, that client 71 was leveraged to 250% of net worth.

[114] Mr. Sellars also acknowledged that he had processed significant loans in October and November of 2008 and he was asked by Staff, in light of his testimony that he had recommended to his clients a "defensive stance" during that period, how such investments could be described as "defensive" at a time where the markets were in a freefall. Mr. Sellars testified that a number of clients had been in the queue to get into leveraged investing. He explained that at that particular time, there was no discussion about the world coming within a hair's breadth of worldwide economic collapse and the literature was suggesting that we were experiencing a momentary adjustment in the marketplace, although there were great concerns that it could be worse. He stated that in view of the situation, it was more a matter of what he would discuss with existing clients about possibly withdrawing funds from these investments in light of the fact that the investment funds themselves might start to reduce their distributions. He said that it called for him to do a very careful review and play a more defensive role and that's why he characterized his activities as defensive as opposed to offensive.

[115] Mr. Sellars testified that while Staff quite rightly pointed out that there was a dramatic market decline going on in September and October of 2008, the results for some of the clients who invested during this period were very positive. Some of these clients are in very sound positions because of the fact that they had purchased investments at a timely moment. Mr. Sellars explained that he did have concerns about the market at that time and if he had been able to predict the future he might have put a stop to the loans. He stated that he has been in the business since 1993 and had witnessed a lot of ups and downs in the market and that financial advisers must take things in stride and not overreact.

[116] Staff asked whether Mr. Sellars would agree that it does not make a lot of sense for a financial adviser to say to an investor on the one hand that the time has come to take a very defensive approach and on the other hand, advise him to invest $300,000 in the market. Mr. Sellars disagreed and said the opposite is true: when the markets are down, that is the time to buy. Staff asked whether this was still true when the market was in a freefall and Mr. Sellars replied that no one knew it was or was going to be in a freefall.

[117] Staff questioned Mr. Sellars about whether leveraged investing was riskier than cash investing. Mr. Sellars' response was that it is about presenting the data in a particular fashion. He believes that there are lots of times when leveraged investing should be recommended, but the average view on the street is contrary to that. He believes that investing in mutual funds calls for a long term view and that the appropriate response is that if the clients are willing to take a long term strategic position with their investments, they should do leveraged investing when it is appropriate for them to do it.

[118] Staff also asked Mr. Sellars whether he would agree that he did not consider leverage-to-net-worth ratio as a determining factor of suitability. Mr. Sellars' response was that there would be information additional to the net worth ratio which would be required to determine whether leveraged investing was suitable for a client.

[119] Mr. Sellars acknowledged that many of his clients were leveraged beyond 70% of their net worth. Mr. Sellars also acknowledged that at a certain point in time he had a book of business of approximately $21.5 Million and that the leveraged assets under his administration were $13,566,399. He also acknowledged that:

- he had 101 mutual fund clients with a leveraged plan;
- 79 of these 101 clients employed the Smith Manoeuvre;
- 62 of the leveraged clients have 2 or more loans from different lenders;
- 71 clients have a loan-to-net-worth ratio which is greater than 70%;
- 5 of the leveraged clients are novice investors; and
- 6 of the leveraged clients are over 60 years old.

[120] In paragraph 13 of Staff's Application, it is alleged that out of those 71 clients of Mr. Sellars that are leveraged over the 70% leverage-to-net-worth ratio, 11 of such clients were leveraged after the MFDA published MR 0069. Mr. Sellars, using the spreadsheet introduced as Exhibit 9, spoke about these 11 "post April 14 2008 leveraged client accounts". He testified that the spreadsheet captured data as at December 2009 and when you looked at these accounts, some are up in value and some are down in value. He explained that the data does not reflect how much these clients have reduced their mortgage debt, nor does the data capture or reflect tax savings. He testified that the 11 clients in question all remain his clients to this day. He testified that he usually has discussions with his clients every three months, either by telephone or by email although the requirement is to meet with clients once a year, at a minimum.

[121] During his testimony, Mr. Sellars spoke about each of the 11 post April 14 2008 leveraged client accounts. In regard to each and every one of the subject clients, Mr. Sellars' testimony was that the client(s) had attended his seminar on leveraged investing, that during the processing of the client(s)' particular transactions, he had met with them and had reviewed with them the contents of the MOU, that they remain his clients to this day and that they were staying the course with the Smith Manoeuvre.

[122] Mr. Sellars was also questioned about the six sets of client accounts detailed in Mr. LeBlanc's affidavit (the sampling of leveraged accounts which had been requested

by Staff from the MFDA). In the case of clients 1 and 2[2], Staff raised an issue in terms of there being misrepresentation as to the value of their home. Mr. Sellars testified that he would have asked the clients about the value of their home and the client would have provided the figure of $250,000.00. He stated that there was also recorded information that the clients had personally done a lot of work to improve the family home and the value thereof. On cross-examination, Staff raised the issue of the loan applications for clients 1 and 2 being processed in June or July 2007 whereas the MOU is dated August 2007. Mr. Sellars responded that they must have developed the MOU during this period and agreed with Staff that reviewing the MOU with the clients after the loans wereprocessed was not ideal.

[123] In the case of clients 3 and 4, an issue was raised because two net worth calculations done on the same day resulted in different values, one net worth calculation being calculated at $233,000.00 and the other one being calculated at $228,000.00. Mr. Sellars explained that the information which each lender was asking for was a bit different. He did not recall whether it was AGF or B2B that did not want the inclusion of household effects in the calculation of the net worth whereas the other lender did. Mr. Sellars also suggested, although his evidence on this point is absolutely unclear, that when he asked them about their pensions, they "upgraded" his information. On cross-examination, Staff also questioned Mr. Sellars about the fact that although clients 3 and 4 did have a $140,000.00 mortgage on their property, it was not reflected in the loan documents. Mr. Sellars agreed that it ought to have been reflected. There were also questions to Mr. Sellars about the amounts indicated on the loan application. Staff questioned Mr. Sellars about the fact that the initial loan application set out a loan amount of $100,000 then this amount was scratched out and an amount of $150,000 was entered in the application. When asked for an explanation for the increase from $100,000 to $150,000, Mr. Sellars stated that "someone" communicated to his office that the loan application was under review or was going to be underwritten and it came back approved for $150,000 and this amount was funded directly to Keybase unbeknownst to his office. He stated that the reason why there

[2] Clients referenced in paragraphs 122-127 identified using the client numbers used in Staff's Application and detailed in Exhibit 5 (Mr. Leblanc's Affidavit) at paragraph 16

might have been a loan application leaving his office without a loan amount in it was due to the fact that the loan application was under review. He then added that when the loan was suddenly funded at $150,000, his office consulted with the clients as to whether or not they would accept that amount and they said "yes, by all means". When Staff asked Mr. Sellars whether it would be fair to say his clients wanted to maximize the loan and this is how he went about it, Mr. Sellars replied "no, I think we applied for a $100,000 loan and AGF funded $150,000, that's what I think."

[124] Mr. Sellars was questioned as well about client 5 and Staff's allegation that his former associate signed documents on his behalf as branch manager. Mr. Sellars acknowledged that his associate should not have signed in this capacity. He testified that things had "evolved" over time and there was a time when he was instructed to sign as branch manager in all instances, in spite of the fact that he was, himself, the approved person doing the transaction. He stated that this way of doing things lasted a few months and the practice was then modified to him signing as a branch manager when he was supervising the junior associate but not in instances when he was reviewing his own files. A review of Mr. Sellars' files was done by the compliance officer at Keybase. Mr. Sellars added that while he still works alone out of the Moncton office, he is no longer the branch manager in New Brunswick. There is now a regional branch manager in Halifax who oversees all of Atlantic Canada. Consequently, his own transactions now get reviewed and processed out of Halifax and are thereafter sent to Keybase headquarters in Toronto for compliance purposes.

[125] An issue was also raised as to the indicated value of client 5's home. Mr. Sellars explained that he obtained the market value of the home directly from client 5. He added that he did not rely on the assessment value for property tax purposes because such assessments rarely rise to value so he relied on the information provided by the client.

[126] Mr. Sellars was questioned about client 8. The issue raised by Staff in relation to this client is the different net asset value shown on two different loan applications, processed on 17 August and 6 September, respectively. Mr. Sellars suggested that this

was a relatively small discrepancy and that cash and liquid investments may have changed by a few thousand dollars which would account for the discrepancy. When Staff went through each of the numbers and suggested that the discrepancy was rather large, Mr. Sellars attributed it to the client providing their pension value. He stated that this kind of discussion with the client was one where the client provided certain information, and the lenders would then conduct a credit check, so they were not the sort of things to which a lot of rigour was applied.

[127] The issue raised in the case of clients 10 and 11 was that the use of net worth as a guideline suggested a loan amount of $56,650 and the use of the total debt service ratio guideline suggested a loan amount of $56,285; however, those amounts were disregarded and the final suggested loan figure in the documents was $100,000. Mr. Sellars testified that the amounts yielded by the guidelines were not "hard and cold calculations" that could never be exceeded. He stated that the client wanted a loan of $100,000 and they would have discussed this but in the end, it was the client who makes the application.

[128] Mr. Sellars reiterated that the data contained in Exhibit 9 did not reflect a lot of things which could be both positive and negative to the clients' overall financial picture, such as the interest cost on the loans; the fact that clients could apply the cost of interest against their personal tax return; and the amount by which the clients' mortgage debt was reduced.

[129] Mr. Sellars also testified about his former client, A.A. He confirmed having been introduced to her by her father, a very good friend of his and recalled having meetings with her in 2006. According to him, A.A. attended two of his seminars with her boyfriend and absolutely wanted to get involved in the Smith Manoeuvre. He stated that she had been given a copy of the book on the Smith Manoeuvre and during one of the couple of meetings he had with her in his office, she said she had read the book, asked questions relating to the safety of investments and generally how one went about applying for the Smith Manoeuvre.

[130] According to him, A.A. did not have enough equity in her home to build a home equity line of credit so the interim plan was to obtain an investment loan and use the distributions to reduce the amount of the loan and as the loan amount was reduced over time, she would be able to build equity. There was also the interest on the loan, which was deductible, that she could apply to her income tax return and then apply the tax refund to reduce her mortgage debt. Mr. Sellars stated that this was an interim step for A.A., a partial leveraged loan process that would help lead to a Smith Manoeuvre. He testified that he did meet with her after she had invested and that he did have discussions with her about the fact that the value of her investment was going down. He did not deny having said to A.A. that she should not worry or stress herself about the investments over the short term and that the market would surely bounce back. He stated that he had not recommended that she sell her investments at that time because she would have been selling at a lesser value than the value for which they were purchased.

[131] During cross-examination, Mr. Sellars acknowledged that the difference between the interest rate which A.A. was paying on her investment loan and the growth of her investment was approximately 1.25% but that she would also deduct from her taxes an approximate amount of $1,300. When asked by Staff whether he agreed that for a 26 year old woman this constituted large risk in view of the minimal gain to her, Mr. Sellars replied that this assertion did not take into account that the distributions were going to be used to pay off the investment loan and that over a long period of time her investments would grow. Staff also questioned Mr. Sellars on the fact that the household net worth calculation on the loan application and the NAAF were different and that the addition of the various figures did not add up to the amount which was shown as the household net worth. Mr. Sellars acknowledged this but explained that the numbers could have been the consequence of a face to face discussion with the client, where the client would have discussed with him the nature of what should be included in the net worth. Mr. Sellars acknowledged that when he was completing or processing these accounts he would not necessarily compare one document to the other to ensure that they were consistent and agreed that it would be more diligent to do so.

[132] During his testimony, Mr. Sellars referred to the Letter of Assignment of A.A.'s Stone Fund investments in favour of AGF (Exhibit 3), and stated that the signature thereon was not A.A.'s signature. According to him, "someone" from his office would have called A.A. and asked if it was OK to sign this form in her stead. He surmised that the signature was placed there by a former assistant. He added that this sort of thing happened often, then said that it didn't happen often but it happened. Mr. Sellars recognized that there were moments when a document was sent to Keybase headquarters without adequate signatures or with missing or inconsistent data but added that that was "quite considerably in the past now" and "would never be repeated by my office".

[133] On cross-examination, Mr. Sellars acknowledged that the Letter of Assignment was the document pursuant to which AGF could have potentially taken possession of the mutual funds in the event that A.A. had been in default on her loan and if A.A. had not signed it, AGF could not have enforced its security. Mr. Sellars was asked whether he was aware of similar incidents occurring from time to time. Mr. Sellars answered that massive amounts of paperwork were processed in his office and there were many occasions where a document required 10 signatures, for example, but that his office would have perhaps missed something and ended up with only 9 signatures. He explained that they would call the client and ask him or her if they wanted to attend the office again for the purpose of signing the document or whether they could sign the document on their behalf. Mr. Sellars estimated that the scenario of someone creating a signature could have occurred in 1 out of 10 applications and added that there was a high volume of paperwork being processed and often times the paperwork came in at different frequencies and wasn't completed all at once. Mr. Sellars was also asked whether he, himself, would have participated in this or whether this was limited to his support staff. He responded that if he was in the office when something like this came to his attention, yes, he would have called the client to say that there was a document missing a signature, asked whether he could sign on the client's behalf and asked the client to confirm that they agreed with this. When further questioned, he acknowledged that it was probably unfair to fault his former assistant for having done

this and added that in any event, it had been wrongly done and the document should have indicated the assistant's name "for A.A.", rather than just signing A.A.'s name. He acknowledged to Staff that if done in the manner which he described, that would be satisfactory to him. Mr. Sellars also added that the document would also have gone to the Keybase compliance department where it would have been reviewed.

[134] Counsel for Mr. Sellars introduced into evidence (Exhibit 10) a policy paper issued by the MFDA on 8 July 2011 entitled "*Mutual Fund Dealers Association of Canada, Proposed Amendments to MFDA rule 2.2.1 (Know-Your –Client) And MFDA Policy No. 2 Minimum Standards for Account Supervision*". When he was asked about his understanding of the guidelines on leveraged investing, he read a paragraph from Exhibit 10, which is found in Part I entitled "*Overview*", at paragraph B, entitled "*The Issues*". This paragraph reads as follows:

> *"policy number 2 sets out a general obligation for members to establish policies and procedures to assess the suitability of leverage, but does not set minimum criteria in this area. Member Regulation Notice MR0069 –Suitability Guidelines (MR-0069) issued on April 14, 2008 sets out guidelines and factors that MFDA staff believe Members and Approved Persons should consider in assessing the suitability of leverage. Unlike MFDA Rules and Policies, Member Regulation Notices are not prescriptive and are intended to provide guidance only"*

[135] Mr. Sellars also referenced that part of Exhibit 10 under the heading C, entitled "Objectives", which reads as follows:

> *"The proposed amendments are intended to clarify that the suitability obligations in Rule 2.2.1 with respect to investments apply equally to leverage strategies, and codify minimum standards for Members and Approved Persons in assessing the suitability of client leveraging."*

and referenced as well a portion of the text found in Part II entitled Detailed Analysis, at paragraph B entitled Proposed Amendments, which reads, in part, as follows:

> *"Where the use of borrowing to invest by the client is determined to be unsuitable, proposed Rule 2.2.1 (f) will also require the Member, or the Approved Person, to advise the client and make recommendations to address the inconsistency between the use of borrowed funds and the essential facts relative to the client and maintain evidence of such advice and recommendations."*

[136] Mr. Sellars was questioned about his understanding of the guidelines and he stated that he had never understood nor used the guidelines as though they were "a line being drawn in the sand". In his view the guidelines were simply a "guide" that would help financial advisers identify why a red flag should be raised and discuss it in greater detail with the client. He went on to provide an example where a client was over 60 years of age and where it would otherwise be interpreted or suggested that this client would be unsuitable for leveraged investing. Mr. Sellars stated that the proper approach was to have a conversation with the client using a principles-based approach and to discuss at great length where and why there was a concern and what alternatives there were to borrowing and that the discussions and recommendations should be carefully documented. He stated that in the end, if the client chooses to ignore the concerns raised as a result of the guidelines, the client's advice or instructions should be followed but to ensure that every explanation with respect to the concerns raised was given to the client and to maintain evidence that such advice was given. He stated that the raising of concerns or a red flag did not constitute a total prohibition from proceeding with the transactions.

4. Findings

[137] The issue before the Commission was stated earlier in this decision. It was also previously noted in this decision that knowing the client means that a registrant must learn a client's "essential facts and characteristics", including the client's age, income, assets, investment knowledge and a host of other information. A financial adviser's determination of suitability will always be fact specific and will necessarily involve consideration of such factors. Staff had the onus of producing clear, cogent and convincing evidence, which, on a balance of probabilities established that Mr. Sellars recommended the use of leveraged investments without regard to the suitability of this strategy for particular clients.

[138] A.A.'s evidence is clear that in hindsight, she would not have engaged in leveraged investments, or perhaps any investments, with Mr. Sellars as her adviser.

However, there is nothing particularly compelling about her evidence which would support a finding that Mr. Sellars failed to properly assess the suitability of the strategy for A.A. A.A. testified that she was the one who provided to Mr. Sellars the information relating to the value of her home for the purpose of completing the loan application form. Mr. Sellars testified that he had reviewed the document with A.A. and A.A. acknowledged that she signed the form but testified that she "did not *recall*" Mr. Sellars reviewing the document with her. Mr. Sellars testified that at no time did A.A. voice to him that there were aspects of what was being proposed to her that she did not understand whereas A.A.' s testimony is that "*he knew*" or "*would have known*" that there were aspects of the transaction which she did not understand. It is understandable that A.A.'s recollection of what transpired in 2006 is not crystal clear but the onus is on Staff to prove the allegations which they are making against Mr. Sellars, and A.A.'s evidence alone does not constitute clear, cogent and convincing evidence that Mr. Sellars breached his obligations in terms of suitability to such an extent as to warrant the continuation of the terms and conditions that have been in place on Mr. Sellars' registration since August of 2010. It is also worth noting that A.A.'s account was not one of those originally highlighted by Staff in their Application to have the terms and conditions imposed.

[139] Staff questioned the leverage-to-net-worth ratio in the case of A.A., as well as other clients of Mr. Sellars, but the fact remains that a leverage-to-net-worth ratio in and of itself cannot be determinative of suitability. That we, Staff, or anyone else, would not recommend leveraged investing to a client in A.A.'s circumstances cannot and should not form the basis of a finding that Mr. Sellars breached his obligations in terms of suitability.

[140] With respect to the Commission's involvement in the investigation of Mr. Sellars, Commission investigator Mr. LeBlanc testified that:

- he did not conduct an investigation on behalf of the Commission;
- he reviewed documents provided to Staff by the MFDA and did not follow up on issues raised in the documents; and

- he did not speak to any of the clients who are holders of accounts about which Staff raised concerns in their Application.

[141] Staff relied heavily on the leverage spreadsheets entered into evidence and have suggested that the Panel is well positioned to assess the indicia of reliability of these documents and the proper weight to be given to them. Staff asserted in their post-hearing submission that "*in any event, Mr. Sellars was in an ideal position to refute any inaccurate information, as it directly concerns business conducted by him*..." and that "*he would have access to any refuting documents and, in fact has provided updated information for several of the accounts in question*." The duty and burden of producing relevant documentary evidence and the basis for any conclusions which Staff want this, or any, Panel to rely on in determining whether allegations have been established is that of Staff. No Panel can, nor should it have to, examine raw data and draw conclusions from same for which the proper context has not been established by Staff. Staff relied heavily on ratios yielded by numbers on a spreadsheet, without providing evidence relating to the context in which the transactions were recommended.

[142] Staff's evidence as to Mr. Sellars' earnings in and of itself is not determinative in the proceedings. The Panel cannot draw inferences that Mr. Sellars somehow breached any of his obligations to his clients because of the income he derived from his business activities. Staff pointed out, quite rightly, that Mr. Sellars' income is directly proportional to the level of purchase of investment products by his clients, whether through leveraging or otherwise. However, for Staff to be successful in its Application, they need to present evidence which goes beyond Mr. Sellars' level of earnings.

[143] Staff have continuously argued that Mr. Sellars made many leverage recommendations to clients that significantly exceeded applicable guidelines. Firstly, Exhibit 10 clearly establishes that the MFDA considers MR-0069 to be not prescriptive and intended to provide guidance only. Secondly, in a lot of instances, MR-0069 was not even published at the time of the impugned transactions. Thirdly, for those leveraged accounts transacted after the publication of MR-0069, the mere fact that

the guidelines were exceeded, without any further evidence as why and how Mr. Sellars' recommendations were not suitable, does not help Staff.

[144] If Staff held a firm view that Mr. Sellars had fallen short of his obligation to ensure his recommended use of leveraged investments was suitable to particular clients at the very least one would expect them to speak with the subject clients and if any relevant evidence was available, to produce evidence that, based on the client's age, income, assets, investment knowledge and other information, the strategies being recommended by Mr. Sellars were unsuitable. Staff surmising that recommendations of leveraged investing made to a client who is close to retirement, or who has a certain level of income, or in circumstances where the market is falling are somehow not suitable to a particular client, is quite plausible but does not constitute clear, cogent and convincing evidence of same. The allegations made against Mr. Sellars are very serious, and difficult to prove without eliciting any evidence directly from clients of Mr. Sellars.

[145] In summary, Staff have not discharged their burden of proof. We understand that the MFDA was conducting its own investigation into the affairs of Mr. Sellars, however the Application at issue in this matter was filed by Staff, and this Panel required Staff to investigate and present evidence to support the allegations made against Mr. Sellars.

[146] The Panel's finding that Staff has not discharged its burden of proof should not be interpreted by Mr. Sellars as a blank endorsement of his way of conducting business. Every investment has a component of risk. If individual A chooses to invest $1,000 of his hard-earned money and withdraws this sum from his bank account to purchase an investment product, he stands to make a gain and he also assumes a risk that his investment may erode to zero and be left with a bank account which is short $1,000. In simplistic terms, if that same individual borrows the sum of $1,000 to purchase the same investment and it erodes to zero, the individual is not only left with an investment with zero value but may also be left with a loan, with interest, which he has to repay. It matters not how the "*data is presented*", leveraged investing can magnify losses and it

is critical that registrants ensure that clients understand the risks of borrowing for the purpose of investing.

[147] However, as Staff has not established to this Panel's satisfaction that Mr. Sellars recommended use of leveraged investments without regard to the suitability of this strategy for particular clients, all terms and conditions contained in the Executive Director's Order of 6 August 2010 (as varied on 8 December 2010), as they relate to Mr. Sellars, are removed.

[148] Keybase did not seek a review of the Executive Director's Order and this Panel has received no evidence from Keybase. At the hearing, in the context of the motion for the stay of proceedings, counsel for Mr. Sellars argued that it would be inconsistent to lift the conditions imposed on Mr. Sellars which were requested by Staff in their Application and granted through the Executive Director's Order, and then insist that Keybase continue to fulfil the conditions arising from the same Application and Order.

[149] Counsel for Mr. Sellars submitted a case where defendants were ordered to pay a certain amount for damages, on a joint and several basis. When one of the defendants was successful on an appeal and the finding of fact and liability upon which the judgment was awarded was overturned, notwithstanding the fact that the second defendant had not appealed, he could not be held to pay the award of damages given the fact that the foundation upon which the award rested had disappeared. With all due respect to counsel for Mr. Sellars, this matter is very different from the case which he submitted. It was made abundantly clear during the hearing that the KPMG audit was conducted not only on Mr. Sellars' client accounts but on a firm-wide basis. The conditions set out in the Executive Director's Order rest upon findings made in relation to Keybase and in relation to Mr. Sellars. The Executive Director's Order requiring Keybase to present policies, procedures and guidelines with respect to all aspects of leveraging for use by Keybase and its personnel goes beyond any allegation or finding made against Mr. Sellars. This Panel has received evidence regarding the matters relating to Mr. Sellars but no evidence as to matters relating to Keybase, save and except in the context where they related to Mr. Sellars.

[150] Consequently, this Panel is setting aside and lifting conditions 1 and 2, as they relate to Mr. Sellars, only.

[151] However, there are portions of both A.A.'s evidence and Mr. Sellars' evidence relating to document management which the Panel considers problematic. A.A. testified that the signature on the Letter of Assignment of Mutual Funds introduced as Exhibit 3 was not hers. Mr. Sellars acknowledged this and testified as to the practice in his office for someone to call a client and ask if they could sign a document in the client's stead. Mr. Sellars' testimony was that circumstance where someone in his office had created a client's signature in such a fashion could have occurred in 1 out of 10 applications. Although Mr. Sellars testified that this practice was "quite considerably in the past now", his assertion that a member of his personnel signing a client's name and indicating that the document was signed "for [the client]" rather than simply signing the client's name would somehow be considered satisfactory, is disturbing to say the least. That transaction documents were sent to the Keybase compliance department, as stated by Mr. Sellars, is of no particular comfort absent some system pursuant to which the Keybase compliance department could verify the client signatures.

[152] This Panel wants to state clearly and emphatically that Mr. Sellars' conduct and attitude relating to the signing of client documents is neither satisfactory nor acceptable. Signing a client's name on a document, even *with* the client's consent obtained by telephone, is a practice which cannot be tolerated and which is incompatible with the high standards of fitness and business conduct expected of reputable registrants. This practice and conduct requires a strong response in order to act as a deterrent to others from engaging in any form of similar misconduct and this Panel considers Mr. Sellars' conduct as a circumstance where it is not only appropriate to exercise its public interest jurisdiction pursuant to section 184 of the *Act,* but a circumstance where this Panel *must* exercise such jurisdiction.

[153] Similar misconduct has resulted, rightly so, in harsh penalties and consequences. In considering what penalty may be appropriate in this particular case, the Panel is aware that there are mitigating circumstances that need to be taken into account:

(a) Mr. Sellars now appears to understand the seriousness of his misconduct in this regard;

(b) There is no evidence of Mr. Sellars, nor of anyone else in his office, signing the clients' names for the purpose of any personal gain or for any dishonest or fraudulent purpose;

(c) Mr. Sellars, and others in his office who engaged in this practice, believed that they had the authority to sign the names of such clients and to pass such signatures off as those of the client and engaged in this practice for the convenience of such clients;

(d) We have no evidence that any of Mr. Sellars' clients suffered any financial harm as a result of this practice; and

(e) Mr. Sellars has been the subject of conditions imposed by the Executive Director since 6 August 2010 and has complied with same.

[154] Considering the whole of the evidence put before this Panel and taking into account the aforementioned mitigating circumstances, and pursuant to sections 184(1) and 193(6) of the *Act,* the Panel considers it appropriate to impose upon the registration of Mr. Sellars the following terms and conditions:

(a) Mr. Sellars shall, no later than 31 July 2012, provide to the New Brunswick Securities Commission a list of his existing clients as of the date of this decision;

(b) Mr. Sellars shall, on or before 31 December 2012, obtain signature cards upon which the client shall have affixed his or her signature, for all clients whose name appears on the list mentioned in paragraph (a), above;

(c) Mr. Sellars shall obtain signature cards, upon which the client shall have affixed his or her signature, for all new clients for whom client accounts are opened after the date of this decision;

(d) Until 31 January 2013, Mr. Sellars shall be subject to close supervision by his assigned Branch Manager, which will involve his providing to the assigned Branch Manager all documents involved in the processing of his client transactions, along with a copy of the subject client's signature card , for verification of the client signature;

(e) the close supervision reports of the assigned Branch Manager shall be forwarded to the New Brunswick Securities Commission on a monthly basis; and

(f) the New Brunswick Securities Commission shall, no later than 31 January 2013, conduct a compliance review of Mr. Sellars' client files to determine compliance or non-compliance with the terms and conditions hereby imposed and in the event of non-compliance, the Commission may take such action as it determines appropriate.

Dated this 28 day of June 2012.

"original signed by"
Denise A. LeBlanc, Q.C., Panel Chair

"original signed by"
Céline Trifts, Panel Member

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