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**CASE SUMMARY # 200809**  
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# MFDA Case Summary

## Enforcement

This case summary was prepared by Staff of the MFDA.

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### **Hearing Panel imposes lifetime ban and \$60,000 fine on Leo Alexander O'Brien and \$10,000 fine and a suspension from acting in a supervisory or compliance capacity with a Member on David Baxter Snow**

**Nature of Proceeding** A Hearing Panel of the Atlantic Regional Council of the Mutual Fund Dealers Association of Canada ("MFDA") has imposed disciplinary penalties on Leo Alexander O'Brien ("O'Brien"), a former Approved Person for Worldsource Financial Management Inc. ("Worldsource"), and David Baxter Snow ("Snow"), presently, an Approved Person for Investia Financial Services Inc. ("Investia") and formerly (at the time of the misconduct) an Approved Person of Worldsource. Both Worldsource and Investia are Members of the MFDA.

**By-Laws, Rules, Policies Violated** Following a hearing on September 24, 2008, the Hearing Panel found that:

- (a) Between April 20, 2005 and June 16, 2006, O'Brien engaged in excessive trading by processing 166 switches in 22 client accounts using limited trading authorizations without obtaining instructions, approval or authorization from the clients, contrary to MFDA Rules 2.3.4, 2.1.1 and outside the scope of his registration as a mutual fund salesperson as stipulated under section 86 of the Consolidated Newfoundland and Labrador

Regulation 805/96, *Securities Regulations under the Securities Act*, O.C. 96-286; and

- (b) Between April 20, 2005 and June 16, 2006, Snow, at all material times the Branch Manager responsible for supervising O'Brien, failed to adequately supervise O'Brien's trading activity, contrary to MFDA Rule 2.5.3(b) and MFDA Policy No 2.

**MFDA Rule 2.1.1** states:

**Standard of Conduct.** Each Member and each Approved Person of a Member shall:

- (a) deal fairly, honestly and in good faith with its clients;
- (b) observe high standards of ethics and conduct in the transaction of business;
- (c) not engage in any business conduct or practice which is unbecoming or detrimental to the public interest; and
- (d) be of such character and business repute and have such experience and training as is consistent with the standards described in this Rule 2.1.1, or as may be prescribed by the Corporation.

**MFDA Rule 2.3.4** states:

**No Discretionary Trading.** A limited trading authorization shall not in any way confer discretionary trading authority upon a Member, an Approved Person or any person acting on behalf of the Member.

**Section 86 of the Consolidated Newfoundland and Labrador Regulation 805/96, *Securities Regulations under the Securities Act*, O.C. 96-286** set out the registration requirements of the applicable securities legislation. Subsection (g) states:

Mutual fund dealer, being a person or company that is registered solely for the purpose of trading in the shares or units of mutual funds;

**MFDA Rule 2.5.3(b)** states:

**Branch Manager**

(b) **Responsibilities.** It is the responsibility of a branch manager to:

- (i) ensure that the business conducted on behalf of the Member by an Approved Person and other employees and agents at the branch is in compliance with applicable securities legislation and the By-laws and Rules;
- (ii) supervise the opening of new accounts and trading activity at the branch office.

**MFDA Policy No. 2** states, in part:

### **III. Branch Office Account Supervision**

Each branch manager must undertake certain activities within the branch for purposes of assessing compliance with the Member's policies and procedures and regulatory requirements. These activities

should be designed to identify failures to adhere to required policies and procedures and provide a means of revealing and addressing undesirable account activity. Among other things, a branch manager must review the previous day's trading for unusual trading activity and the review should include at a minimum, a sample of trades in accounts operating under limited trading authorizations.

The Hearing Panel imposed the following penalties on O'Brien:

**Penalty**

- (a) a permanent prohibition from conducting securities-related business in any capacity pursuant to s. 24.1.1(e) of the MFDA By-Law No. 1 (the "By-law");
- (b) a fine in the amount of \$60,000.00 for engaging in excessive trading in 22 client accounts using limited trading authorizations without obtaining instructions, approval or authorization from the clients, pursuant to s.24.1.1(b) of the By-Law; and
- (c) costs attributable to conducting the investigation and prosecution of this matter in the amount of \$5,000.00, pursuant to s. 24.2 of the By-Law.

The Hearing Panel imposed the following penalties on Snow:

- (a) a prohibition from acting in a compliance or supervisory capacity with a Member for a period of three (3) years, pursuant to s. 24.1.1(c) of the By-Law;
- (b) a requirement to re-write the appropriate proficiency examination prior to becoming registered in any compliance or supervisory capacity with a Member, pursuant to s. 24.1.1(c) of the By-Law;
- (c) a fine in the amount of \$10,000.00 for failing to supervise O'Brien, pursuant to s. 24.1.1(b) of the By-Law ; and
- (d) costs attributable to conducting the investigation and prosecution of this matter in the amount of \$5,000.00, pursuant to s. 24.2 of the By-Law.

**Summary of Facts**

From June 2004 to September 2006, O'Brien was registered as a mutual fund salesperson with Worldsource working out of its Newfoundland branch. From November 1981 to June 2004, O'Brien was registered as a mutual fund salesperson with other mutual fund dealers in the province of Newfoundland and Labrador. O'Brien was terminated by previous mutual fund dealers for failing to follow company procedures and for charging excessive commissions and switch fees. In September 2006, O'Brien was terminated by Worldsource. Since that time, he has not been registered in the securities industry in any capacity.

From June 2004 to September 2006, Snow was registered as a mutual fund salesperson and Branch Manager of the Newfoundland branch of

Worldsource. From November 1991 to April 2004, Snow was registered as a mutual fund salesperson and from September 1995 to April 2004, he was registered as a branch manager with other mutual fund dealers in the province of Newfoundland and Labrador. In September 2006, Snow was terminated by Worldsource. Since September 2006, Snow has been registered as a mutual fund salesperson for Investia and subject to close supervision.

From April 20, 2005 to June 16, 2006, O'Brien made 166 switches in 22 client accounts. O'Brien made the switches using limited trading authorizations ("LTA's") provided to him by the clients. The existence of an LTA for a client's account does not relieve an Approved Person of the obligation to obtain specific, express instructions from the client for each trade made pursuant to the LTA and to maintain evidence of such client instructions and the date and means by which such instructions were received (e.g.; phone, in person or by facsimile) – See Member Regulation Notice MR-0035. O'Brien failed to obtain prior specific instructions from the clients before making the switches and all of the switches were made without the clients' knowledge, approval or authorization. By carrying out the switches without specific instructions from the clients, O'Brien engaged in discretionary trading contrary to the terms of his registration as a mutual fund salesperson and MFDA Rules 2.3.4 and 2.1.1.

For each switch, O'Brien charged the client a fee of up to 2% of the gross amount of the switch, 2% being the maximum amount permitted under the prospectus of the mutual fund. As O'Brien did not obtain client instructions prior to the execution of switches, at least some clients did not confirm to pay the 2% switch fees applied to the frequent transactions processed in their accounts without their knowledge, approval or authorization. In total, between April 20, 2005 and June 16, 2006, O'Brien received \$64,179.48 in switch fees in respect of the 166 switches that he made in 22 client accounts. The switches were apparently made as part of a strategy to time the market. The strategy produced little or no economic benefit to the clients while resulting in a disproportionately high economic benefit to the Respondent. Frequent trading or market timing strategies are seldom appropriate with mutual fund products because of the diversified nature of mutual fund holdings and because of the risk inherent in attempting to time the markets. Furthermore, such strategies can harm a fund's performance and the value of other investors' holdings in the fund. By engaging in the excessive trading activity, O'Brien placed his own interests ahead of the clients' interests. Such conduct is often referred to as churning. See Member Regulation Notice MR-0065.

Snow was the branch manager for the Newfoundland branch of Worldsource. He received an override on commissions earned from O'Brien's trading. At all material times, Snow was responsible for

supervising O'Brien's trading activity to ensure that the business conducted by O'Brien was in compliance with MFDA By-laws and Rules and applicable securities legislation. . Between April 20, 2005 and June 16, 2006, Snow failed to fulfill his supervisory obligations as the Branch Manager. In particular, he failed to make reasonable inquiries to O'Brien to question the inordinately high number of switches that were made using LTAs and the substantial switch fees charged in the client accounts serviced by O'Brien that occurred during a short period of time and to ensure that O'Brien received appropriate client instructions before executing trades pursuant to an LTA, despite his knowledge of O'Brien's misconduct at previous dealers. He also failed to raise concerns about such conduct to head office or to impose any type of discipline on O'Brien to prevent the continuation of such activity..

For greater detail, see the Decision and Reasons dated November 25, 2008 posted on the MFDA's website in the "Completed Cases" section under "Enforcement".

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