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CASE SUMMARY #200820
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MFDA Case Summary

Enforcement

This case summary was prepared by Staff of the MFDA.

Hearing Panel accepts Settlement Agreement with Sterling Mutuals Inc.

Nature of Proceeding

A Hearing Panel of the Central Regional Council of the Mutual Fund Dealers Association of Canada (“MFDA”) has accepted a Settlement Agreement between the MFDA and Sterling Mutuals Inc. (“Sterling”), a Member of the MFDA.

By-Laws, Rules, Policies Violated

The Hearing Panel considered and accepted the Settlement Agreement at a hearing held on August 21, 2008 in Toronto, Ontario.

In the Settlement Agreement, Sterling admitted that between January 2003 and February 2006, it failed to establish, implement and maintain policies and procedures to ensure that the handling of its business was in accordance with MFDA Rules 1.1.7, 2.5.4, 5.3.3 and MFDA Policy 2, contrary to MFDA Rule 2.5.1 and MFDA Policy 2.

Sterling also admitted that in the same period it (i) failed to establish, implement and maintain a two-tier compliance structure to supervise client account activity, contrary to MFDA Rule 2.5.1 and MFDA Policy 2; and (ii) prevented its branch managers from discharging their supervisory responsibilities under Rule 2.5.3(b)(ii) by failing to establish, implement and maintain a two-tier compliance structure, contrary to MFDA Rule 2.5.1 and MFDA Policy 2.

Rule 1.1.7(c) governs the use and approval of trade names other than the Member’s name by Approved Persons. **Rule 2.5.3(b)(ii)** states that “It is the responsibility of a branch manager to...supervise the opening of new

accounts and trading activity at the branch office.” **Rule 2.5.4** requires Members to maintain records of all compliance and supervisory activities undertaken by the Member, its partners, directors, officers, compliance officers and branch managers pursuant to MFDA By-laws and Rules. **Rule 5.3.3** stipulates the contents of client account statements. **Policy 2** establishes minimum industry standards for account supervision.

Rule 2.5.1 states:

“**Member Responsibilities.** Each Member is responsible for establishing, implementing and maintaining policies and procedures to ensure the handling of its business is in accordance with the By-laws, Rules and Policies and with applicable securities legislation.”

Policy 2 states, in part:

“Effective self-regulation begins with the Member establishing and maintaining a supervisory environment which both fosters the business objectives of the Member and maintains the self-regulatory process. To that end a Member must establish and implement procedures which are supervised by qualified individuals.”

Penalty

Under the terms of settlement, Sterling agreed to pay a fine of \$50,000 and costs of \$5,000. Sterling also agreed to retain a monitor to resolve the compliance deficiencies set out in the Settlement Agreement.

Summary of Facts

Sterling became a member of the MFDA on March 8, 2002. Sterling is registered as a mutual fund dealer in Alberta, British Columbia, Manitoba, New Brunswick, Nova Scotia and Saskatchewan. In Ontario, Sterling is registered as a mutual fund dealer and limited market dealer.

1. Repeat Compliance Deficiencies

In December 2002, MFDA Compliance Staff conducted a first round compliance examination of Sterling (the “First Examination”).

The First Examination identified numerous compliance deficiencies which required immediate corrective action by Sterling. Following a number of communications between Staff and Sterling aimed at resolving the deficiencies, Staff advised Sterling that, based on the Sterling’s actions to date, and provided that Sterling proceeded to take certain other corrective measures, Staff was satisfied that the deficiencies either had been, or would be, resolved.

In April 2006, Staff conducted a second round compliance examination of Sterling covering the period January 2003 to February 2006 (the “Second Examination”).

The Second Examination revealed that several deficiencies found during the First Examination had not been resolved. Sterling either had not taken the

corrective measures which it undertook to implement or the corrective measures it took were inadequate to resolve the deficiencies. The principal repeat deficiencies included:

(i) Evidence of Trade Supervision

Between January 2003 and February 2006, Sterling failed to establish, implement and maintain policies and procedures which ensured that evidence of trade reviews was maintained in accordance with Rule 2.5.4, contrary to Rule 2.5.1 and Policy 2.

In particular, the First Examination revealed that the head office Compliance Officer did not consistently initial and date Sterling's daily trade blotter. In addition, the Compliance Officer was reviewing and approving his own trading activity.

The Second Examination revealed that of 37 trades sampled by Staff, the head office Compliance Officer had failed to evidence the date of his trade review in 32 instances.

(ii) Approval & Use of Trade Names

Between January 2003 and February 2006, Sterling failed to establish, implement and maintain policies and procedures adequately governing the use of business, trade or style names by its Approved Persons and failed to ensure that any such names were approved by Sterling and used in accordance with Rule 1.1.7, contrary to Rule 2.5.1.

In particular, during the First Examination Staff obtained copies of business cards being used by several of Sterling's Approved Persons. The legal name of Sterling did not appear on the business cards in at least equal size to that of the Approved Person's trade or business name. Staff reminded Sterling that Rule 1.1.7 requires that the legal name of the Member must appear in at least equal size to that of the Approved Person's trade or business name.

The Second Examination revealed that many of Sterling's Approved Persons used trade names, however Staff found no evidence of Sterling's written authorization for such use. Furthermore, MFDA records indicated that Sterling had failed to notify the MFDA of the use of these trade names, as required by Rule 1.1.7.

(iii) Content of Client Name Statements

Between January 2003 and February 2006, Sterling failed to establish, implement and maintain policies and procedures which ensured that client name account statements which it produced and delivered to clients contained the information required by Rule 5.3.3(b) and (c), contrary to Rule 2.5.1.

In particular, the First Examination revealed that Sterling's client name account statements for the period ending September 30, 2002 did not contain

all of the account and transaction information required by Rule 5.3.3(b) and (c), in particular:

- (i) all debits and credits;
- (ii) the quantity and description of each security purchased, sold, transferred and the dates of each transaction;
- (iii) for automatic payment plan transactions, the date the plan was initiated, a description of the security and the initial payment made under the plan;
- (iv) the date the statement was issued; and
- (v) the period covered by the statement.

The Second Examination revealed that client name account statements for the period ending December 31, 2005 still failed to meet all of the content requirements of Rule 5.3.3(b) and (c).

2. Inadequate Compliance Structure

The Second Examination revealed that Sterling did not require its branch managers to supervise client account activity at the branch office level, meaning that:

- (i) Sterling had failed to establish, implement and maintain a two-tier compliance structure to supervise client account activity, contrary to Rule 2.5.1 and Policy 2; and
- (ii) by virtue of the misconduct described in (i) above, Sterling had prevented its branch managers from discharging their supervisory responsibilities as required by Rule 2.5.3(b)(ii), contrary to Rule 2.5.1 and Policy 2.

By virtue of Sterling maintaining a single-tier compliance structure, trading activity at the branch office level was not being supervised by Sterling's branch managers, being the individuals with the greatest knowledge of and familiarity with the clients and client accounts serviced by the Approved Persons under their supervision.

Reasons for Decision

In its *Reasons for Decision*, the Hearing Panel stated "It is trite to say that the Rules, Regulations and Policies of the MFDA are designed to preserve the integrity of its members and to protect the public with whom they deal. It is, therefore, of the utmost importance that they be followed, and that deficiencies identified as a result of MFDA audits not only be implemented, but that this be done in a timely fashion."

For more detail see the *Settlement Agreement* dated July 24, 2008 and the *Reasons for Decision* dated September 3, 2008, both of which are posted on the MFDA's website in the "Completed Cases" section under "Enforcement".