Ontario

Ontario Securities Commission | Commission des valeurs mobilières de l'Ontario | P.O. Box 55, 19th Floor, 20 Queen Street West, Toronto ON M5H 3S8 | CP 55, 19e étage, 20, rue queen ouest, Toronto ON M5H 3S8

IN THE MATTER OF THE *SECURITIES ACT*,
R.S.O. 1990, c. S.5, AS AMENDED

AND

IN THE MATTER OF
JOHN DAUBNEY AND CHERYL LITTLER

REASONS AND DECISION
(Section 127 of the *Securities Act*)

Hearing:	October 9, 10, 11, 12, 15 and 17, 2007 Written submissions were completed on November 23, 2007.	
Decision:	April 30, 2008	
Panel:	Robert L. Shirriff, Q.C. Carol S. Perry Margot C. Howard	- Commissioner (Chair of the Panel) - Commissioner - Commissioner
Counsel:	Alexandra Clark	- For the Ontario Securities Commission
Agent:	James C. Morton	- For John Daubney

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REASONS AND DECISION

A. OVERVIEW

[1] This was a hearing on the merits before the Ontario Securities Commission (the "Commission") pursuant to section 127 of the Securities Act, R.S.O. 1990, c. S.5, as amended (the "Act"), to consider whether John Daubney ("Daubney") breached the Act and acted contrary to the public interest.

[2] The parties agreed that this proceeding should be bifurcated; first, a hearing on the merits of the case, and second, if necessary, a hearing on sanctions.

[3] This proceeding arose out of a Statement of Allegations and Notice of Hearing filed by Staff of the Commission ("Staff") on July 14, 2006. Staff alleged that Daubney and Cheryl Littler ("Littler") indiscriminately recommended an aggressive and risky investment strategy to their clients, without taking proper account of their clients' risk tolerance, investment objectives, investment knowledge, age, income or net worth, and thereby provided investment advice that was unsuitable for their clients, contrary to their obligations under section 1.5(1)(b) of OSC Rule 31-505. Staff also alleged that Daubney and Littler failed to deal with their clients fairly, honestly and in good faith, contrary to section 2.1(2) of OSC Rule 31-505. Further, Staff alleged that Daubney and Littler made misleading and inaccurate undertakings about the investment returns that their clients should expect from following their advice, in contravention of section 38(2) of the Act.

[4] Staff and Littler entered into a settlement agreement on October 3, 2007 which was approved by the Commission on October 4, 2007 (the "Settlement Agreement"). As a result, Daubney is the only remaining respondent in this proceeding.

[5] The hearing took place over six days in October 2007. At its conclusion, the parties agreed to submit written submissions on November 2, 2007 (Staff's closing submissions), November 14, 2007 (Daubney's closing submissions) and November 23, 2007 (Staff's reply submissions).

B. THE RESPONDENT

[6] Between 1990 and 2002, Daubney was registered under the Act as a salesperson with the following dealers:

- August 1, 1990 to September 1, 1991: Investors Syndicate Limited, a dealer in the categories of mutual fund dealer and limited market dealer under the Act;
- January 1, 1992 to July 2, 1996: Investors Group Financial Services Inc. ("Investors Group"), a dealer in the categories of mutual fund dealer and limited market dealer under the Act;
- June 30, 1996 to July 22, 1999: Hewmac Investment Services Inc. ("Hewmac"), a dealer in the categories of mutual fund dealer and limited market dealer under the Act; and

- July 30, 1999 to June 17, 2002: Wealth Map Financial Limited ("Wealth Map"), a dealer in the categories of mutual fund dealer and limited market dealer under the Act.

[7] Daubney's registration was suspended by the Commission in January 2003.

C. THE ISSUES

[8] The issues before us are i) whether Daubney made unsuitable investment recommendations to six of his clients in breach of OSC Rule 31-505 and ii) whether Daubney, with the intention of effecting the investments, gave any written or oral undertakings to his clients relating to the future value of the investments he recommended, in breach of section 38(2) of the Act.

D. THE LAW

1. Standard of Proof

[9] There is no dispute in this case about the standard of proof. Staff bears the onus of proving its allegations on a balance of probabilities, the civil standard of proof. Because of the seriousness of the allegations and their consequences for the Respondent, Staff must provide "clear and convincing proof based upon cogent evidence." (*Investment Dealers Association of Canada v. Boulieris* (2004), 27 O.S.C.B. 1597 at para. 33-34, aff'd [2005] O.J. No. 1984 (Div. Ct.).)

2. The Know-Your-Client and Suitability Rule

[10] At all material times, paragraph (b) of subsection 1.5(1) of OSC Rule 31-505– *Conditions of Registration* (1999), 22 O.S.C.B. 731, required a registrant to "make such enquiries about each client" as "are appropriate, in view of the nature of the client's investments and of the type of transaction being effected for the client's account, to ascertain the general investment needs and objectives of the client and the suitability of a proposed purchase or sale of a security for the client."

[11] Staff, in its written submissions, provided an extensive analysis of the know-your-client and suitability rules. Daubney did not challenge Staff's analysis, but submitted that (i) the mere fact that losses were incurred, standing alone, did not demonstrate lack of suitability; and (ii) leveraging is not, *per se*, inappropriate.

[12] We accept Staff's analysis of the know-your-client and suitability rules.

[13] We also accept Daubney's submission that his investment recommendations must be judged as at the time they were made, and not with the benefit of hindsight after a market downturn. Investor losses are neither necessary nor sufficient to show that a registrant failed to comply with his obligations. We accept that determining whether a registrant satisfied his know-your-client and suitability obligations requires a fact-sensitive assessment of the registrant's investment recommendations in light of the circumstances of his clients. Accordingly, we consider that the use of leveraging and

investment in exempt products can be appropriate for some investors, a point that Daubney makes and Staff concedes.

[14] The Act imposes certain duties on registrants, including know-your-client and suitability obligations and a general duty to "deal fairly, honestly and in good faith" with clients. The issue before us is whether Daubney fulfilled these obligations under the Act. (Sections 1.5 and 2.1(2) of OSC Rule 31-505 – *Conditions of Registration*, (1999), 22 O.S.C.B. 731, amended (2003), 26 O.S.C.B. 7170 ("OSC Rule 31-505").)

[15] The Commission has recognized that the know-your-client and suitability requirements "are an essential component of the consumer protection scheme of the Act and a basic obligation of a registrant, and a course of conduct by a registrant involving a failure to comply with them is an extremely serious matter" (*Re E.A. Manning Ltd. et al.* (1995), 18 O.S.C.B. 5317 at 5339).

[16] The Alberta Securities Commission (the "ASC") described these two obligations as follows:

> 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. (*Re Marc Lamoureux* (2001), ABSECCOM 813127 ("*Re Lamoureux*") at 10.)

[17] Canadian securities authorities have adopted a three-stage analysis of suitability, according to which a registrant is obliged to:

> a) use due diligence to know the product and know the client;
>
> b) apply sound professional judgement in establishing the suitability of the product for the client; and
>
> c) disclose the negative as well as the positive aspects of the proposed investment.
>
> (*Re Foresight Capital Corp.*, 2007 BCSECCOM 101 ("*Re Foresight*") at para. 52.)

[18] 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.

E. THE POSITIONS OF THE PARTIES

[26] Staff submitted that Daubney's investment recommendations were unsuitable for the six investors called by Staff (the "Six Investors") in two major respects: (i) the use of excessive leveraging; and (ii) in the case of three of the Six Investors, the recommendation to invest in the BPI Global Opportunities Fund ("BPI GOF").

[27] In particular, Staff alleged that Daubney, in advising the Six Investors: (i) did not "know the product"; (ii) did not "know the client"; and (iii) did not demonstrate that an accurate and balanced assessment was made as to the suitability of his recommended investment approach for these clients, given the risks and the clients' circumstances and goals.

[28] Staff alleged that the market downturn in 2000-2001 revealed the high-risk nature and unsuitability of Daubney's investment advice. The combined effect of diminished investment values, margin calls, and continuing debt obligations caused financial and personal hardships for these highly-leveraged clients.

[29] Daubney challenged the evidence of the investors on the basis that (i) as a result of delay in bringing the matter forward, the witnesses' memories had faded; (ii) investors generally have a tendency to overestimate their own investment risk tolerance in search of higher returns; (iii) there would have been no complaint had there not been a market downturn; (iv) the investors had an interest in the outcome of this proceeding because of collateral litigation relating to the matter; and (v) the Six Investors represented only a small proportion of his clientele.

[30] However, there were few significant factual disputes in this case. In general, Daubney took the position that he gave good advice to his clients and complied with the know-your-client and suitability rules.

F. EVIDENCE AND FINDINGS

1. Overview

[31] We heard testimony from twelve witnesses.

[32] Staff called Paul De Souza, an investigator with the Commission ("De Souza"), Littler, and the Six Investors.

[33] Daubney testified on his own behalf, and called three investors as witnesses: Investor Seven, Investor Eight and Investor Nine.

[34] We find that Daubney gave similar investment advice to all of the Six Investors. Indeed, the investors he called to testify also described a similar investment approach.

[35] The general investment program Daubney recommended to the Six Investors involved the following double-leveraging scheme:

- move all existing investments and securities to Daubney, which included liquidating these investments and purchasing units of mutual funds selected by Daubney, and in some cases, converting RRSPs into RRIFs;
- take out or increase a loan (in the form of a mortgage or a line of credit) on their respective homes to approximately 75 percent of their appraised value;
- invest the proceeds of the mortgage in mutual funds selected by Daubney;
- pledge the mutual funds purchased as security for a two-for-one investment loan from a financial institution;
- invest the proceeds of the investment loan in more mutual funds selected by Daubney; and
- where they existed, use withdrawals from the RRIFs to help finance the debt service charges on these loans.

[36] Daubney's investment recommendations for the Six Investors included mainly equity mutual funds. Daubney stated that bond funds were not part of his leveraged investment program because they would not generate sufficient income to meet the debt service obligations of the investment loans. All or a majority of the mutual funds were sold on a Deferred Sales Charge ("DSC") or "back-end load" basis. This meant that the clients would not pay a charge when they initially bought units of a mutual fund, but would pay a charge if they redeemed those units within a prescribed time period. Typically, the DSC was at the outset 6 percent of the net asset value of the mutual fund units purchased, and diminished by 1 percent per year, for six years. If a client held the units for at least six years, they could be redeemed at that time with no DSC payable. Five investors testified that they did not recall knowing what "DSC" meant and the implications of such a sales charge structure in relation to early redemption of their mutual funds in order to meet margin calls on their investment loans.

[37] All of the Six Investors testified that in recommending this investment program, Daubney gave optimistic projections of how their "money" could grow. In many cases, he would show them a financial plan that would generate income for the investor which projected constant equity investment returns of 10 to 12 percent per annum versus annual interest rates on their loans approximating 7 percent. Daubney advised his investors that an annual equity investment return of 12 percent was a conservative estimate. In all the equity investment return and interest cost schedules provided by Daubney to his clients, annual equity investment returns were shown to be constant and ranged from 10 to 12 percent for periods of 10 years or longer. There were no examples of what would happen in a declining market.

[38] The investors testified that Daubney advised of the financial benefits of investing in the equity market, but did not explain what would happen if the market did not increase or went down. For example, one investor was under the impression that she

would still receive a return when the market was not doing well, except that the returns would be lower. Daubney also advised several of the investors that even if the market went down, it would always recover, and in the meantime, he could make the portfolio corrections as necessary.

[39] Daubney did not appear to discuss in detail the risks of leveraging. Most of the investors testified that they did not recall discussing with Daubney the risk disclosure forms they signed for Daubney's firms. The risk disclosure forms included Hewmac's "Borrowing to Invest (Leveraging) Disclosure" statement and Wealth Map's "Borrowing Money to Buy Investment Funds (Leveraging)" statement and letter of acknowledgement. Some of the investors also testified that they were not given copies of these documents.

[40] Three of the investors repeatedly expressed to Daubney their concerns about losing their homes, and Daubney dismissed those concerns by denying that this could happen. For example, one investor stated that Daubney's response was that "there was absolutely no concern of losing the house." Despite his investors' expressed concerns, Daubney continued to represent that his investment program was common and safe, and would be beneficial for them to follow.

[41] All of the Six Investors further testified that Daubney did not mention "margin calls" to them when discussing the investment strategy. They recalled being quite confused when they received their first margin call letters in the mail. Several investors testified that Daubney advised them to ignore the margin call letters or throw them away, and that they would stop receiving them when the markets recovered.

[42] The investors indicated in their testimony that they did not understand that if a declining equity market resulted in margin calls being made on their outstanding loans, that it would result in their having less money from their investments to meet their loan obligations.

[43] On Daubney's advice, three of the Six Investors invested in BPI GOF. This was an exempt product, sold under an Offering Memorandum ("OM") rather than a prospectus, and available to Ontario investors with a minimum investment of $150,000.

[44] The BPI GOF OM includes three pages of risk factors, including international markets, emerging market securities, no fixed guidelines for diversification, illiquid securities, short sale equity positions, use of options (which are stated to entail "greater than ordinary market risks"), forward contracts, portfolio turnover, counterparty risk, low rated or unrated debt obligations, offshore residency and assets, conflicts of interest, and unitholder liability. Further, the fund's investment strategies are stated to include leveraging against net asset value and investing in "emerging markets where political volatility has led to deeply discounted stock and bond prices, and 'pre-emerging' markets where a lack of brokerage research coverage has left many productive assets undervalued."

[45] The OM also explains the BPI GOF Income and Capital Gains Distributions policy, as follows:

> It is the Fund's policy to distribute annually to investors sufficient investment income and capital gains (net of applicable losses) so that it effectively will not pay any Canadian federal income tax. … Distributions are paid on the last business day of the year and are automatically reinvested in additional Units at the Net Asset Value per Unit on the date of distribution unless a unitholder elects, by notice to the Manager, to receive such distributions in cash.

[46] Daubney also recommended that some of the Six Investors purchase Universal Life insurance policies, the premiums for which were to be paid from returns on their mutual fund investments. These policies had very high annual premiums, which the investors could not afford to carry.

2. The Investors

a) Investor One

[47] Investor One testified about the investments that he and his wife made through Daubney. Investor One and his wife met with Daubney in 2000 to discuss investing through him. They were 53 and 50 years old respectively. That year, Investor One was employed as a real estate broker and had an income of $51,000. Investor One's wife was a retired nurse and had an income of approximately $3,000. Together, they had an income of approximately $54,000 that year.

[48] At that time, the major assets of Investor One and his wife consisted of a mortgage-free house worth $140,000, investments held in RRSP accounts worth approximately $287,000, and mortgage investments worth approximately $156,000. Overall, their net worth was approximately $583,000. At that time, they had no significant liabilities although they had an available line of credit secured against their house from which they were able to withdraw up to $96,000.

[49] Investor One and his wife had some limited investment experience. Investor One had experience with Guaranteed Investment Certificates ("GICs") and mutual funds purchased through banks and their financial advisors. He also had invested in several mortgages. Investor One's wife had done some limited investing through a stockbroker.

[50] By investing through Daubney, they had hoped to attain early retirement, have a retirement income, preserve capital and save on income tax. Investor One and his wife however, had concerns of losing their home as a result of the leveraging strategy. When Investor One's wife repeatedly expressed her concern to Daubney, Daubney advised that they had "absolutely no concern of losing the house", that they had enough money to carry them for 15 years if "that should even come close to happening", and that it would not happen because he had his pulse on the market and would make portfolio corrections as necessary. Despite the concerns of Investor One and his wife, Daubney assessed their

risk tolerance as "medium-high" in their KYC form. The actual risk assessment was not discussed with them.

[51] The investment program Daubney recommended to Investor One and his wife consisted of transferring their existing investments to his firm and converting their RRSP investments into RRIFs, and taking out loans to invest. In recommending this program, Daubney advised them that he was always able to get a 12 percent annual return for his clients, and in many cases 14 percent. He assured them that they could expect a 12 percent annual return on their investment portfolio even though others would only quote 10 percent, because he was confident that he could get a 12 percent return on a steady basis.

[52] Daubney showed Investor One and his wife a number of scenarios projecting increases in income, including forecasts that showed loans eventually being paid out and net assets increasing, and charts showing how long it would take them to go through their money. Investor One did not recall on the other hand, any discussion of what would happen in the years that the market returns and income did not increase or went down, or the possibility of margin calls.

[53] Under Daubney's direction, Investor One and his wife drew on their unused line of credit on their house to borrow funds, from which $95,000 was provided to Daubney to invest in mutual funds. In March 2000, Investor One and his wife applied to Laurentian Bank and received a two-for-one loan in Investor One's name in the amount of $230,000, and three months later in June 2000, they applied for a further loan of $150,000 on a one-to-one basis from M.R.S. Trust in Investor One's wife's name. The proceeds of both loans were provided to Daubney to invest. In March 2001, due to the declining value of their leveraged investments, $150,000 of the two-for-one loan was converted to a one-to-one investment loan.

[54] Investor One and his wife signed risk disclosure forms pertaining to the loans, but the forms did not appear to be signed contemporaneously with the loan application. With respect to both the Laurentian Bank two-for-one loan and the M.R.S. Trust one-to-one loan, the risk disclosure forms were signed after the loan applications were already made. In 2001, when Investor One and his wife applied to convert $150,000 of their two-for-one loan to a one-to-one loan, they executed a risk disclosure document several days after the loan application. By this time, Investor One was getting "suspicious" of Daubney's advice and made a point of dating the document.

[55] Investor One also testified that he did not recall signing the risk disclosure forms, except that he was asked to "sign here, sign here", and did not remember a discussion of the forms or receiving a copy of them. Investor One testified that he was asked to sign so many documents that he did not know what he was signing. He also signed many blank forms authorizing trades in his mutual funds because he was told that it would be easier for Daubney to do the investment switching.

[56] Investor One's understanding of "DSC" was that it stood for "delayed service charge," that as long as you left the fund in place for 7-10 years, you did not have to pay a fee.

[57] In total, Investor One and his wife borrowed approximately $475,000 to invest through Daubney. In 2001, they switched to new financial planners and sold securities to retire both their loans. At that time, the majority of their line of credit secured on their house was still outstanding. Investor One is still working and feels he is "working harder than ever".

b) Investor Two

[58] Investor Two testified about the investments that he and his wife made through Daubney. Investor Two and his wife met Daubney in 1999 when they were 56 and 49 years old respectively. At that time, Investor Two was working as a forklift operator earning approximately $49,000 per year and his wife was providing childcare services in the couple's home, earning approximately $20,000 per year. Their combined household income was approximately $69,000 per year.

[59] At that time, the assets and liabilities of Investor Two and his wife included a house that was worth $330,000 subject to a mortgage of $117,500, leaving them with home equity of $212,500; financial investments comprising approximately $52,000 held in RRSP accounts, $15,000 in non-RRSP stocks, and investment club holdings of approximately $8,000; a car worth $6,000; cash savings of $7,000; and, other liabilities consisting of a $29,500 line of credit, a loan of $13,500 and $4,000 in credit card debt. Taken together, their net worth was approximately $254,000.

[60] Investor Two and his wife had some limited investment experience. They had previously held mutual funds that were recommended by a financial planner and Investor Two had participated in an investment club at his workplace. Investor Two however, did not propose or select investments.

[61] Investor Two and his wife were referred to, and met with Daubney because Investor Two was recently informed that his employer was closing its business and he was about to lose his job. He was concerned about his prospect of finding a new job given his age and limited education and experience, and worried that he would have to sell their house. By investing through Daubney, Investor Two and his wife had hoped to maintain their current lifestyle and home, retire comfortably, improve investment returns, travel and save on income tax. Investor Two did, in fact, lose his job in February 2000.

[62] Given their circumstances, Investor Two and his wife felt they could not afford any high risk investments and informed Daubney accordingly. Investor Two testified that he and his wife repeatedly expressed their concerns about risk and that they wanted to keep their house because it was their "dream home". On their KYC form, Daubney indicated that their risk tolerance was "medium".

[63] The investment scheme Daubney recommended for Investor Two and his wife consisted of moving their current investments into his care and taking out loans to

generate additional funds for Daubney to invest. When Daubney presented Investor Two and his wife with investment proposals, he showed them charts with different returns based on the amount of initial investment and a rate of 12 percent annually over 15 years. Daubney also advised that it was not unusual for annual returns to be more than 12 percent, even up to 20 percent. Although specific rates of return were never guaranteed, these were always presented as fair figures. On the other hand, Investor Two does not recall Daubney discussing the risks of investing or what would happen if the markets declined, such as the possibility of margin calls on his loans.

[64] In accordance with Daubney's investment plan, in November 1999, Investor Two and his wife transferred the investments held in their RRSP accounts, and increased their mortgage to $210,000, which paid off the existing mortgage and left $92,500 of the proceeds to be invested through Daubney.

[65] In December 1999, under Daubney's direction, Investor Two and his wife obtained a two-for-one loan in the amount of $100,000 from M.R.S. Trust, the proceeds of which also went to Daubney for investment.

[66] In the same month, Investor Two and his wife took out a second mortgage on their house in the amount of $40,000, but it is unclear from the evidence whether the proceeds were sent to Daubney to invest.

[67] When Investor Two received his severance payment as a result of losing his job in February 2000, the majority of the payment also went to Daubney to be invested in mutual funds.

[68] Investor Two testified that he does not recall discussing the risk disclosure forms that he signed. Some of the forms authorizing trades in his mutual funds were signed in blank. Investor Two was not aware of what "DSC" meant in relation to the purchase of mutual funds.

[69] In total, Investor Two and his wife borrowed approximately a minimum of $193,000 to invest in mutual funds through Daubney. They also purchased a Universal Life insurance policy through Daubney in 2000.

[70] In 2001, Investor Two and his wife left Daubney and retained new financial advisors. A mortgage on their home of approximately $178,000 is still outstanding.

c) Investor Three

[71] Investor Three met Daubney in 1991 and was 46 years old at that time. She was a widow with two grown children, and was employed as a secretary with an income of approximately $18,000 per year.

[72] At the time, her major assets included a mortgage-free condominium worth approximately $140,000, an RRSP account holding approximately $50,000, and a residential mortgage investment of $100,000. She also had a car loan of $14,000. Taken together, her net worth was approximately $276,000.

[73] Investor Three had limited investment knowledge. Her RRSP account was established by her husband, which she believed was invested largely in GICs and term deposits, and her mortgage investment was arranged by her brother who was a real estate agent. She did not know much about mutual funds and felt she needed to rely on the advice of others.

[74] Investor Three's investment goal through Daubney was to achieve some financial security so that she would be able to retire at age 65. Her circumstances changed when she met her common-law partner in 1996 and relocated to Meaford, Ontario and stopped working. Daubney's advice was that she could afford to do so.

[75] Investor Three testified that she repeatedly informed Daubney of not wanting high-risk funds and that she was not comfortable in having loans or borrowing. In response, Daubney told her that she should not worry and that borrowing is "how wealthy people do it." Despite Investor Three's desire for safe investments, Daubney assessed her risk tolerance as "high" in her KYC forms.

[76] Daubney's investment program involved Investor Three transferring her current RRSP investments to him, and as her mortgage investments came due, transferring the resulting funds to him, the proceeds of which were invested in mutual funds recommended by him. These mutual funds were pledged as security for loans to make further investments. In recommending borrowing to invest, Daubney assured her that paying back the loans would not be a problem. He showed Investor Three charts estimating 10 and 12 percent in annual returns, and advised that 10 percent was a conservative estimate. Investor Three testified that Daubney advised that she would not notice the loan payments because they would come automatically from the return on the mutual funds. In terms of advising her of risks, Daubney advised that there may be blips in the mutual fund market, but that it always went back up so that she didn't need to worry.

[77] Accordingly, Daubney arranged for a loan to be taken out with the Bank of Montreal for $50,000, the proceeds of which paid off her existing car loan and left approximately $36,000 for Daubney to invest in mutual funds.

[78] When Investor Three moved to Meaford in 1996, she sold her condominium and after a portion of the proceeds was used to purchase a house in Meaford, Daubney requested that she invest the remaining funds with him, which amounted to approximately $70,000.

[79] Further, in May 1997, Daubney arranged for Investor Three to take out a two-for-one loan with National Trust in the amount of $125,000 to invest in mutual funds.

[80] In recommending the two-for-one loan, Investor Three testified that Daubney did not advise her of the possibility of margin calls. Although she worried about taking out further loans, Daubney told her not to worry. Gains from her mutual funds would enable her to keep making the loan repayments as well as provide her with income. Investor

Three did not recall whether she knew what "DSC" meant in relation to the purchase of mutual funds.

[81] Investor Three also testified that she signed blank forms authorizing trades in her mutual funds, "usually five at a time" for Daubney. She understood that it was necessary so that "when things needed to be moved around, if the timing was right, it could be done."

[82] One of the investments Daubney arranged for Investor Three was BPI GOF. Investor Three was under the impression that it was just a regular mutual fund and did not recall being told of the $150,000 minimum investment requirement. Investor Three invested $190,000 in BPI GOF in October 1999 and recalled that Daubney intended to invest all of her assets into this fund. In December 2000, her entire investment portfolio was invested in this fund.

[83] In December 2000, when Investor Three was experiencing a significant decline in the value of her leveraged investments, Daubney recommended that she increase the mortgage on her house to 75 percent of the appraised value and use the proceeds to increase her investments. Investor Three testified that he advised her that "now that it had dipped this low, if you take a mortgage, these funds will really do really, really well, and bring it right back up for you". Daubney also provided tables showing the cost of borrowing estimated at 7 percent per annum against an annual investment rate of return estimated at 12 percent. In that instance however, Investor Three did not follow Daubney's recommendation.

[84] In total, Investor Three borrowed approximately $160,000 to invest through Daubney. From the mutual funds, she withdrew approximately $28,000 for a new car and an unknown amount for tax liabilities and living expenses. In 2004 or 2005, Investor Three paid off the last of her loans.

d) Investor Four

[85] Investor Four met Daubney in March 1997. She was 71 years old. She was a widow who had retired from her position as a secretary and stated that it was not possible for her to return to the workforce. Her income consisted of pension and old age security payments of approximately $32,000 per year.

[86] At the time, her only major asset was her house, which was worth $250,000 and secured an outstanding mortgage of $46,000. Other assets and liabilities consisted of a car that was worth approximately $6,000, a bank account with approximately $3,000 in savings, and consumer loans of approximately $9,000. Taken together, her net worth was approximately $204,000.

[87] Investor Four had very limited investment knowledge. She primarily dealt with Canada Savings Bonds purchased through her bank and had once bought common shares through a payroll deduction plan. Investor Four did not know what DSC meant in relation to the purchase of a mutual fund.

[88] Investor Four wanted to invest in order to increase her monthly retirement income, but informed Daubney several times that she only wanted investments that were similarly safe as savings bonds, because she felt she would be unable to return to work. In her KYC forms however, Daubney assessed her risk tolerance as "medium" in 1997.

[89] Daubney's advice included a financial plan showing annual returns of 10 or 12 percent such that Investor Four would be receiving extra income each month. From her discussions with Daubney, Investor Four was under the impression that she would receive a return each month, which would vary according to how well the markets were performing. She understood that if the markets were doing well, her returns would be extremely good, but if the markets were down, that her returns would be less.

[90] Investor Four's investment program recommended by Daubney consisted of taking out loans to invest. Investor Four testified that Daubney's advice did not include the risks of using borrowed money to invest, the possibility of selling investments to make loan payments or the possibility of margin calls. She also did not know what a two-for-one investment loan meant.

[91] First, Daubney arranged for Investor Four to apply for an increase in Investor Four's mortgage on her house to 75 percent of its value. The bank however, only granted a mortgage of $176,250, of which $46,000 was used to pay off the existing mortgage and approximately $130,000 was given to Daubney to invest in mutual funds.

[92] Shortly afterwards, Daubney arranged for a two-for-one loan of $120,000 with National Trust by pledging the mutual funds as security. The proceeds of the loan were also invested in mutual funds under Daubney's direction.

[93] It appears that Investor Four did not sign any risk disclosure forms at the time these investments were made, although it appears she signed some risk disclosure forms subsequently. There is also evidence that in 1998, she signed blank forms authorizing trades in her mutual funds, which were given to Daubney.

[94] It also appears that subsequent to Daubney's investment strategy being put in place, Investor Four changed investment advisors for a period. Investor Four's evidence was that she believed Daubney remained as her investment advisor until March 2001.

[95] In total, Investor Four borrowed approximately $250,000 to invest through Daubney. From the investments in mutual funds, Investor Four testified that the only personal benefit she received from her investments was the $23,000 she withdrew to buy a used car. In 2003, Investor Four still had approximately $150,000 outstanding on her mortgage. The mortgage is still outstanding.

e) Investor Five

[96] Investor Five testified about the investments that he and his wife made through Daubney. Investor Five and his wife met Daubney in the fall of 1996, at which time they were 65 and 67 years old respectively. Investor Five had been retired from his position as a schoolteacher since 1991 and was receiving an annual pension of approximately

$45,000. Investor Five's wife was retired from her position as a bank branch manager since 1990 and was receiving an annual pension of approximately $11,500 per year. Together, they received an annual income of approximately $57,000.

[97] At that time, the major assets and liabilities of Investor Five and his wife comprised a mortgage-free house worth $182,000, financial investments in RRSP accounts totalling approximately $261,000, a vehicle worth $15,000 and an outstanding debt of $9,000. Taken together, their net worth was approximately $450,000.

[98] The investment experience of Investor Five and his wife consisted of the RRSP accounts that they held at Nesbitt Burns. The accounts held bonds and GICs together with other investments that were recommended by their financial advisor.

[99] Investor Five and his wife were hoping that investing through Daubney would reduce the impact of income taxes on withdrawals from their RRSP accounts, and add to their retirement income which would allow them to do some travelling.

[100] In their KYC form, Daubney assessed their risk tolerance as "medium-high." Subsequently, Daubney assessed their risk tolerance as "high". Investor Five testified that he does not recall discussing their risk tolerance with Daubney, and that this risk tolerance would not have been acceptable to them had they known. In fact, Investor Five testified that the KYC form might not have been completed when he signed it.

[101] In recommending an investment program, Investor Five testified that Daubney gave the impression that he had studied the market and had good information to find the appropriate funds. Investor Five stated that Daubney was "quite confident that he could generate 12-percent annual return on the investments of these high-rate mutual funds that he would recommend." On the other hand, Investor Five testified that he did not recall any significant discussions about risk and does not recall discussing the concept of margin calls.

[102] Under Daubney's direction, Investor Five and his wife transferred their existing RRSP accounts to Daubney and converted some of these accounts into RRIFs.

[103] They took out a mortgage for 75 percent of the value of their house, amounting to $135,000. They used $9,000 to pay off their existing loan and provided the remainder to Daubney to invest in mutual funds.

[104] They used these mutual funds as security for a two-for-one loan in the amount of $250,000 from the Bank of Montreal in October 1996. Daubney also arranged for the loan to be increased on three different occasions, and as of March 2000, the amount owed was approximately $416,000. Other than approximately $21,000 taken from the first loan increase to purchase a car and $35,000 from the third loan increase to make a loan to Investor Five's step-son, the remaining proceeds went to Daubney to invest in "high-yield mutual funds of a conservative nature".

[105] Additionally in October 1997, Daubney arranged for another two-for-one loan from National Trust in the amount of $250,000 to be taken out by Investor Five and his

wife, the proceeds of which were invested in mutual funds. Investor Five testified that he thought the purpose of this loan was to pay down the loan from the Bank of Montreal and was surprised that these proceeds were used to invest in more mutual funds. He was also surprised that the amount applied for from National Trust was $500,000 instead of the $270,000 he expected.

[106] There is no evidence that Investor Five and his wife signed a risk disclosure form at the time they initially took out loans in 1996 and Investor Five testified that he does not recall signing one. There is evidence however, that Investor Five signed a risk disclosure form in September 1998, but this was well after he took out his initial loan and even after he took out his National Trust loan. Investor Five also did not recall Daubney discussing the document with him at this time.

[107] Investor Five testified that he recalls signing at Daubney's request, between 50 and 100 blank forms authorizing trades in his mutual funds. Investor Five did not recall whether Daubney explained to him what "DSC" meant in relation to the purchase of mutual funds.

[108] The mutual fund investments Daubney selected for Investor Five and his wife included BPI GOF. Daubney advised Investor Five and his wife that it was about to declare a dividend, the proceeds of which they could use to meet their loan obligations. Daubney also told them that the fund was for "sophisticated investors", which flattered them. Investor Five and his wife invested $300,000 in this fund at the end of 1999, and for income splitting purposes purchased this investment in Investor Five's wife's name. By December 1999, this product constituted 100 percent of the assets held in Investor Five's wife's name, and approximately 30 percent of the joint assets of Investor Five and his wife.

[109] In total, on Daubney's advice, Investor Five and his wife borrowed approximately $792,000. After deducting the funds used for other purposes, the amount borrowed by Investor Five and his wife to invest through Daubney approximated $736,000.

[110] Daubney also arranged for Investor Five and his wife to purchase several Universal Life insurance policies with annual premiums totalling $96,000. Investor Five testified that Daubney assured him that the return on his investments would carry the premiums for those policies.

[111] Investor Five testified that in 2006, Investor Five and his wife needed to "downsize" and sold their house and discharged the outstanding amount of their mortgage with the proceeds.

f) Investor Six

[112] Investor Six met Daubney in 1997. She was 67 years old at the time. She was employed as a real estate agent, but was past the usual retirement age and planned to retire within the next year. Her income was approximately $37,000 per year.

[113] At that time, Investor Six's assets and liabilities included a mortgage-free house worth $170,000, two condominiums with net values of $56,000 and $34,000, a vehicle worth $20,000, gold bars worth $1,000, RRSPs with a value of $182,000, mutual funds with a value of $176,000, Canada Savings Bonds with a value of $64,000, treasury bonds worth $6,000, shares in a private investment worth $3,500, cash savings of $27,000, taxes of $20,000 owing to Revenue Canada, and an outstanding car loan in the amount of $28,000. Taken together, her net worth was approximately $692,000.

[114] Investor Six's investment experience primarily consisted of holding RRSP accounts with two financial planners, Regal Capital Planners and Midland Walwyn. She believed her investments were largely placed in mutual funds and relied on her financial planners to make the investment decisions.

[115] Investor Six's goal in investing through Daubney was to retire comfortably, enjoy recreation and travel, and minimize her tax exposure. In her KYC forms, Daubney indicated that her investment knowledge was good and that her risk tolerance was "high" or "medium-high", but Investor Six doesn't recall any discussion about the assessment.

[116] In recommending a leveraged investment approach, Investor Six does not recall Daubney discussing the possibility of potential losses or what would happen if the markets went down, such as the possibility of margin calls. Investor Six testified that Daubney mentioned an annual return rate of 12 percent and always gave her the impression that things were fine and "rosy" even if he did not guarantee a specific rate of return.

[117] The investment program Daubney implemented for Investor Six included transferring her existing investments and portions of her savings to Daubney's firm and converting the RRSP accounts into RRIFs. In March 1998, Daubney arranged for a mortgage to be taken out for 75 percent of the value of Investor Six's house, which amounted to $127,500 and invested the proceeds in mutual funds.

[118] Approximately a month later in April 1998, Daubney arranged for a two-for-one loan from Laurentian Bank in the amount of $250,000.

[119] Two years later in April 2000, Daubney advised that taking out a second loan would be beneficial and arranged for another two-for-one loan in the amount of $250,000 from TD Bank to invest in mutual funds.

[120] There is no evidence that Investor Six signed a risk disclosure form with her first investment loan with Laurentian Bank. She did sign such a document when she secured her second loan with TD Bank, but she does not recall any discussion about it. Investor Six did not recall discussing with Daubney what "DSC" meant in relation to the purchase of mutual funds.

[121] Investor Six invested $150,000 in BPI GOF through Daubney in 1999. She does not recall any discussion with Daubney about the fund, the reasons she was investing in it, or that it required a minimum investment.

[122] In total, Investor Six borrowed approximately $628,000 to invest through Daubney. From the mutual funds, Investor Six withdrew approximately $35,000 to pay her tax liabilities.

[123] In July 2001, Investor Six transferred her investments from Daubney to another financial planner, Money Concepts, and the loans were paid off in 2006.

3. Summary of Amount Leveraged

[124] The following chart summarizes our analysis based on the net worth and net income of each of the Six Investors at the time they initially met with Daubney.

Client, Age	Approximate initial net worth*	Approximate initial net income	Initial Employment status	Approximate total amount borrowed to invest in mutual funds through Daubney	Daubney's assessment of client's risk tolerance	Approximate percentage of total amount borrowed to initial net worth
Investor One, 53 /Investor One's wife, 50	$583,000	$54,000	Employed / Retired	$475,000	Medium-high	81%
Investor Two, 56 /Investor Two's wife, 49	$254,000	$69,000	Employed, facing layoff / Employed	$193,000	Medium	76%
Investor Three, 46	$276,000	$18,000	Employed	$160,000	High	58%
Investor Four, 71	$204,000	$32,000	Retired	$250,000	Medium	123%
Investor Five, 65 /Investor Five's wife, 67	$450,000	$57,000	Retired / Retired	$736,000	Medium-high to High	164%
Investor Six, 67	$692,000	$37,000	Employed	$628,000	Medium-high to High	91%

*The amount of the equity in their homes as a percentage of their initial net worth ranged from 24% to almost 100% for the Six Investors.

4. Littler's Evidence

[125] Litter testified that she got involved in the financial services industry in 1996 when she applied for a job with Neil Mathieson, an accountant in Orangeville. Neil Mathieson introduced her to Daubney, who was then at Investors Group. Investors Group sponsored her for her mutual fund licence. However, she never worked for Investors Group because Daubney left to create Hewmac just as she completed her courses, and she transferred her registration to Hewmac. Littler was registered under the Act as a mutual funds salesperson with Hewmac from March 13, 1997 to July 22, 1999, at which time she followed Daubney to Wealth Map. After Wealth Map closed, Littler's registration was suspended on July 17, 2003 and she allowed it to lapse. She has not sold mutual funds since then.

[126] Daubney was Littler's mentor. She accompanied him to visit clients for the first three or four months, but then she began to develop her own client base.

[127] Littler described her own sales practices and what she observed of Daubney's sales practices. Her evidence with respect to Daubney's investment recommendations was consistent with the evidence of the Six Investors.

[128] She testified that she and Daubney would first have an information-gathering meeting with a new client at the client's home. Then Daubney would develop a financial strategy which would be explained and left with the investor at a later meeting.

[129] According to Littler, leveraging was a "pretty consistent" part of the "package" as she learned it from Daubney:

> The usual pattern was taking equity from the home, purchasing mutual funds with that, leveraging those mutual funds to one of the lenders that John offered a two-for-one loan. So that's pretty standard as far as what package would be presented or the process we would follow. (*Hearing Transcript in the Matter of John Daubney and Cheryl Littler,* dated October 12, 2007 (the "*Oct. 12 Transcript*") at 126:5-10.)

[130] Asked what factors would be considered in determining whether leveraging was suitable, Little stated:

> I can't really even recall a time when it wasn't suitable. Certainly age was a factor. John often said that just because somebody was old, they shouldn't be excluded from the leveraged program. They were just as entitled to be leveraged. I do not recall ever leaving a meeting with a client that there wasn't some form of leverage that would have been suitable. (*Oct. 12 Transcript*, *supra* at 128:2-8.)

[131] Asked further whether she recalled attending any initial presentations with Daubney where leverage was not part of the package, Littler stated: "No, I don't recall one." According to her, leveraging would be offered even if the investor did not own a house or had no income stream.

[132] Littler testified that she could not recall Daubney discussing margin calls or the risks of leveraging with his clients. Indeed, she testified that she did not understand what a margin call was until they started happening and clients began calling the office with their concerns. Littler testified that generally Daubney was not available, and she responded to the calls instead.

[133] If a client expressed concern about leveraging, Daubney would explain that the investor could "run to cash" in the event of a market downturn.

[134] According to Littler, more than half of Daubney's clients were leveraged in 1997, when she began working with him. Littler also recommended leveraging to her clients. She testified that at her peak, 20-25 percent of her 140 clients were leveraged. She also leveraged her own investments and those of her family.

[135] Littler was questioned about the income tax implications of leveraging. She testified that borrowing to invest sometimes offered tax savings. Asked whether there were guidelines for deciding when income tax was a consideration, Littler testified she and Daubney considered tax issues across the board, and not only for higher income clients.

[136] With respect to the expected rate of return of the investments they sold, Littler testified "[i]t was standard practice to use 12 percent." Depending on the fund, other figures and charts might be used, but "as far as a financial strategy as a wealth map, that was always done at 12 percent." However, according to Littler, investors were also told that as long as the rate of return on the investment was the same as the rate of interest on the loan, they would be ahead because of the tax advantages of leveraging.

[137] Littler testified that the first step in the investment program was for the investor to transfer all existing investments to Daubney. Then Daubney would arrange for pre-clearance of a home equity loan through the Bank of Montreal. The documents would be taken to the investor for signature. Littler could not remember whether a risk disclosure form was used at Hewmac, though she remembered one being used at Wealth Map. Once the mortgage or home equity loan was in place and the mortgage proceeds invested, a two-for-one loan would be arranged at National Trust or M.R.S. Trust and invested in equity mutual funds. She could not recall a discussion of risks apart from the discussions about cashing out in the event of a market downturn and the loss of the DSC. She thought margin calls were not discussed until late 1999 or 2000.

[138] According to Littler, she and Daubney began to ask investors to "pre-sign" blank forms authorizing trades in their mutual funds because changing interest rates and loan payment amounts made the administration of the accounts difficult.

[139] Littler testified that she and Daubney recommended mostly "progressive" equity funds, "the high performers. It was pretty much the flavor of the month whereby they happen to be super performers, and you would be trying to utilize it and get the growth out of them." They had very few balanced funds, and no bonds or GICs. There was no formal fund selection process.

[140] Since the majority of their funds were back-end-loaded, any investor needing to redeem funds because of a margin call would incur a DSC, thereby increasing the investor's losses. Littler could not recall discussing this "in great depth" with Daubney, though she recalled his saying that investors would hold these funds for years. Margin calls were not discussed until "we were kind of hit with it."

[141] Littler also testified about BPI GOF. In 1999, Littler understood that it was a hedge fund. She was aware of the $150,000 minimum investment, but did not, at that time, understand the reason for that requirement. She testified they recommended it for their leveraged investors who were able to meet the minimum investment amount:

> A lot of my clients, what we had done is taken approximately $50,000 of either growth or other mutual funds and pledged those in order to get a two-for-one which now gives us $150,000 and therefore we could go and buy the BPI. (*Oct. 12 Transcript, supra* at 149:5-9.)

[142] Littler testified about her disagreement with Daubney concerning the year-end payout from BPI GOF, which she described as a distribution and Daubney described as a dividend. According to Littler, this was a return of the investor's capital, made whether or not the fund gained in value, and it was taxable in the investor's hands. For this reason, Littler's strategy was to move her clients out of the fund before the distribution occurred. According to Littler, Daubney's strategy was to move clients into the fund just prior to the distribution because it put cash in their hands: "To the client, it appears that they'd had a huge bonus just given to them." Littler testified that she discussed this "a number of times" with Daubney. On cross-examination, when it was suggested to her that this was a dividend and that Daubney's strategy, though different from her own, was not obviously inappropriate, Littler stated:

> It is completely backward to industry. In fact, we had a number of people question his theory, inquire whether he really intended to do that: Did he understand the consequences of what he was doing? These were people, meaning reps such as myself and the others. There were wholesalers from the fund companies who would call him and say John, do you realize what you're doing? It's completely backwards from what any other rep would do. (*Oct. 12 Transcript, supra* at 167:23-168:6.)

[143] Finally, with respect to mutual funds, Littler testified about the commission structure. The mutual fund companies generally offered commissions of about 5 percent on the amount invested, of which 65 percent went to Littler as the representative (70 or 75 percent to Daubney were he the representative), 20 percent to the dealer, and the remaining 15 percent to John Daubney & Associates. Littler thought trailer fees were 50 basis points (or half a percent), and were allocated and paid on the same basis. Littler also testified that the commission was higher when leveraging was used because more money was being invested. However, she testified that they received no compensation from the lending institutions for arranging the home equity loans or two-for-one loans.

[144] Littler was also a licensed life insurance salesperson. She testified that Universal Life policies became a standard part of "the package" she and Daubney presented to investors. She stated:

> […] in the beginning stages, it was a place to put their growth and stop the taxation on it. So that is how it first started to come about. Later, it sort of switched to we did the leveraging and the UL almost all in one step instead of waiting for that growth to happen, and it was just a structural part of the strategy that John made a little twist to." (*Oct. 12 Transcript*, *supra* at 178:9-16.)

[145] Littler further testified that the Universal Life policies recommended by Daubney to his clients required the payment of very high annual premiums that "would have been almost impossible for them to maintain." As a result, she testified that clients were not able to keep paying the premiums and would reduce the amount of coverage to reduce the premium cost.

[146] Littler testified that the commission payable on the sale of life insurance policies was "much, much higher" than commissions paid on the sale of mutual funds. Interestingly, when Daubney was asked about commissions payable with respect to the sale of Universal Life policies, he testified:

> A. On all insurance policies that are sold, there is an arrangement through the MGA network, which is the managing general agent network, that they receive 140 percent of the annual premiums that go in there for the first year.
>
> Q. So it was 140 percent of that first year?
>
> A. That's correct. […] Now, because I did quite a lot of insurance business, I think I was put at about 120 percent and I forget where Ms. Littler was, I think she was probably 110 or 115 because she was pretty good too at the insurance business. (*Hearing Transcript in the Matter of John Daubney and Cheryl Littler*, dated October 17, 2007 (the "*Oct. 17 Transcript*") at 174:21-175:12.)

5. Daubney's Evidence

[147] Daubney testified that he followed a standard procedure with new clients. Most of his clients were referred to him, and the first meeting was to get to know each other and complete a KYC form. This could take several hours in an evening. The purpose of the meeting was to obtain information about the client's income, assets, liabilities, current investments, as well as their investment knowledge and risk tolerance. The client would then sign the form. In cross-examination, he testified that he asked the investor's age, employment status, retirement plans, liquid and illiquid assets, debts, and prior investment experience.

[148] Also at the first meeting, Daubney would ask clients if they were happy with their current returns on their RSP or locked-in-pension. If the client expressed interest in changing their investments, Daubney would tell them he needed to analyze the situation and come back with a full set of recommendations. To illustrate the market's historical performance, he would give them a copy of a chart showing historical returns of 11.86 percent.

[149] After the first meeting, Daubney testified he would prepare a set of recommendations to present to the client at a second meeting. He would offer three options, an "extremely conservative," "conservative" and "a very, very high risk, very aggressive proposal," along with average rates of return. He would then present these options to the client in a second meeting. He would provide charts "to back up the return rates." He would also explain that these were longer term investments, "more than five years, preferably between five and ten and maybe fifteen to twenty, if we had that time." He recognized that some investors would only have a time horizon of five to seven years, but stated "there has never been a period of five consecutive years where the market has lost money in the whole history of the markets. There have been two years, three years, but then the markets have always gone up." The investor would then choose one of Daubney's options "based on their particular tolerances and knowledge of strategies."

[150] Daubney would then return to his office and prepare forms for the investor to sign, including "if we're doing leverage, different lender's forms, different mutual fund investment forms, disclosure documents, even another know your client form" and review the recommendations again with the investor. The forms would be signed at a third or subsequent meeting. Daubney denied putting a stack of documents in front of an investor for signature. He testified that he explained each document to each investor in detail. He insisted that 'we spent more time on the risk side of it than on the good side of it. Unfortunately, human nature being what it is, people tend to dwell on the good side and not on the bad side, because that's what they want to hear, it's music to their ears. That's why you have to stress the bad side of it and make sure they understand it."

[151] If Daubney's investment recommendations were accepted by a client, he would take the following steps. First, all existing investments would be transferred to mutual funds recommended by Daubney. The second step was to increase an existing home loan or take out a new one (in the form of a mortgage or line of credit) for up to approximately 75 percent of the appraised value of the home. Daubney admitted he "pointed them in the right direction" to arrange the home loan through the Orangeville branch of the Bank of Montreal, with which he had a relationship. Indeed, he admitted it was "more than likely" that he filled out the application forms and would have suggested the amount to be requested. The proceeds of the home loan were used to purchase further mutual funds, which, in turn, were used as security for an investment loan, the proceeds of which were invested in more mutual funds.

[152] With respect to the choice of mutual fund investments, Daubney testified that apart from historical returns and volatility, another consideration was "diversification." He viewed diversification in terms of the underlying securities included in a given equity

fund – for example, making sure BPI, CI Asian Fund, Franklin Templeton Resources Fund did not hold the same securities.

[153] With respect to risk, Daubney testified that he would tell investors that the biggest risk is lack of exposure to the market, and explain that T-bills, bonds, mortgages may not be suitable, even for a conservative investor, because:

> all you're doing there is basically standing pat. And the mutual funds offer you a chance to increase the return considerably over those of T-bills, savings accounts, bond funds and mortgage funds. Now, traditionally, when bond funds go up mortgage funds go down, so somebody had the bright idea of combining a mortgage fund and a bond fund and calling that a hedge fund. The problem is you don't go anywhere with that either because what you lose on one side you gain on the other. Once again, it's a stand pat type of – the dividend fund is a little different in that it pays regular dividend income to investors and it can be, I suppose, termed as a more risky investment in that there are no guarantees of returns like you get on GICs where there is a guaranteed rate or return or Canada Savings Bond[s] where there is a guaranteed rate of return; albeit it, far, far lower than the prime interest rate. (*Oct. 17 Transcript*, *supra* at 33:18-34:10.)

[154] With respect to BPI GOF specifically, Daubney agreed that he had characterized it as a high yield conservative fund. He described it as a dividend fund and as a hedge fund, which "tends to be conservative by nature." In fact, he understood a hedge fund to be a balanced fund and a conservative investment option:

> It's sort of along the line of a bond versus mortgage type fund, although that's not the investments that they put them in, but the idea is the same. If one section of the market goes up, the other one is going to obviously take a hit. That's a balance fund or a hedge fund, whatever term you want to give it. (*Oct. 17 Transcript*, *supra* at 76:8-14.)

[155] Daubney recommended to three of the Six Investors that they invest in units of BPI GOF shortly before a year-end distribution by BPI GOF in 1999. Daubney disagreed that such a distribution would amount to a return to the unitholders of a portion of the purchase price they had just paid for their units. Daubney described the distributions as a dividend:

> […] because she had the same number of shares prior to taking the dividend out as afterwards, after it had gone out. If that had been a return of her own money, that number of shares would have dropped drastically. (*Oct. 17 Transcript*, *supra* at 146:22-147:1.)

[156] Daubney testified that tax considerations were not his only reason for recommending leveraging, but was an important one. He testified on the factors that would suggest leveraging as appropriate as follows:

> Q. What would be the factors, from your understanding, that would suggest leverage is appropriate? What would be the factors that would suggest it's not appropriate?
>
> A. The big one was saving on income tax. That was always one. The other was if they had not a lot of underlying investment, but wanted to retire comfortably or increase their retirement income, this would be the type of candidate that you would choose for leverage.
>
> Q. Let me come back to those two factors in a moment, the saving of tax and the increased retirement income. What, from your understanding, would be counter factors towards seeking a leveraged investment? What would prevent – you would say you are not an appropriate candidate for leverage?
>
> A. Well, if they were very, very nervous types of investors. If they – and I would put it to them several times during our meetings, but if they showed a sort of general distaste towards the whole idea of borrowing money, then obviously you're not going to put those people into a leveraged investment because, quite frankly, they just couldn't handle the thought of the risk and then possibly losing money and having to pay their payments, even though they've probably got a mortgage on their house and the same thing could happen there. (*Oct. 17 Transcript, supra* at 17:5-18:7.)

[157] With respect to leveraging, Daubney also testified in cross-examination that leveraging is not necessarily suitable or unsuitable for older people because he did not "discriminate based of age or sex, colour, race or anything." Similarly, someone who was about to retire was not precluded from leveraging and leveraging was not necessarily ruled out for someone whose only asset was their house. Further, when questioned about his awareness of his clients' formal educational qualifications, Daubney testified that he did not "usually make a habit of inquiring into people's educational backgrounds." Daubney also conceded that he might recommend additional leveraging where someone's investments are declining in value.

[158] Daubney denied that he "guaranteed, promised, or in any way hinted at" any specific rate of return on investments. He testified that he used a 12 percent annual rate "to illustrate a more conservative rate of return than that experienced by the market in general." He also described this as an average rate of return. In cross-examination, he conceded this meant that returns might be lower for two or three years at a time. He admitted, as well, that the investment loans taken out by the Six Investors were variable rate loans. He agreed that for leveraging to benefit the investor, the return on the investment has to be greater than the cost of borrowing. He also admitted that he did not recommend any bond funds because the yield would not cover the cost of borrowing.

[159] In general, Daubney's evidence was that the risks and benefits of leveraged investing were explained to the Six Investors and they chose the investment options they

believed were best for them. According to Daubney, their investments did well initially, and the investors had no complaints until the general market downturn in 2000/2001.

[160] For example, Daubney testified that Investor Three decided to go ahead with leveraging after discussing it with Daubney and "on the advice of her daughters, her brother she checked with and the people that had referred me to her." Further, Investor Three's investments initially "grew very rapidly," and she was taking out about $35,000-40,000 a year to enhance her lifestyle. However, in cross-examination, Daubney conceded that he recommended that Investor Three borrow more money when her investments declined in value.

[161] Daubney testified that it was Neil Mathieson who suggested leveraging to Investor Five and his wife and explained the advantages and disadvantages to them, which Daubney reiterated. According to Daubney, the investments of Investor Five and his wife were "extremely successful" initially, and Investor Five redeemed fund units to pay for vacations, a golf club membership, a small line of credit, and to make loan payments on his leveraged investments.

[162] Daubney admitted that he recommended leveraging to Investor Two despite the fact that Investor Two was in his late fifties when they met, worked as a forklift operator, and advised Daubney, at their second meeting, that he was likely to lose his job in about a year. Daubney conceded that leveraging "might not be suitable" for someone who was going to lose their job in the near future. However, he testified that Investor Two told him he should not worry about that because Investor Two, "being a smart man, he had no problem finding a job anywhere." Daubney testified that Investor Two chose the middle of the road option of the three presented by Daubney.

[163] Daubney denied Staff's suggestion that the Six Investors told him they wanted low risk investments. For example, he specifically contradicted Investor Four's evidence that she told him she wanted her investments to be as safe as Canada Savings Bonds. According to Daubney, Investor Four's investments also did "extremely well," initially, and were in a "very positive" position when she transferred them to Neil Mathieson. Daubney testified that any margin calls must have occurred after this transfer.

[164] Daubney insisted that his clients were asked to sign detailed KYC forms before investing. He also insisted that all the investors were given the risk disclosure form before they decided to borrow. For example, he insisted that Investor Four and Investor Six had signed a risk disclosure form, though none was entered in evidence; he testified that Investors Group had the documents. The evidence would indicate however, that both Investor Four and Investor Six met Daubney in 1997, after he had left Investors Group.

[165] Contrary to Littler's evidence, Daubney testified that he returned the calls of all investors who called the office, unless he was incapacitated, in which case Littler returned the call. In fact, he did call Investor Two twice from his hospital bed because Investor Two "had become extremely nervous about the state of the market."

6. Investors Called by Daubney

a) Investor Seven

[166] Investor Seven was 51 years old when he met Daubney in the summer of 1998. He had just retired from teaching elementary school, and wanted advice about how to invest his locked-in teacher's pension, worth about $525,000. His wife did not work and they had four children in high school or university.

[167] Apart from his pension, Investor Seven's assets consisted of the family home, which was then worth about $300,000, and his own and a spousal RRSP with a combined value of approximately $35,000 to $40,000, invested mainly in Canada Savings Bonds. The house was unencumbered and we heard no evidence that Investor Seven had any debts at the time. He had no previous investment experience and did not actively manage his pension investments.

[168] Investor Seven testified that his brother-in-law invested through Daubney and his niece worked for Daubney. However, Investor Seven met with two other people before deciding to invest through Daubney. Investor Seven and his wife met with Daubney several times before engaging him.

[169] Investor Seven was unable to give any details about Daubney's investment advice. He did not recall Daubney referring to any particular rate of return, but "[h]e was very positive about it, as you would expect, because the market was doing so well." Daubney said there would be "a reasonable" or "very reasonable" return, and showed Investor Seven charts reflecting increases in the market.

[170] Investor Seven understood that Daubney would receive a commission, but could not recall a specific figure. Investor Seven also testified that Daubney discussed front-end and back-end load funds, and that he invested in both.

[171] Investor Seven testified that Daubney introduced the idea of leveraging, but did explain there were risks. On cross-examination, he admitted he did not recall Daubney explaining that borrowing money to invest can inflate profits and losses. Investor Seven also testified that he did not know what margin calls were until he received them.

[172] Investor Seven pursued the following investment plan on Daubney's advice. First, he transferred his locked-in pension to Daubney for investment in mutual funds.

[173] Next, Daubney helped him take out a mortgage on his house through the Orangeville branch of the Bank of Montreal. Though Investor Seven was unsure of the amount, he thought it was likely $175,000; he was unable to recall whether the mortgage came to 75 percent of the value of his house. All of this money was transferred to Daubney, who invested it for him.

[174] Finally, the mutual funds bought with the proceeds from the mortgage were used as security to take out a two-for-one loan with M.R.S. Trust. Again, Investor Seven was unsure of the amount, initially saying $270,000-300,000, then stating it was around

$200,000. The proceeds from the M.R.S. Trust loan were also invested in mutual funds through Daubney.

[175] As well, Daubney helped Investor Seven arrange a line of credit, secured on his house, to buy a farm. The purchase price of the farm was $230,000, and Investor Seven borrowed $210,000 from his line of credit. Investor Seven and his wife also cashed in their RRSPs for a down payment.

[176] Daubney also sold Investor Seven a Universal Life insurance policy with annual premiums of $40,000 that were to be paid from the returns on his mutual fund investments.

[177] When the market went down in 2000-2001, and his investments lost value, Investor Seven received margin calls from M.R.S. Trust. Though he was unsure of dates, on cross-examination he testified that in the summer of 2002, problems with Daubney were occurring.

[178] Investor Seven left Daubney and transferred to new financial advisors in about January 2003. The new advisor helped him clear the M.R.S. Trust loan by cashing in the investments he had bought with it, leaving about $80,000 of those investments. Investor Seven also transferred his Universal Life policy to a life insurance policy because he could not afford the premiums.

[179] At the time of the hearing, Investor Seven testified that his locked-in pension was worth about $585,000, but was now invested with his new advisor. He still had his house and his farm. He also had significant liabilities: a mortgage of about $140,000 on his house and a debt of about $200,000 on the line of credit relating to the farm.

b) Investor Eight

[180] Investor Eight, who was 59 years old at the time of the hearing, met Daubney in late 1990 or early 1991, when Daubney was with Investors Group. Investor Eight was referred to Daubney by a friend for whom Daubney had provided financial planning advice. Investor Eight had no particular investment experience at the time. Daubney visited Investor Eight and his wife at their home, and on the third visit, Investor Eight made an investment through Daubney.

[181] Investor Eight testified that in the first two meetings, Daubney explained the benefits and the risks of leveraged investing. Asked about Daubney's discussion of anticipated rates of return, Investor Eight testified as follows:

> That particular time, I believe the market average was at – rates of returns of 8 to 10 percent could be expected. In certain circumstances, certain funds had done 10 to 12 percent. Over the short period of time, certain funds have done phenomenal and have got – you even see it now, where a fund will perform better than 15 percent over a short period of time. (*Hearing Transcript in the Matter of John Daubney and Cheryl Littler*, dated October 15, 2007 at 61:11-17.)

[182] According to Investor Eight, Daubney explained that “the value of your portfolio could at times be less than the amount of money that you borrowed to purchase that investment,” and that leveraged investing “is a long-term strategy.”

[183] Investor Eight testified that he “believed” he and his wife invested $60,000 through Daubney. They used their home equity to leverage the investment, but Investor Eight did not say how much they borrowed. He did not take out a two-for-one loan.

[184] Investor Eight testified that he joined Investors Group in 1995, and at that time, he took over the management of his own investments and Daubney ceased to be involved. He also took over the portfolios of two of Daubney’s clients at Investors Group. He admitted that he did not engage in any further leveraged investing after dealing with Daubney and has not done so on behalf of his own clients either. Indeed, he has moved into “lower-risk, more secure funds” because of his age and pending retirement.

c) Investor Nine

[185] Investor Nine and his wife met Daubney in the fall of 1996; they had been referred by a friend. At the time, Investor Nine was a 59 year old union representative, earning about $75,000 per year. His wife, who was 54, was a child counsellor. Investor Nine testified he told Daubney he had “minimal” investment knowledge, but wanted to plan for his retirement at age 65.

[186] Investor Nine’s main asset at the time was his house, which was worth about $140,000, with about $5,000 left on the mortgage. He and his wife had investments with Investors’ Group worth about $10,000 and a small RSP, worth about $2,000, for which he paid through payroll deductions.

[187] Investor Nine testified that Daubney arranged for him to take out a line of credit through the Orangeville branch of the Bank of Montreal. Investor Nine borrowed about $60,000, secured on his house, and gave it to Daubney to invest.

[188] In 1997, Investor Nine took advantage of an early retirement package offered by his employer. He testified that this “blew a hole in” his investment plan. He received a severance package of one-year’s salary, and about $20,000 of it went to Daubney for additional investments.

[189] After Investor Nine retired, Daubney arranged for a new two-for-one loan at the Toronto Dominion Bank for $160,000 or $180,000. The proceeds of this were used to pay off the Bank of Montreal loan and the rest to buy more investments to be managed by Daubney. Investor Nine also transferred his Investors’ Group funds and his RSPs to Daubney at this time.

[190] Investor Nine testified that at one time, in 2001 or 2002, his investments were worth three-quarters of a million dollars, but they went down in value. At no time did Investor Nine withdraw money except to make his loan payments. In about August 2006, when his funds had regained some of their lost value, Investor Nine sold them to pay off the TD loan and some other debts. He was left with $60,000.

[191] Investor Nine testified that Daubney explained that the risk of leveraging was that the borrower would have to repay the principal plus interest even if the value of the portfolio dropped. He also explained margin calls and that borrowing money to invest could magnify losses.

[192] In chief, Investor Nine testified that Daubney never said he would receive any particular rate of return: ". . . he would mention what the particular fund was averaging at that point in time, but he always made it very plain that there were no guarantees attached and that figure, whatever it was, the percentage could go up or it could go way down."

[193] Daubney also sold Investor Nine a life insurance policy with a face value of about $1 million. The premiums were over $1,000 a month, and Investor Nine paid them out of his severance payments. However, after no more than three months, he and his wife decided they could not afford the premiums. They considered whether they should keep the policy at all, but ultimately decided to reduce the coverage to $100,000, for which Investor Nine pays about $97 per month.

G. ANALYSIS

[194] We prefer the evidence of the Six Investors where it differed from Daubney's evidence. We find that each of them gave a plausible, coherent, appropriately detailed account of their dealings with Daubney. Their consistent evidence was corroborated by Littler's testimony, and by the documentary evidence.

[195] Indeed, two of the investors called by Daubney (Investor Seven and Investor Nine) gave similar accounts with respect to his approach to leveraging and risk. In any event, the issue before us is whether Daubney met his obligations as a registrant in his dealings with the Six Investors.

[196] Further, we find that Daubney's evidence did not help his cause. Rather, what came through clearly from his testimony was his misplaced confidence in the suitability of the advice he had given, his failure to understand basic investment concepts, and his perfunctory approach to his know-your-client and suitability obligations. We take the testimony of the investors called by Daubney as further indication that he did not know what an assessment of suitability properly entailed. It appears that Daubney called these witnesses to show that he took a consistent approach to explaining investment options and risks and that they appreciated the risks. However, we find that the evidence was unhelpful in determining that Daubney made suitable investment recommendations.

[197] We find that Daubney failed to comply with the know-your-client and suitability obligations under OSC Rule 31-505 and failed to deal fairly, honestly and in good faith with the Six Investors. We are not persuaded however, that Daubney gave undertakings to his clients relating to the future value of the investments he recommended, in breach of section 38(2) of the Act. Our detailed findings are as follows.

1. Know-Your-Client and Suitability

a) Knowing the Product

[198] We find that Daubney's knowledge of investment products and approaches was seriously deficient. In particular, his testimony demonstrated that:

- Daubney presented himself as a financial planner who would help his clients manage their finances for a comfortable retirement. However, his plan for nearly all the investors was to achieve maximum exposure to equity mutual funds through leveraging any leverageable asset. There was never a discussion of appropriate asset allocation and return objectives taking into account each investor's time horizon and risk tolerance.
- Daubney did not understand the risks inherent in the leveraging strategy he proposed. While it is true that markets have trended up over long periods of time, the long term trend is made up of years of positive and negative returns of varying magnitudes. Daubney recommended a strategy (or product if you will) that left his clients with few unencumbered assets (liquid or otherwise) to meet any margin calls in the event of a market downturn. His clients could not remain exposed to the market in the long run. Any significant downturn would immediately produce margin calls which would require mutual fund units to be sold. This would in turn reduce the assets securing the investment loans, which would then require more assets to be sold. If a downturn occurred during the years when a redemption fee was payable, a deferred sales charge would be deducted from the proceeds and the losses would be exacerbated.
- Daubney did not understand the risks inherent in BPI GOF as shown by his testimony on this product that it was a "high-yield conservative fund". BPI GOF was not a conservative fund as the risks were extensive, as outlined in paragraph 44 of these Reasons and Decision.
- We find that Daubney did not understand the effect of the BPI GOF distributions and the adverse tax consequences they could impose on his clients. Year end distributions include undistributed dividends, interest and capital gains earned in the year and can be taken in cash or reinvested in units. When the distribution is made it results in a decrease in the net asset value of the units of the fund (market fluctuations aside) which is offset by the cash distributed or the number of new units received upon such reinvestment. If an investor purchased the units just prior to the distribution and took the distribution in cash, they would effectively be getting back part of the money they had just invested with adverse tax consequences.

b) Knowing the Client

[199] We find that Daubney failed to make appropriate enquiries to assess his clients' investment needs and failed to assess their needs in any reasonable way. For example:

- Daubney testified that a client who was already invested in mutual funds was "a cut above the average in investment knowledge because a lot of people even today don't know what a mutual fund is." In cross-examination, he confirmed this was his view even if someone else had selected the mutual funds for the investor. Though the investment knowledge and experience of the investors who testified varied, none was a sophisticated investor, and all of them had previously invested in conservative products or products managed by others.
- Daubney did not understand the importance of time horizons in assessing an investor's tolerance for risk. His repeated assertions, to investors and before us, that the markets have shown a 12 percent annual rate of return since 1929, betrays a failure to understand that these investors, given their ages and retirement plans, had few earnings years left to them. This meant that (i) they would have little ability to recoup losses by working longer; and (ii) they would likely be depending on their earnings from those investments within only a few years. Each of the Six Investors was assessed by Daubney as having a risk tolerance of medium to high despite circumstances which clearly indicated that this was inappropriate. For example, it is clear that this level of risk would be totally inappropriate for an investor in the circumstances of Investor Two, who was facing a job loss, whose main asset was his house, and expressed concerns of losing his house; or, in the circumstances of Investor Four, who was 71 years old, whose main asset was her house, and felt she was unable to return to work.
- Daubney placed his clients in a position where they owned insufficient unencumbered liquid assets to meet any margin calls.
- His plan failed to consider the Six Investors' expressed desire for safe investments in their retirement years and in particular their concern to ensure their main asset – their home – was secure.

[200] In short, Daubney recommended a standard investment package that took very little account of the financial circumstances and investment needs of these particular investors, and exposed them to risks of severe losses from which they could not recover should the market decline significantly.

[201] We find that these investors were relatively vulnerable because of their lack of investment knowledge. We accept their evidence that they relied on Daubney's advice. We also find that this was or should have been evident to Daubney. While we recognize that clients have responsibilities to understand the potential risks and returns on their investments, this does not relieve Daubney of his duty as a registrant to make certain that they have this understanding and to make appropriate recommendations, especially in circumstances where he is dealing with investors who have relatively little investment experience.

[202] We find that, while Daubney did question his clients in detail about their financial circumstances, including, in particular, their liquid and illiquid assets and ability to earn,

he did not do so in order to assess from an objective viewpoint their ability to "ride out" a bad market and recoup market losses. Instead, Daubney focussed on whether they were willing to borrow money to fund their investments and how much they could borrow. He disregarded the central importance of risk tolerance in recommending suitable investments. We agree with the following statement made by the ASC in *Re Lamoureux, supra* at 17:

> 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.

c) Suitability

[203] We find that Daubney failed to recommend suitable investments for the Six Investors. Indeed, the investment approach he recommended was highly risky and fundamentally unsuitable for these investors, by any reasonable standard.

[204] We find that Daubney recommended excessive leveraging that was entirely unsuitable for these investors because: (i) they did not have sufficient income or unencumbered liquid assets to be able to respond to any market reverses; (ii) for many of the investors, their homes were their main assets; (iii) they were retired, about to be unemployed or close to retirement and had few earnings years left in which to make up any losses; and (iv) they told Daubney they wanted conservative investments that did not threaten their financial security.

[205] We also find that Daubney's investment recommendations to the Six Investors were unsuitable in that:

- He focussed almost exclusively on seeking sufficient investment growth to cover the cost of borrowing. He essentially invested 100 percent of the Six Investors' portfolios in equity mutual funds. Though the investors were retired, planning for retirement, or about to be unemployed, Daubney considered only their desire for added retirement income, and failed to consider their limited ability, once retired, to recoup market losses, or their expressed need, as investors, for security in their retirement.
- His decision to sell only back-end-loaded funds meant that an investor who was forced to sell early at a loss in order to satisfy a margin call was faced with an additional cost at the time of redemption.
- Daubney's testimony that he would advise investors to "run to cash" in the event of a market downturn was aimed at calming their concerns of having excessive leverage. In practice, Daubney could not execute this part of the strategy.

[206] We do not believe Daubney's testimony that he clearly explained the risks of the investments he recommended, as well as the benefits. We prefer the evidence of the

investors that he focused on high rates of return, and virtually disregarded the potential for disaster in the combination of leveraged investing in high-risk investment products. We find that he disregarded or gave scant regard to relative risks.

[207] Further, Daubney did not seem to understand the risks associated with BPI GOF. Indeed, his decision to recommend this fund to these investors suggests he may not have read or understood the clear language of the OM. Daubney however, placed three of the Six Investors into this fund.

[208] We find that BPI GOF was unsuitable for these investors because: (i) the $150,000 minimum investment was too large a portion of their net worth to allow for appropriate asset allocation; (ii) its high risk nature, which is clearly set out in the OM, made it unsuitable for leveraged investing; (iii) in any event, it was unsuitable considering their personal and financial circumstances; and (iv) it did not offer the tax benefits Daubney believed it did.

[209] Though Daubney's role in selling insurance products is not an issue before us, we note that he took the same reckless approach in recommending the purchase of Universal Life insurance policies to some of the Six Investors as part of their investment package. It should have been clear to him that they would not be able to carry the very high premiums these insurance policies required in conjunction with the debt service obligations on their investment loans.

d) The Role of the Clients and the Registrant

[210] We take particular exception to any suggestion that Daubney's clients are responsible for their unsuitable investments. While investors are well advised to be cautious in choosing investments, the Act places the duty of care on the registrant, who is better placed to understand the risks and benefits of any particular investment product. That duty cannot be transferred to the client. This has been made clear in previous Commission decisions. For example, in *Re Marchment & MacKay Ltd. et al.* (1999), 22 O.S.C.B. 4705 (*"Re Marchment"*) at 4735, the Commission said:

> The obligation to determine suitability clearly rests with the registrant. Although the co-operation of the customer is necessary to enable the registrant to discharge his or her obligation, a registrant cannot transfer this obligation to the customer by expecting the customer to highlight discrepancies between the assessments recorded by the junior salesmen on a new client application form and the customer's own risk tolerance.

[211] In any event, there was no evidence that Daubney's clients received suitable investment advice from him which they disregarded. Instead, we heard consistent evidence from the investors that they depended on Daubney for his recommendations. We accept the investors' evidence. Also, we find that these investors told Daubney everything he needed to know to assess their risk tolerances and yet his recommended investment approach was entirely unsuitable for them.

[212] In *Re Marchment, supra* at 4708, the Commission stated:

> The duty to know the client's investment objectives, financial means and personal circumstances, and to recommend only those investments which are suitable for the client is fundamental to the obligation of every dealer and registered representative dealing with the public.

[213] A registrant's failure to meet those obligations is amongst the most serious of allegations. As stated by the Commission, the know-your-client and suitability requirements "are an essential component of the consumer protection scheme of the Act and a basic obligation of a registrant, and a course of conduct by a registrant involving a failure to comply with them is an extremely serious matter" (*Re E.A. Manning Ltd. et al., supra* at 5339).

2. Representations as to the Future Value of Securities

[214] Staff alleged that by presenting overly optimistic forecasts of investment returns, Daubney contravened subsection 38(2) of the Act. In the alternative, Staff alleged that by failing to make balanced representations concerning the future value of their investments, Daubney failed to deal fairly, honestly and in good faith with the Six Investors and contravened section 2.1(2) of OSC Rule 31-505.

[215] Daubney denies guaranteeing any particular rate of return to his clients. He submitted that none of the Six Investors testified that he guaranteed a specific rate of return. Rather, their testimony was consistent with his evidence that he provided examples of potential returns based on historical trends in the market.

[216] Subsection 38(2) of the Act states:

> No person or company, with the intention of effecting a trade in a security, shall give any undertaking, written or oral, relating to the future value or price of such security.

[217] As stated above, we find that Daubney gave insufficient consideration to risks in making investment recommendations for the Six Investors. However, while the evidence indicates that Daubney frequently discussed the performance of the stock market over the given period and, in this regard, often referred to a longer term return of 10 to 12 percent per annum or even higher, we do not find that these discussions amounted to an undertaking relating to the future value or price of a security under subsection 38(2) of the Act.

[218] We however, do find that Daubney failed to deal fairly, honestly and in good faith with his clients, based on his failure to describe the negative as well as the positive aspects of his proposed leverage investment program.

H. CONCLUSION

[219] Accordingly, we find that Daubney violated the "know-your-client" and suitability requirements of OSC Rule 31-505 by making unsuitable investment recommendations to the Six Investors who form the subject of Staff's allegations and by

failing to deal fairly, honestly and in good faith with the investors. We find that Daubney utterly failed to fulfill his obligations as a registrant under the Act, and his conduct caused great harm to the investors who relied on him.

[220] Indeed, this is an egregious case of a registrant's reckless disregard of his obligations under the Act. We find that Daubney has acted contrary to the public interest.

[221] The parties shall contact the Office of the Secretary within 10 days of this decision to set a date for a sanctions hearing, failing which a date will be fixed by the Office of the Secretary.

DATED in Toronto this 30th day of April, 2008.

"Robert L. Shirriff"
____
Robert L. Shirriff, Q.C.

"Carol S. Perry"
____
Carol S. Perry

"Margot C. Howard"
____
Margot C. Howard