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

- AND -

IN THE MATTER OF
AN APPLICATION FOR A HEARING AND REVIEW OF
THE DECISION OF DIRECTOR BRIDGE OF THE ONTARIO SECURITIES COMMISSION, PURSUANT TO SUBSECTION 8(2) OF THE *SECURITIES ACT*,
R.S.O. 1990, c. S.5, AS AMENDED

- AND -

IN THE MATTER OF STERLING GRACE & CO. LTD. and GRAZIANA CASALE

REASONS AND DECISION
(Section 8 of the *Securities Act*)

Hearing:	February 19, 20 and March 28, 2014	
Decision:	September 3, 2014	
Panel:	Mary G. Condon	- Vice-Chair and Chair of the Panel
	Judith N. Robertson	- Commissioner
	Deborah Leckman	- Commissioner
Appearances:	Melissa MacKewn Natalia Vandervoort	- For Sterling Grace & Co. and Graziana Casale
	Michelle Vaillancourt Mark Skuce	- For Staff of the Commission

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REASONS AND DECISION

I. OVERVIEW

A. Introduction

[1] This is an application (the "**Application**") by Sterling Grace & Co. ("**Sterling**") and Graziana (Grace) Casale ("**Casale**") (together, the "**Applicants**"), pursuant to subsection 8(2) of the *Securities Act*, R.S.O. 1990, c. S.5, as amended (the "**Act**"), for the Ontario Securities Commission (the "**Commission**") to review a decision of a Director of the Commission issued November 18, 2013 ((2013), 36 O.S.C.B. 11243 (the "**Director's Decision**")).

[2] The Director's Decision suspended Sterling's registration as an exempt market dealer ("**EMD**") and Casale's registration as dealing market representative, ultimate designated person ("**UDP**") and chief compliance officer ("**CCO**"). Deputy Director, Marrianne Bridge (the "**Director**"), found that the Applicants lacked the requisite integrity and proficiency to remain registrants.

[3] A hearing before a Panel of the Commission to consider the Application commenced on February 19, 2014 (the "**Hearing and Review**"). The Applicants were represented by counsel and Casale appeared in person. Staff of the Commission ("**Staff**") appeared to oppose the Application. The Application was heard as a hearing *de novo*, at which two investor witnesses, one for the Applicants and the other for Staff, testified on February 19 and 20, 2014, respectively. The parties made further submissions on March 28, 2014.

B. The Applicants

[4] Sterling was registered with the Commission as a limited market dealer ("**LMD**") on December 7, 2006 and its registration was recategorized as an EMD on September 28, 2009. Sterling was also registered as an EMD with securities regulators in Alberta and British Columbia on February 2, 2012. Sterling has offered for sale securities of several issuers, including Genwealth Venture Limited Partnership ("**Genwealth**"), which is an investment fund, Redstone Investment Corporation ("**Redstone**"), a finance company that holds itself out as providing loans to small and medium sized businesses, and Gingko Mortgage Investment Corporation ("**Gingko**").

[5] Casale is registered with the Commission as UDP, CCO and dealing representative of Sterling. She is also a permitted individual, as defined is paragraph [288] below, and has been an officer, director and shareholder of Sterling since the firm's inception. Casale is also registered in Alberta and British Columbia as Sterling's UDP, CCO, dealing representative and a permitted individual as of February 13, 2012.

C. History of the Matter

[6] Between November 2012 and July 2013, Staff of the Compliance and Registrant Regulation Branch of the Commission ("**CRR**") conducted a compliance review of Sterling, pursuant to section 20 of the Act, for the review period of December 1, 2011 to November 30, 2012 (the "**Compliance Review"**). As part of that review, Casale provided an interview under oath on April 16, 2013 (the "**Casale Interview**"). On July 3, 2013, Staff noted at least eleven

deficiencies in a compliance report (the "**Compliance Report**") sent to the Applicants. On the same day, in light of certain classified "significant deficiencies", Staff advised the Applicants via letter that they had recommended that the registration of Sterling and its registered individuals be suspended and that certain conditions be placed upon reinstatement.

[7] The Applicants gave notice to the Commission that they wished to exercise their right for an Opportunity to be Heard, pursuant to section 31 of the Act ("**OTBH**"). On October 28, 2013, an OTBH was held for the Director to consider Staff's recommendations. On that day, the Director heard submissions on behalf of Staff and the Applicants.

[8] The Director issued a written decision and reasons accepting Staff's recommendations on November 18, 2013.

D. The Director's Decision

[9] As referenced above, the Director made the following decision:

(a) the registration of Sterling is suspended permanently;
(b) the registration of Casale as UDP and CCO is suspended permanently;
(c) the registration of Casale as a dealing representative be suspended, and that she not be permitted to apply for reinstatement for a period of two years;
(d) Casale successfully complete the *Conduct and Practices Handbook Course* before applying for reinstatement of registration;
(e) Casale be subject to one year of strict supervision in the event her registration is reinstated; and
(f) Casale shall not be a permitted individual of a registered firm for a period of five years.

(Director's Decision, *supra* at para. 1)

[10] The Director found that Staff proved its allegations with respect to issues of integrity. These allegations included the existence of conflicts of interest, unreported capital deficiency, misrepresentations to Staff and trading without registration. The Director concluded that both of the Applicants lack the requisite integrity to remain registrants (Director's Decision, *supra* at para. 42). The Director was not persuaded by the Applicants' submissions that certain issues should be considered as issues of proficiency, rather than integrity (Director's Decision, *supra* at para. 40).

[11] The Director also found that Staff proved its allegations with respect to issues of proficiency. These allegations included improper reliance on prospectus exemptions, failure to discharge the Know Your Product ("**KYP**") obligation, failure to discharge the Know Your Client ("**KYC**") and suitability obligations. She concluded that both of the Applicants lack the requisite proficiency to remain registrants (Director's Decision, *supra* at para. 48). The Director noted that because each of the proficiency issues she found related directly to the proficiency of a dealing representative, they support the suspension of Casale's registration as a dealing representative (*Ibid.*).

E. Application to Stay the Director's Decision

[12] On November 27, 2013, pursuant to subsection 8(4) of the Act, the Commission granted an application to stay the Director's Decision pending the hearing and review of that decision, but ordered that the stay apply until no later than February 20, 2014, subject to certain conditions ((2013), 36 O.S.C.B. 11637 (the "**Stay Order**") at para. 34). The Stay Order required the Applicants to post a link to the Director's Decision on the Sterling website and to provide a copy of the Director's Decision to all new and existing clients. The Stay Order also specified that Sterling:

> may state on its website and when providing the Director's Decision to clients that "The decision to suspend the registration of Sterling Grace and Casale was stayed pursuant to the decision of the Commission dated November 27, 2013. An application for a hearing and review of the Director's Decision under section 8 of the Act has been requested and will be scheduled to be heard by a panel of the Commission in early 2014".

(Stay Order, *supra* at para. 35)

[13] Further, the Commission directed that an investor alert posted on the Commission's website on November 19, 2013, following the issuance of the Director's Decision, be removed as requested by the Applicants (Stay Order, *supra* at para. 36). The Commission did not, however, find there were grounds to issue a retraction of the investor alert, as requested by the Applicants (Stay Order, *supra* at para. 33).

F. Application for Hearing and Review pursuant to Subsection 8(2) of the Act

[14] By letter dated November 20, 2014, the Applicants filed a formal request for the stay of the Director's Decision, discussed above, and a hearing and review of the Director's Decision, pursuant to subsection 8(2) of the Act (the "**Application**"). We note that the Application was not perfected in accordance with Rule 14 of the Commission's *Rules of Procedure* (2012), 35 O.S.C.B. 10071 (the "***Rules of Procedure***"). Following the Stay Order, the Commission issued a Notice of Hearing and, due to the exceptional circumstances of this case, we hereby waive the requirements in Rule 14, pursuant to Rule 1.4(3) of the *Rules of Procedure*.

[15] The Applicants argue that the Director erred by failing to consider or give sufficient weight to the evidence presented by the Applicants and made findings based on a mischaracterization of issues of "proficiency and "integrity". Therefore, the Applicants submit that the Director imposed sanctions that are unwarranted and unnecessary to fulfill the regulatory objective that the Applicants operate in compliance with Ontario securities laws and in the best interests of clients.

[16] In the Application, the Applicants further submit that the Director's Decision fails to deliver adequate reasons for requiring suspensions that, in effect, put the Applicants out of business. It is the Applicants' position that the Director erred in finding that the Applicants lack the requisite integrity for a registrant or that it would be inappropriate for Casale to remain registered as a dealing representative. Further, the Applicants argue that the Director erred in failing to apply relevant prior decisions, failed to give due consideration to the level of cooperation demonstrated by the Applicants in the Compliance Review and failed to give due

consideration to Casale's willingness to step down as CCO and UDP of Sterling. Lastly, the Applicants submit that Staff did not seek the imposition of terms and conditions on the registration of the Applicants for more than eleven months between the commencement of the Compliance Review and the date of the Director's Decision.

[17] Staff takes the position that the Applicants lack the requisite integrity and proficiency to maintain their registration, they have failed to comply with Ontario securities law and that their continued registration is otherwise "objectionable". Staff's submissions are set out in more detail below.

[18] On February 19, 2014, the Applicants requested an adjournment of the Hearing and Review to enable the Applicants to pursue an application, pursuant to section 11 of National Instrument 31-103 – Registration Requirements, Exemptions and Ongoing Registrant Obligations ("**NI 31-103**"), for Staff to review a transaction that proposes the sale of Sterling to third parties (the "**Proposed Transaction**"). Upon considering the submissions of the parties, the Panel was not persuaded that an adjournment would be in the public interest and denied the adjournment request for oral reasons given that day. However, the Panel did find that it would be appropriate to consider the outcome of the Proposed Transaction when deliberating on the issues and determined that, if Casale wished to pursue the transaction and file it with Staff, she should do so by the deadline she proposed of February 28, 2014. Further, the Panel required Staff to respond by March 24, 2014 and provided the parties with an opportunity to make supplemental oral submissions on March 28, 2014.

[19] On March 28, 2014, the parties made oral submissions on the Proposed Transaction. Staff advised that on March 27, 2014 Staff notified the Applicants that the Director objected to the Proposed Transaction, pursuant to subsection 11.10(6) of NI 31-103, because insufficient information had been provided by Sterling to allow the Director to evaluate the Proposed Transaction in accordance with criteria set out in subsection 11.10(2)(c) of NI 31-103. Counsel for the Applicants submitted that they would like Staff to make a decision based on complete information and requested more time for Staff to consider the Proposed Transaction. Staff submitted that there were still uncertainties surrounding the Proposed Transaction. As of March 21, 2014, the Proposed Transaction was in its third revised structure, naming different purchasers and new consideration.

[20] On April 1, 2014, the Panel instructed the Secretary to advise the parties that it intended to proceed with its deliberations of the Hearing and Review. The Panel reviewed the material provided by the parties on February 19, 20 and March 28, 2014 with respect to various versions of the Proposed Transaction. It took the view that there were still considerable uncertainties and contingencies related to the Proposed Transaction. For instance, in a letter dated March 21, 2014, Casale advised Staff that "a personal suspension of Casale may result in the Amended Proposed Acquisition not proceeding" (Exhibit 29 of the Hearing and Review- Affidavit of Hui sworn on March 27, 2014, Tab J at p. 3). The Panel determined, in light of the uncertainty regarding the suspension of Casale's registration, a decision with respect to her registration may be necessary to provide clarity. In addition, the Panel was persuaded by the submission of Staff that a number of issues related to the Proposed Transaction still require careful consideration, including: (i) a plan for addressing compliance deficiencies; (ii) appropriate terms and conditions on Sterling's registration related to potential conflicts of interest arising from the proposed appointment of a

lawyer as its ultimate designated person; and (iii) the status of a subordinated loan from Casale as it relates to Sterling's working capital.

[21] The Panel instructed the Secretary to remind the parties that the Director's Decision to suspend the registration of Sterling and Casale has been stayed since November 27, 2013 (Stay Order, *supra* at para. 34). The Panel did not consider it to be in the public interest to delay deliberation of this matter any further as the Proposed Transaction is only one of many considerations the Panel must take into account with regard to the Hearing and Review. On April 2, 2014, by email copied to counsel for the Applicants, Staff advised the Panel that it received notice from Casale that the application pursuant to section 11.10 of NI 31-103 for the Proposed Transaction would not be moving forward.

II. HEARING AND REVIEW PURSUANT TO SECTION 8 OF THE ACT

[22] Subsections 8(2) and 8(3) of the Act govern a hearing and review of a decision of the Director and provide that:

> **[8.] (2) Review of Director's decisions** – Any person or company directly affected by a decision of the Director may, by notice in writing sent by registered mail to the Commission within thirty days after the mailing of the notice of the decision, request and be entitled to a hearing and review thereof by the Commission.
>
> **(3) Power on review** – Upon a hearing and review, the Commission may by order confirm the decision under review or make such other decision as the Commission considers proper.

[23] The case law interpreting subsection 8(3) of the Act has established that, in a hearing and review of a Director's decision, a panel of the Commission may substitute its own decision for that of the Director (*Re Sawh* (2012), 35 O.S.C.B. 7434 ("***Sawh***") at paras. 16 and 17, citing *Re Triax Growth Fund Inc*. (2005), 28 O.S.C.B. 10139 at para. 25 and *Re Istanbul* (2008), 31 O.S.C.B. 3799 ("***Istanbul***") at para. 14)).

[24] Further, it is well established that a review of a Director's decision pursuant to section 8 of the Act is a hearing *de novo* and, therefore, a fresh consideration of the matter (*Istanbul*, *supra* at paras. 14-15). As such, new evidence is permitted to be tendered at the hearing and review of the matter (Rule 14.5 of the *Rules of Procedure*).

[25] Staff has the onus of establishing that the Applicants are not suitable for registration or that registration is otherwise objectionable (*Sawh, supra* at paras.148 and 149; (*Re Pyasetsky* (2013), 36 O.S.C.B. 3897("***Pyasetsky Review***") at para. 89). Staff also bears the onus, under section 28 of the Act, of establishing that the Applicants failed to comply with Ontario securities law.

III. ISSUE

[26] The issue is whether the Applicants are suitable to maintain their registrations, whether they have failed to comply with Ontario securities law or whether their continued registration is otherwise objectionable. The legal framework for consideration of the issue is outlined below.

IV. POSITIONS OF THE PARTIES

[27] Both counsel for the Applicants and counsel for Staff made oral and written submissions.

A. The Applicants

[28] The Applicants are seeking to maintain their registrations, for Sterling in the category of EMD and for Casale as an EMD dealing representative. The Applicants propose to address proficiency issues and take the position that there are no integrity concerns. The Applicants emphasize that any future operation of Sterling would include properly qualified UDP and CCO personnel. The Applicants were actively working on a transaction to sell Sterling, in which Casale would relinquish the roles of UDP and CCO and majority ownership in the firm.

[29] The Applicants submit that the compliance function of the Commission is a gatekeeping one to ensure that purposes and principles of the Act are upheld (Act, *supra*, s. 1.1 and 2.1(2)(ii)). This can be distinguished, the Applicants submit, from the enforcement function of the Commission. The appropriate regulatory response should be prophylactic in nature – to provide protection to investors and capital markets from potential future misconduct (*Istanbul*, *supra* at para. 77, citing *Mithras Management Ltd.* (1990), 13 O.S.C.B. 1600 ("***Mithras***") at 1610 and 1611).

[30] The Applicants submit that Staff's recommendations and the Director's Decision have impermissibly crossed the line into the realm of punishment. They submit that the "punishments" sought are enforcement-like in every respect and should be remedies of last resort. Instead, the Applicants submit, they should be afforded the opportunity to work with Staff to remedy the compliance concerns.

[31] The Applicants argue that the matter should be considered in the relevant context. In June 2012, Staff conducted a sweep of 45 EMDs to assess compliance with KYC, KYP and suitability obligations under NI 31-103. In their report, Staff observed that "Over 75% of the EMDs reviewed were deficient in collecting, documenting or maintaining adequate KYC information" Where Staff was satisfied that non-compliance with the Accredited Investor ("**AI(s)**") exemption was not intentional, the EMD had taken steps to resolve the matter and had revised the KYC collection process, Staff did not recommend enforcement action (OSC Staff Notice 33-740 (2013), 36 O.S.C.B. 5647 ("**OSC Staff Notice 33-740**") at pages 3 and 5). The Applicants argue they ought to be held to the same standard as their peers.

[32] The Applicants submit that matters of proficiency are addressed through education, supervision and, if necessary, monitoring and/or consulting retainers. By comparison, the Applicants take the position that significant matters of integrity merit periods of suspension to serve purposes of general and specific deterrence (*Istanbul, supra* at paras. 72-73 and 79-80; *Re Obasi* (2011), 34 O.S.C.B. 3012 ("***Obasi***") at paras. 1, 30-32; *DiPronio* (2011), 34 O.S.C.B. 6345 ("***DiPronio***")).

[33] In relation to the general application of section 28 of the Act, counsel for the Applicants submits that the parties agree that an assessment of suitability for continued registration engages considerations of proficiency, solvency and integrity. Further, counsel for the Applicants acknowledges that the language of section 28 of the Act involves discretionary decision-making by a director or a panel and that a suspension or revocation of a registration or the imposition of

terms and conditions could be ordered if the registrant was suitable but did not comply with Ontario securities law.

[34] However, the Applicants submit that there is no concern that their integrity is at issue in this matter. They submit that honesty is an essential component of integrity (Companion Policy 31-103 "*Registration Requirements and Exemptions*" ("**31-103CP**")). They note that the Commission has explained the integrity requirement as requiring a consideration of "the honesty and character of the applicant" (*Istanbul*, *supra* at para. 66, citing *Re Wall* (2007), 30 O.S.C.B. 7521 ("***Wall***") at para. 23). The Applicants also rely on case law relating to the prospectus receipt process, which states, pursuant to subsection 61(2)(e) of the Act, that the Director shall not issue a receipt if it appears that "the business of the issuer may not be conducted with integrity". The Applicants submit that the Director must have "reasonable grounds" for invoking subsection 61(2)(e) of the Act because "[t]he integrity of a person and the possible continued existence of a business [could be] at stake" and, therefore, a higher degree of certainty is appropriate (*Re Cycomm International Inc.* (1994), 17 O.S.C.B. 21 at p. 13). In further submissions, counsel for the Applicants acknowledged that Staff has the onus to prove on a balance of probabilities on clear and cogent evidence that the Applicants are not suitable for continued registration and confirmed that reliance on the above case is not a suggestion that the standard should change.

[35] The Applicants take the position that their conduct does not demonstrate a lack of integrity and that the seven deficiencies identified by Staff are all matters of proficiency. In their submission, the Director conflated integrity and proficiency by finding that many of the issues are both integrity and proficiency matters (Director's Decision, *supra* at para. 4). In response to the alleged integrity issues, the Applicants made the following submissions:

(a) Conflict of Interest – Casale did not appreciate that a conflict existed in respect of the issuer Genwealth and M.L., Sterling's dealing representative, who sold the product to his family and friends, each of whom were aware of his relationship to the issuer. Further, Casale understood that the offering memorandum of the issuer Redstone would be amended to disclose a loan provided by Redstone to the Applicants.

(b) Unreported Capital Deficiency – The Applicants reported Sterling's capital deficiency to Staff when it was discovered. The issue is, by definition, an issue of solvency and not integrity and, in any event, the issue no longer exists.

(c) Misrepresentation – Acknowledging that this is a matter of credibility, Casale's evidence is that she was truthful when asked by Staff about her involvement with the Gingko product and when she was retained by Gingko.

(d) Trading Without Registration – At the time that certain sales took place on behalf of Sterling M.L., was registered with another dealer, however through an administrative oversight his registration had not yet been transferred to Sterling.

[36] The Applicants put forward the Commission's decision in *Kingsmont* as a factually similar case (*Re Kingsmont Investment Management Inc.* (2013), 36 O.S.C.B. 9577 ("***Kingsmont***")). In *Kingsmont*, Staff identified compliance deficiencies from their review of the EMD, including: insufficient collection of KYC information, insufficient KYP due diligence, unsuitable

investments and trading without registration (*Kingsmont*, *supra* at para. 14). The Applicants argue that the director found Staff's recommendations for resolution of the matter to be too harsh and instead ordered a six-month suspension of Warner as a dealing representative. Further, they submit that it appears the director's reasoning primarily resulted from her finding that the matters deemed by Staff to relate to integrity were, in fact, matters of proficiency (*Kingsmont*, *supra* at para. 30).

[37] The Applicants argue that cases relied upon by Staff at the OTBH are distinguishable on their facts and that decisions based on joint recommendations are of little assistance because of the lack of transparency associated with negotiated resolutions.

[38] At the time of the Hearing and Review, the Applicants expressed concern that the positive changes undertaken by them were not considered by Staff or the Director and reiterated that Casale is willing to give up her positions at CCO and UDP. In conclusion, they submit that a proficiency case requires a balanced approach.

B. Staff

[39] Staff takes the position that the Applicants are unsuitable for registration as they lack the requisite integrity and proficiency to remain registrants.

[40] As factors for assessing ongoing registration, Staff requests that the Panel consider the requirement for dealer registration, pursuant to subsection 25(1) of the Act, the director's power to revoke or suspend registration, pursuant to section 28 of the Act, and criteria of suitability for registration found in section 27 of the Act.

1. Integrity

[41] Staff submits that, although not defined, assessment of integrity should be guided by the need to maintain high standards of fitness and business conduct that ensures honest and responsible conduct by market participants (*Sawh*, *supra* at para. 257, citing *Istanbul*, *supra* at para. 68). Further, Staff relies upon *Wall*, cited in *Sawh* and *Istanbul*, where the director explains that Staff look at the honesty and character of an applicant when analyzing integrity and, in particular, dealings with clients, compliance with Ontario securities laws and the use of prudent business practices (*Wall*, *supra* at para. 23; *Sawh*, *supra* at para. 257; *Istanbul*, *supra* at para. 66). Staff argues that an individual's honesty and candour in their dealings with Staff is also relevant (*Re Pyasetsky* (2012), 35 O.S.C.B. 2092 ("***Pyasetsky Director's Decision***") at paras 13-17; affirmed *Pyasetsky Review*, *supra*).

[42] Staff submits that Casale impugned her integrity for registration by the following acts and omissions:

(a) undisclosed material conflicts of interest;

(b) failure to report to Staff Sterling's capital deficiencies in April and May 2012;

(c) making misrepresentations to Staff about her role in Gingko distributions; and

(d) allowing M.L. to trade on Sterling's behalf without appropriately registering him, and trading in securities in other provinces without registration.

[43] Staff further submits that section 13.4 of NI 31-103 requires registered firms to identify existing and potential material conflicts of interest, respond and, if a reasonable investor would expect to be informed, then disclose that conflict of interest. Further, Staff relies upon section 2.1 of OSC Rule 31-505 – Conditions of Registration ("**OSC Rule 31-505**"), which articulates that a registered dealer and its representatives shall deal fairly, honestly and in good faith with their clients. Staff argues that in *White Capital*, circumstances similar to this case led to suspension of an EMD's registration (*Re White Capital Corporation* (2013), 36 O.S.C.B. 819 ("***White Capital***") at paras. 9, 11 and 13, additional reasons at (2013), 36 O.S.C.B. 5313).

[44] Staff submits that M.L.'s concurrent roles as manager of Genwealth and a dealing representative of Sterling constituted a material conflict of interest that ought to have been identified by Casale. Staff further submits that a reasonable investor would have expected to be informed of the material conflict of interest arising from Redstone's loans to Sterling. Staff submits that the Applicants' position that the $73,000 was not disclosed to investors because So suggested that the loan relative to the fund size would not be considered material, ignores the fact that the $73,000 was essential to Sterling's solvency and continued registration and, therefore, highly material to Sterling.

[45] Staff notes that despite the submission that the Applicants were willing to disclose the conflict in a Redstone offering memorandum ("**OM**") expected in November/December 2013, the most recent Redstone OM, dated March 1, 2013, contains no reference to any loans to the Applicants. Staff argues that the Applicants continued to sell the Redstone securities in the apparent absence of a revised OM.

[46] Staff refers the Panel to section 12.1 of NI 31-103, which requires a registered firm to notify the regulator as soon as possible if, at any time, its excess working capital, as calculated in the prescribed form, is less than zero. Staff submits that the provision is predicated on the good faith and conduct of registrants and plays an important role in Staff's ability to oversee the financial condition of registered firms. Staff submits that Casale did not report Sterling's capital position in April and May 2012, despite being aware of the deficiencies at the time and of her obligation to report them. Staff argues that this conduct is particularly troubling in light of Staff's earlier recommendation to the Director in October 2011 that Sterling's registration be suspended due to its capital deficiency and Casale's failure to report it to Staff.

[47] With respect to dealings with Staff, Staff argues that misrepresentations to Staff may impugn a registrant's integrity and result in a suspension (*Re Kaplan et al.* (2012), 35 O.S.C.B. 9457 ("***Kaplan***") at para. 30 and Appendix). Staff submits that on two occasions Casale omitted to disclose to Staff her involvement in the Gingko distribution to 22 investors, despite being involved and receiving a compensation of $10,000 for her work.

[48] Staff submits that subsection 25(2) of the Act expressly requires that a registered representative act on behalf of the dealer with which he or she is registered, while in this case M.L. acted on behalf of Sterling and not Harris Brown, the firm for which he was registered at the time. Staff also submits that Casale traded in securities in Alberta and British Columbia before she was registered in those jurisdictions. In this regard, Staff relies upon the facts in *Blueport*, including unregistered trading, which led to suspension after a compliance review (*Re Blueport Capital Corp. and Hare* (2012), 35 O.S.C.B. 681 ("***Blueport***") at paras. 15).

2. Proficiency

[49] Staff submits that proficiency requirements are established to ensure that the public deals with qualified registrants and that the requirements support, promote and enhance the purposes of the Act (*Sawh, supra* at para. 158). Staff relies upon subsection 3.4(1) of NI 31-103, which provides that an individual must not perform registerable activity unless he or she has the education, training, and experience that a reasonable person would consider necessary to perform the activity competently.

[50] Staff submits that Casale impugned her proficiency for registration by the following acts and omissions:

(a) failure to assess client qualifications to rely on the AI exemption;

(b) failure to discharge her KYP obligations with respect to Redstone and Genwealth;

(c) failure to discharge her KYC obligations; and

(d) failure to discharge her suitability obligations.

[51] Staff takes the position that as an EMD, Sterling's activities are limited to trading in securities that are exempt from prospectus requirements set out in National Instrument 45-106 – Prospectus and Registration Exemptions ("**NI 45-106**") (subsection 7.1(2)(d) of NI 31-103). In this case, Staff submits that the Applicants primarily relied upon the accredited investor ("**AI(s)**") exemption, pursuant to section 2.3 of NI 45-106 and in particular the tests of "net financial assets" and "annual income" to qualify as an AI ("accredited investor" definition at subsections 1.1(j) and (k) of NI 45-106). Staff submits that an EMD has an obligation to ensure that an investor meets the criteria and that AI status cannot be established on the basis of a statement from the investor certifying that he or she meets the criteria (*Sawh, supra* at para. 175-176 and 183).

[52] Staff argues that in the past the director has suspended a registration where evidence has shown, among other things, that the registrants sold securities pursuant to the AI exemption in circumstances where that AI exemption did not apply (*Re FCPF Corporation* (2013), 36 O.S.C.B. 9855 ("***FCPF***"); *White Capital, supra; Blueport, supra; Re Waterview Capital Corp.* (2011), 34 O.S.C.B. 5059 ("***Waterview***")). Staff submits that in this case Sterling sold securities of Redstone or Gingko to at least 22 investors in circumstances where the investor either did not qualify as an AI or there was insufficient evidence to support reliance on the AI exemption.

[53] In addition, Staff submits that an EMD must assess the suitability of a trade for their client (subsection 13.3(1) of NI 31-103). Staff relies upon the Commission's decision in *North American*, which set out a process for registrants to assess suitability including, using due diligence to know the product, applying professional judgment in establishing the suitability of the product for the client and disclosing both positive and negative aspects of the proposed investment (*Re North American Financial Group Inc.* (2013), 36 O.S.C.B. 12095 ("***North American***") at para. 274).

[54] In *Sawh*, Staff argues, the Commission found that the manner in which a registrant discharges their KYP obligation has a direct bearing on the registrant's proficiency. This obligation is particularly important in the context of products sold in the exempt market because

of risks associated with certain products (*Sawh, supra* at paras. 178 and 238). The CSA Staff Notice 33-315 – Suitability Obligation and Know Your Product ("**CSA Staff Notice 33-315**"), lists factors registrants should consider when assessing investment products for their clients, including the issuer's financial position and the qualifications, reputation and track record of the parties involved in key aspects of the product. Staff submits that the Applicants failed to discharge KYP obligations by failing to appreciate that many of the loans in Redstone's portfolio were in distress and that there was a disconnect between the actual business of Genwealth and the business described in its OM.

[55] Staff relies on subsection 13.2(2) of NI 31-103 for its submission on the KYC obligations of a registrant to identify the client and obtain sufficient information to meet suitability obligations under section 13.3 of NI 31-103. Staff cites the Companion Policy to NI 31-103 ("**31-103CP**"), for its position that registrants act as gatekeepers of the integrity of the capital markets and are required to establish the identity of, and conduct due diligence on, their clients.

[56] Staff submits that Casale admitted during an interview with Staff that she allowed Redstone to distribute Sterling's KYC forms directly to investors and that she accepted KYC forms that were already completed without her involvement. Staff argues that such conduct purports to delegate her KYC obligation, which cannot be delegated to third parties.

[57] Staff takes the position that the Applicants also sold Redstone or Gingko securities to at least 45 investors in circumstances where the investment may not have been suitable for the investor, or there was insufficient information to demonstrate its suitability. Staff refers the Panel to subsection 13.3(1) of NI 31-103, which requires a registrant to ensure, before it makes a recommendation or accepts an instruction to buy or sell a security, that the purchase or sale is suitable for the client. Staff notes that subsection 13.3(1) of 31-103CP specifically states that registrants cannot delegate their suitability obligations or satisfy them by simply disclosing risks of the trade. Staff submits that Casale could not confirm that she met or spoke with all investors who had invested in Redstone through Sterling, which is consistent with information gathered by Staff from investors J.W., P.W., M.P., B.P. and A.G., all of whom stated that they did not speak to anyone from Sterling prior to investing. Further, Casale admitted to acting as a "dealer after the fact", which Staff submits is inconsistent with subsection 13.3(1) of NI 31-103.

[58] Staff also argues that the Applicants' conduct since the Director's Decision raises concerns because of the approach taken to compliance with the terms of the Stay Decision, as well as their failure to remove references to So and Redstone from Sterling's website. Staff relies upon the Commission's decision in *Sawh*, which states that the applicants' lack of care in removing from their website references to ensure that they did not represent themselves as being able to conduct registerable activity added to the panel's discomfort, in that case, "about their ability to conduct themselves in accordance with requirements of regulated activity" (*Sawh, supra* at para. 296).

3. Failure to Comply with Securities Law and Registration is Otherwise Objectionable

[59] Staff takes the position that in addition to its submission that the Applicants are not suitable for continued registration, the Applicants' registrations should be suspended because they have failed to comply with Ontario securities law and their registration would be "objectionable".

[60] Staff submits that, by virtue of their conduct in relation to the seven compliance deficiencies identified by Staff, the Applicants have failed to comply with the Act and NI 31-103, which became a Rule under the Act by Ministerial Approval dated September 18, 2009 (Notice of Ministerial Approval of National Instrument 31-103 – Registration requirements and Exemptions (2009), 32 O.S.C.B. 7325 ("**Approval of NI 31-103**"); subsection 1(1) of the Act). Further, Staff submit that the Applicants have demonstrated a pattern of non-compliance that is not appropriate for registrants (*Waterview, supra* at para. 22).

[61] Staff also argues that in light of the seven compliance deficiencies, continued registration of the Applicants runs counter to the Commission's mandate to protect investors and foster fair and efficient capital markets (section 1.1 of the Act) and, therefore, their continued registration would be otherwise objectionable pursuant to subsection 28(b) of the Act (*Sawh, supra* at para. 289).

4. Remedies Sought By Staff

[62] Staff recommends the same remedies it recommended to the Director, including that:

(a) the registration of Sterling be permanently suspended;

(b) the registration of Casale as UDP and CCO be permanently suspended;

(c) the registration of Casale as dealing representative be suspended and she not be permitted to apply for reinstatement for a period of two years;

(d) Casale successfully complete the *Conduct and Practices Handbook Course* before applying for reinstatement of registration;

(e) in the event that Casale's registration is reinstated, her registration be subject to terms and conditions requiring her strict supervision for a period of one year; and

(f) Casale shall not be a permitted individual of a registered firm for a period of five years.

[63] Staff submits that the remedies recommended above are consistent with those agreed to in *White Capital*, a case involving similar compliance deficiencies by an EMD (*White Capital, supra*). Staff requests the Panel to consider the designation and obligations of a UDP and obligations of a CCO, pursuant to sections 5.1, 5.2 and 11.2 of NI 31-103 and 31-103CP. Staff further highlights the definition of the term "permitted individual" at section 1.1 of National Instrument 33-109 – *Registration Information* ("**NI-33-109**").

[64] Staff takes the position that the package of proposed remedies is designed to meet a number of objectives. First, the UDP and CCO suspensions would prohibit Casale from occupying positions of responsibility for the compliance of a registered firm with securities law requirements. Second, the two year dealing representative suspension and the requirement to take the *Conduct and Practices Handbook Course* would allow Casale to resume a career as a dealing representative after an appropriate period of reflection and industry-related education. Third, the remedies requested allow Casale the opportunity to assume an executive-level position within a

registered firm, and to acquire a significant equity stake, after an appropriate period away from those roles, subject to the requirement that she not be UDP or CCO.

V. EVIDENCE

A. Overview

[65] Casale's Affidavits, sworn on February 4 and 12, 2014 were tendered at the Hearing and Review and the Applicants called one investor witness (M.B.). Staff also called one investor witness (D.H.) and relied upon a number of affidavits described below. The names of the witnesses who are not the Applicants are anonymized to protect the privacy of those witnesses.

[66] The entire record of the OTBH was filed with the Commission for the purpose of the Hearing and Review and additional exhibits from the examination of the two witnesses were also tendered into evidence, as were supplementary documents.

[67] Both the Applicants and Staff referred to hearsay evidence, which is admissible in Commission proceedings pursuant to subsection 15(1) of the *Statutory Powers Procedure Act*, R.S.O. 1990, c. S.22, as amended.

B. Staff's Evidence of Alleged Compliance Deficiencies

[68] To provide a framework for our analysis, we find it helpful to set out the evidence of the seven compliance deficiencies alleged by Staff and supported by six affidavits of Chris Zolis ("**Zolis**"), a forensic accountant in CRR, sworn on August 20, 2013, and four affidavits of Karin Hui ("**Hui**"), also an accountant in CRR, sworn on August 21 and 22, 2013 and February 11 and 14, 2014. Staff characterizes the first four deficiencies as integrity issues and the latter three as proficiency issues.

1. Conflicts of Interest

[69] On July 3, 2013, Staff raised two conflicts of interest with the Applicants in the Compliance Report, as discussed below.

(a) Redstone

[70] On April 18, 2011, Casale received a $25,000 loan from 1710814 Ontario Inc., a company controlled by So who was the principal of Redstone, with an interest rate of 12% per annum (the "**First Loan**").

[71] On October 11, 2011, Staff informed the Applicants that Sterling was capital deficient by $97,512, based on the firm's audited financial statements as at December 31, 2010. On October 21, 2011, Staff notified the Applicants that it had recommended that Sterling's registration be suspended due to its capital deficiencies as of December 31, 2010 and September 31, 2011 and its failure to report those deficiencies to Staff as required by law. On October 24, 2011, Staff and Casale agreed that if she injected the requisite funds into Sterling, Staff would withdraw its recommendation. On November 1, 2011, Casale advised Staff that a bank transfer of $73,000 was made to the Sterling bank account (the "**Second Loan**").

[72] On April 16, 2013, at the Casale Interview, Casale confirmed that the source of the $73,000 used to rectify the capital deficiency in November 2011 was an undocumented loan from Redstone, with no interest payable or other terms of repayment. When asked by Staff if she perceived either the First Loan or the Second Loan (together, the "**Loans**") to be a conflict of interest, Casale responded that she did not.

[73] In 2012, following receipt of the Loans, Sterling earned $195,083 in commissions for sales of Redstone securities. Sterling earned at least a further $66,806.25 in commissions from sales of Redstone securities after it was notified by Staff on July 3, 2013 of the compliance deficiency relating to its conflict of interest with Redstone.

(b) Genwealth

[74] During the Compliance Review, Staff became aware that M.L., as a dealing representative of Sterling, sold securities of Genwealth, a venture capital fund that was managed by him. In 2012, Sterling earned $13,145 in commissions for sales of Genwealth securities.

[75] On December 5, 2012, Casale informed Staff that she did not perceive a conflict of interest with respect to the firm's distribution of Genwealth securities.

2. Failure to Report Capital Deficiencies

[76] On November 18, 2011, after Sterling rectified its capital deficiency, Casale consented to the imposition of terms and conditions on Sterling's registration for a period of six months, including a requirement of specified monthly financial reporting to the Commission from October 2011 to March 2012.

[77] On March 30, 2012, Sterling filed audited financial statements and a Form 31-103, required within 90 days of its fiscal year end, which shows Sterling had a working capital deficiency of $7,403 as at December 31, 2011. On July 31, 2012, Staff informed Casale of Sterling's December 31, 2011 capital deficiency. Casale responded that Sterling had met working capital requirements from January through March 2012. On August 1, 2012, Staff requested, and Casale provided, Sterling's unaudited financial statements as at June 30, 2012, which shows Sterling had excess working capital of $9,327. The Affidavit of Hui indicates that, as a result of Casale's demonstration that Sterling met working capital requirements in January, February, March and June 2012, Staff refrained from recommending that additional terms and conditions be imposed on Sterling for the December 31, 2011 capital deficiency (Ex. 11 – 2nd Affidavit of Hui at para. 15).

[78] During the Compliance Review, on February 6, 2013, Casale informed Staff that Sterling had been capital deficient in April (-$12,687) and May (-$20,040) 2012, the two months between the financial reports delivered to Staff. At the Casale Interview, Casale confirmed that she knew about the capital deficiencies in April and May 2012 and did not notify the Commission, despite acknowledging that she understood her obligation to notify the Commission as soon as it occurred. At the Casale Interview, Casale also gave evidence that in 2012 her accountant was preparing the Forms 31-103 on a monthly basis.

3. Misrepresentations to Staff

[79] Staff reviewed an application for EMD registration submitted by Capital Hill in the spring of 2012 (the "**Capital Hill Review**"). The principals of Capital Hill were also the principals of Gingko, an issuer whose securities were sold by Sterling. During the Capital Hill Review, Staff became aware of a Gingko distribution to 19 investors, for which Sterling had filed a Form 45-106F1 *Report of Exempt Distribution*.

[80] Through correspondence, representatives of Capital Hill and Gingko informed Staff that the distributions to those 19 Gingko investors (the "**19 Investors**"), were effected through Sterling Grace, but were not required to be made through an EMD as the investors were close personal friends or business associates pursuant to the private issuer exemption. Therefore the Form 45-106F1 had been filed in error. In the Casale Interview, Casale told Staff that she received $4,000 for acting as a "dealer after the fact" for the sales of Gingko shares to the 19 Investors.

[81] On June 19, 2012, counsel for Gingko advised Staff that an additional 22 investors (the "**22 Investors**") subscribed for shares of Gingko, but that Sterling was not involved in these transactions. Appended to the letter sent by Gingko's counsel on June 19, 2012 was a letter addressed to Staff and signed by Casale confirming the accuracy of the counsel's letter, therefore affirming that Sterling was not involved in the distribution to the 22 Investors.

[82] On July 17, 2012, Staff sent an email to counsel for Gingko, Capital Hill and Casale summarizing the contents of a telephone call amongst them of the previous day. The substance of the phone call included that "Sterling was not involved in the private placement that took place during March 2012 to May 2012 to an additional 22 investors and has not performed KYC or suitability reviews for these investors or received any fees…for these investments". The email asked the recipients to explain if they believed the summary of the call to be inaccurate or incomplete. Subsequently, Casale called Staff on July 17, 2012 to request a clarification of another point in the email, and stated that everything else in the email "seemed pretty straightforward" (Exhibit 21 of the Hearing and Review – Supplementary Brief of documents at Tab 10).

[83] During the Compliance Review, Staff obtained 20 client files pertaining to the 22 Investors. Six of these included Sterling KYC forms signed by clients and dated prior to June 19, 2012. The Affidavit of Zolis states that four of the six Sterling KYC forms also were also signed by Casale on the same day as the client (Exhibit 16 of the Hearing and Review – 3rd Affidavit of Zolis sworn on August 20, 2013 at para. 18; Tabs H, J-K and L). At the Casale Interview, Casale testified that she provided the same type of services for the 22 Investors as she had provided for the 19 Investors and received approximately $10,000 in compensation for her work.

[84] On November 21, 2013, after the OTBH and the issuance of the Director's Decision, the Commission received a complaint from investor D.L. and her husband, D.H., regarding investments they made in LTP Financing Inc. ("**LTP**") through the Applicants. Investor D.H. testified at the Hearing and Review and his evidence is found below. Despite a request for complete information on books and records, Casale did not disclose her involvement in the LTP distribution to Staff during the Compliance Review, even though the LTP transactions with

investors D.H and D.L. occurred in the review period of December 1, 2011 to November 30, 2012.

4. Trading Without Registration

(a) M.L. in Ontario

[85] From August 18, 2011 to December 30, 2011, M.L. was registered as a dealing representative with Harris Brown & Partners Ltd. ("**Harris Brown**"). M.L. told Staff that he notified Harris Brown on or about October 27, 2011 that he would be leaving within weeks. Shortly after this notice he reached an agreement to have Sterling sponsor his registration. M.L. was not registered with Sterling until February 14, 2012.

[86] At least six clients purchased securities of Redstone from M.L., acting on behalf of Sterling, prior to his being registered with Sterling. One of those sales was signed by the investor and M.L. on February 1, 2012, while M.L. was not registered with either Harris Brown or Sterling.

(b) Sterling in Alberta & British Columbia

[87] Sterling and Redstone entered into an "Engagement Agreement" on January 1, 2011 whereby Sterling would act as an EMD for Redstone. On February 2, 2012, Sterling became registered as an EMD in Alberta and British Columbia. Between January 1, 2011 and February 2, 2012, at least eleven residents of Alberta and British Columbia completed a Sterling KYC form and their names appeared on Sterling's trade blotter as having invested in Redstone.

5. Failure to Discharge KYP Obligations

[88] On July 3, 2013, Staff identified certain KYP compliance deficiencies in the Compliance Report, two of which are discussed below.

(a) Redstone

[89] Redstone is a finance company that holds itself out as providing loans to small and medium sized businesses.

[90] During the Casale Interview, Casale admitted that in December 2012 she told Staff that Redstone had not experienced any defaults, although some companies had missed interest payments, and that no loans were past due more than one year. Casale further testified that by April 2013 her understanding was that there were two Redstone loan defaults since she spoke with Staff in 2012.

[91] The Redstone OM states that, at October 5, 2012, the total principal amount advanced in its loan portfolio is $10,361,564 and that as of October 10, 2012, Redstone had loans in aggregate of $1,290,700 that were in default. So provided Staff with Redstone's loan portfolio summary as at November 9, 2012, which reports 18 outstanding loans, ten of which are overdue past their maturity date but only one of which was overdue for more than one year. Of the ten overdue loans, default judgement had been obtained in three cases, a receiver had been appointed in another and five others were identified as becoming the subject of remedial action by Redstone.

(b) Genwealth

[92] Genwealth is a venture capital investment fund managed by M.L.

[93] The Genwealth OM, dated November 4, 2011, states that the fund will: (a) "create a diversified portfolio"; (b) focus on businesses that "have experienced and capable senior management"; (c) include "public and private companies"; (d) "largely remain a passive investor"; and (e) maintain "a significant bias toward long-term equity positions".

[94] During the Compliance Review, Staff determined that (a) Genwealth's portfolio consists of at least three start-up companies; (b) Genwealth is not a passive investor because M.L. is involved in active management and consulting with the three start-up companies; and (c) M.L.'s working experience prior to joining Sterling is limited to a part-time job in his father's construction company and his five-month employment with Harris Brown.

6. Improper Reliance on Accredited Investor Exemption

[95] The Compliance Report indicates that Sterling sold securities of Redstone or Gingko to at least 22 investors in reliance on the AI exemption to the prospectus requirement, in circumstances where the investor did not qualify or there was insufficient evidence to support the client's reliance on the exemption.

[96] For example, investors J.W. and P.W. were not AIs on the face of their Sterling KYC form and did not speak to anyone at Sterling prior to investing. There are two notations on J.W. and P.W.'s KYC form referring to: (a) the private issuer exemption; and (b) referral by So. Further, investors M.P. and B.P. were identified on their KYC form as being AIs, but upon being interviewed by Staff they stated that they did not speak to anyone from Sterling prior to investing and it became apparent that their real estate had erroneously been included in their financial assets. Lastly, investor A.G. did not have relevant information on his KYC form to support reliance on the AI exemption, and when interviewed by Staff he confirmed that he was not an AI and had not spoken to anyone from Sterling prior to investing.

7. Failure to Discharge KYC and Suitability Obligations

[97] The Compliance Report indicates that Sterling sold securities of Redstone or Gingko to at least 45 investors in circumstances where the investment may not have been suitable or there was insufficient information to demonstrate suitability.

[98] For example, investor P.C. made three investments of $150,000 in Redstone, but his Sterling KYC form initially stated that he had poor or no investment knowledge, low risk tolerance, low income and no specified net worth. After his last investment, a second KYC form was signed indicating good investment knowledge and high risk tolerance. Further, investor J.C. made three investments of $75,000 in Redstone, prior to completing a Sterling KYC form. Upon completion of the KYC form, and after J.C. had made the investments, it became apparent that she had limited investment knowledge and a low risk tolerance. Lastly, investor M.D. invested in a four year Redstone "promissory note", despite the fact that her Sterling KYC form indicated she had a liquidity need of less than one year.

[99] During the Casale Interview, Casale told Staff that Sterling's mandate with Redstone involved qualifying investors after they had already made their investment. Further, she admitted that initially Redstone distributed Sterling's KYC forms directly to investors and she would be provided with those forms already completed by the investor. Casale could not confirm that she met and spoke with all investors who had invested in Redstone through Sterling. Investors J.W., P.W., M.P., B.P. and A.G. all told Staff that they did not speak to anyone from Sterling prior to investing.

[100] In relation to the 19 Investors, Casale admitted she acted as a "dealer after the fact" for Gingko. When asked about the 22 Investors, Casale stated that she took the job of calling as many as she could for Gingko, but some were "after the fact".

C. Staff's Witness - Investor D.H.

[101] In May 2012, D.H. and his wife, D.L., invested in LTP. D.H. gave evidence that he invested $107,000 and D.L. invested $127,000 in LTP from money in Locked-in Retirement Accounts ("**LIRA**") that had originated from their Ontario Municipal Employees Retirement System ("**OMERS**") pensions. D.H. testified that, at the time, they had five properties, consisting of one primary residence and four rental properties, and their net equity in properties was approximately $250,000 to $300,000.

[102] D.H. testified that in 2012, when he invested in LTP, he and his wife had no income, except perhaps $1,000 to $1,500 in rental income per month after paying debt. D.H.'s evidence was that their yoga business was either breaking even or had slightly negative cash flows, so they were not drawing income from it. He testified that neither his nor his wife's income has ever been $200,000 per year and they have never had a combined income of $300,000 per year.

[103] D.H. testified that he learned about LTP from one of its principals, Paul Van Benthem ("**Van Benthem**"). D.H. stated that Van Benthem provided D.H. and D.L. with financing ideas. D.H. testified that Van Benthem knew about their OMERS pension plans and suggested that if they invested in his company that he could invest the money back into their yoga studios in the form of a loan. D.H. did not recall receiving an offering memorandum for LTP.

[104] D.H. was put in contact with Sterling by Van Benthem. He recalled meeting with Casale once at a coffee shop in May 2012. He thought that the meeting occurred after his and his wife's funds were transferred to LTP. D.H. testified that, to his knowledge, his wife never spoke to Casale in person. It was D.H.'s evidence that Van Benthem had counseled D.H. to tell Casale about their properties and to give her an estimate of the real estate value. D.H. testified that Van Benthem advised D.H. to invest in LTP for a five year term so that he and his wife would have more time to pay back the loan, when LTP provided the funds back to them. D.H. testified that they never did get the loans promised by Van Benthem. As a result, their yoga business became insolvent and they were forced to close it down.

[105] D.H. identified his wife's Sterling KYC form, which indicated she had good investment knowledge and a high risk tolerance. D.H. testified that he filled in his wife's form, apart from the notes section. He further testified that it was likely in fact his form because D.L. does not have good investment knowledge and has a low risk tolerance.

[106] D.H. testified that Casale never asked him why he was investing in LTP, nor did she discuss the risks of investing in LTP or disclose that Sterling would receive a commission for the sale of LTP securities to them. D.H. also testified that when he met with Casale in May 2012 they did not discuss Van Benthem having had regulatory issues.

[107] Staff put a decision of the Investment Industry Regulatory Organization of Canada ("**IIROC**"), dated April 13, 2010, to D.H. (*Re Van Benthem & Petroccione*, [2010] I.I.R.O.C. No 18). D.H. testified that, in the fall of 2012, his wife discovered via an internet search that Van Benthem had been the subject of IIROC sanctions. It was their understanding at that time that the decision banned Van Benthem from acting as a stock broker.

[108] Under cross-examination, D.H. admitted that he was aware that he could not use his retirement savings to directly invest in his yoga business and confirmed that he was unable to get any other financing of that magnitude for the business. D.H. also admitted that he never told Casale that he had a "side deal" with Van Benthem for money to flow back to him.

D. Casale's Evidence Relating to the Alleged Compliance Deficiencies

[109] As set out above, Casale is Sterling's UDP, CCO and dealing representative. She is also the sole shareholder of the company. Casale acknowledges that between 2008 and 2011 Sterling was largely inactive.

[110] Casale acknowledged that Sterling, like many other EMDs, had compliance imperfections from the outset of the period under review by Staff. Casale confirms that she is prepared to step down as CCO and UDP and is working towards selling Sterling, subject to Staff's approval or non-objection, such that the best interests of clients may be met by having other qualified registrants take on those roles. The issue for the Panel to determine, from Casale's perspective, is her ability to retain her registration as dealing representative of Sterling. , Casale states that the new UDP and CCO would provide additional supervision over her activities for a period of time and she is willing to fulfill additional requirements that the Panel considers necessary.

[111] It is Casale's evidence that the Compliance Review, commencing on or about December 4, 2012, was unannounced and that Staff spent several days in her office "peppering" her with questions and "photocopying what appeared to be the full contents of [her] filing cabinets" (Exhibit 4 of the Hearing and Review - Affidavit of Casale sworn on February 4, 2014 at para. 11). Casale gave evidence that she was professional and cooperative with Staff throughout the process and responded willingly and promptly to requests. Casale takes issue with the fact that seven months later Staff released the Compliance Report and made the registration suspension recommendations without providing her with an opportunity to address or explain any of the deficiencies. Casale notes that Staff also did not seek to impose any terms and conditions on the Applicants' registrations in the seven month period prior to Staff recommendations.

[112] Casale reiterates that Staff's concerns may be addressed through her willingness to step down as UDP and CCO, additional education for her role as dealing representative and a period of supervision over her activities in that role. Casale states that she has made an effort to remain educated and informed on matters relating to EMD registration and requests the Panel to

consider that there have been no client complaints regarding the Applicants of which she was aware at the date of swearing her first affidavit.

[113] Casale gave evidence that Sterling does not take custody of client funds and stresses that the Applicants have implemented positive changes to Sterling's processes since the Compliance Review. Positive changes include revision of the Sterling KYC form, ensuring referral agreements are documented in writing, with terms clearly set out, and obtaining acknowledgement and agreement from clients that (a) the referring party did not provide investment advice regarding products offered through Sterling and (b) a referral fee would be payable by Sterling to the referring party. Further, Casale states that she is no longer accepting "historic clients" and that as of January 2013 Sterling's financial activity is recorded on an accrual basis. Casale is aware of the firm's monthly capital position and reporting of income and expenses occurs on a monthly basis.

[114] As of the fall of 2013, Casale confirms that the Applicants are no longer dealing representatives of Gingko or Genwealth products. Casale also confirms that, since learning of disconcerting news about So in December 2013, she has sought assurances from the new president of Redstone that investments made through Sterling remain in good standing and that investors will not suffer losses. Casale gave evidence that she was not currently distributing Redstone's products and was uncertain of her future relationship with that issuer.

1. Conflicts of Interest

[115] In relation to the alleged Genwealth conflict of interest, Casale gave evidence that Sterling no longer works with Genwealth and M.L. is no longer a Sterling dealing representative. However, Casale notes that M.L. sold Genwealth securities primarily to his family and friends, who were fully aware of his involvement with Genwealth. With respect to the alleged Redstone conflict of interest, Casale states that the operational loan of $73,000 was not disclosed to investors because So had informed her that he discussed it with his legal counsel, who suggested that the loan relative to the fund size would not be considered material and disclosure was not required. Subsequently, Casale states, she asked So to confirm that the matter would be addressed in Redstone's revised OM and was assured that he was working with counsel to address the issue in a compliant manner. Despite this, Casale states that in future she will exercise due diligence and seek professional advice directly to ensure any potential conflicts of interest are identified and addressed.

2. Failure to Report Capital Deficiencies

[116] On the matter of capital deficiency, Casale gave evidence that the issue was rectified in June 2012 and that Sterling has been in full compliance with its capital obligations since then. She provided Forms 31-103F1 "Calculation of Excess Working Capital" dated January 2013 to September 2013. Casale states that she had no intention of hiding the April and May 2012 deficiencies from Staff, that she is aware of her obligation to report capital deficiencies and that she did so when she became aware of them. She assures the Panel that the accounting measures she has implemented will ensure that she is aware of Sterling's capital position and indicates that, in any event, a new CCO would be responsible for ensuring the firm's capital position is maintained.

3. Misrepresentations to Staff

(a) Gingko

[117] Although the Director accepted that Casale made misrepresentations to Staff, it is Casale's evidence that in July 2012 Casale confirmed to Staff that Sterling was not involved in the private placement of Gingko securities to the 22 Investors, or performance of KYC and suitability reviews with regard to their investments, because it was not at that time. Casale gave evidence that subsequent to Staff's inquiry she was retained by Gingko to act in a purely administrative manner and, as a result, she reviewed the subscription agreements of the 22 Investors after they had already invested. Casale states that in April 2013, at the Casale Interview, she candidly responded in the affirmative to Staff's question concerning her receipt of compensation in respect of the 22 Investors. It is Casale's evidence that the six investors, whom Staff identified as having Sterling KYC forms, were exempt under the private issuer exemption and she did not effect the sale of securities to any of them or qualify them. Casale recognizes that filings made by Gingko may have confused matters, but states that the experience has informed her decision not to take on "historic clients" or provide such administrative services.

(b) LTP

[118] Casale gave evidence that she believed D.H. and D.L. were AIs at the time they made their investment with LTP. Casale recalled meeting with D.H. in May 2012 and that during that meeting D.H. informed her that he had over $1 million in financial assets, including, but not limited to, Registered Retirement Savings Plans ("**RRSPs**") and cash. Casale stated that she completed a KYC form and D.H. executed it confirming he was an AI. Casale has been unable to locate her copy of D.H.'s KYC form, but produced a copy of D.L.'s KYC form, which Casale states was completed and executed by D.L. and mailed to Casale after her meeting with D.H.

[119] Casale also gave evidence that in October 2012 she was asked by Van Benthem of LTP to handle an investment for P.J. and S.J., which would involve transferring approximately $500,000 from their RRSP accounts to LTP. Casale states that she had immediate concerns about suitability given that it was a large sum of savings going towards a risky investment and expressed that concern to them over the telephone. Casale attempted to schedule various meetings with P.J. and S.J., all of which were cancelled by them, and she subsequently refused to handle the proposed investment.

[120] Casale has not acted as a dealing representative for LTP since she dealt with D.H. and D.L.

4. Trading Without Registration

(a) M.L. in Ontario

[121] In respect of the allegation that the Applicants traded without registration, Casale's evidence is that the six sales at issue were made when M.L. was a registrant in good standing and while Sterling was in the process of transferring his registration. Casale acknowledges that the trades should have been made through Harris Brown, but states that at no time were the investors dealing with an unregistered dealing representative.

(b) Sterling in Alberta & British Columbia

[122] Casale's evidence is that her role, in relation to trades in Alberta and British Columbia, was only administrative and that most of those trades were made in reliance on the private issuer exemption. Casale recognizes that Sterling's KYC forms were sometimes used by iBrokerpower and So and/or Redstone to sell Redstone securities to residents of Alberta and British Columbia, but states that she no longer accepts administrative mandates.

5. Failure to Discharge KYP Obligations

[123] On the matter of KYP obligations, Casale gave evidence that she knows the material attributes of all issuers for which Sterling acts. It is Casale's evidence that she required each issuer that Sterling deals with to disclose copies of, as applicable: (a) the last three years of audited and unaudited financial statements; (b) a business plan and/or executive summary; (c) the OM; (d) revenue projections; and (e) general security agreements. Casale provided a copy of Sterling's "Issuer Investment Due Diligence Preliminary Report" checklist. Casale also states that she maintains regular contact with the principals of each issuer, makes inquiries as to whether there have been material developments and maintains updated due diligence binders.

(a) Redstone

[124] Casale states that she spoke and met regularly with So and asked him how the loans were performing, including whether any were in default. Casale states that So repeatedly assured her that there would be no losses on the fund and Casale is not aware of investors losing money on a Redstone investment. Casale gave evidence that she had not seen the chart purportedly prepared by So in respect of the Redstone portfolio showing loans in default. After being shown Redstone's loan portfolio summary by Staff, Casale contacted So and he informed her the list was old, all the items had been dealt with and many involved simply a default in an interest payment. Casale takes the position that if the information was material to the product the issuer is responsible for disclosing it, however, she does not believe that the information in the chart would have changed an investor's decision to invest in the product.

(b) Genwealth

[125] Casale's response to Staff's evidence in respect of Genwealth is that she knew the product at the level expected of an EMD and that any complaint that information in the OM may have been misleading ought to be made against Genwealth directly.

6. Improper Reliance on Accredited Investor Exemption

[126] In response to Staff allegations that the Applicants improperly used prospectus exemptions, Casale's evidence is that she believes all investors who invested in reliance upon the AI exemption met the necessary requirements. Casale reviewed Staff's list of 22 investors and provided brief reasons for the Applicants' reliance on the AI exemption or otherwise provided an explanation for the investment or investments. Casale also collected letters from 18 investors confirming they were AIs at the time they made their investments through Sterling, at least nine of whom were also investors listed in Staff's chart. For example, Casale's evidence is that investor H.W.L. confirmed to Staff that his net worth is $1 million, Casale provided a Sterling KYC form with information she gathered from H.W.L. in support of that position and H.W.L.

subsequently provided a letter confirming his AI qualification. In summary, Casale's evidence is that while paperwork may not have been perfect, the substantive issues were addressed.

[127] Casale also requests that the Panel recognize that in some instances she has refused to accept investment renewals, as investors did not meet the AI requirements. Casale also states that some investors provided Staff with somewhat different information than that identified in the Sterling KYC form. Casale's explanation of this is that Staff approached the investors, through cold calls, which may have resulted in reluctance to disclose personal financial information. It is Casale's evidence that she has told, and continues to tell, every investor that the investments for which Sterling acts as dealing representative are high risk. Casale suggests that the Panel consider a newly implemented and more detailed Sterling KYC form that will ensure that information obtained from each investor she qualifies is clear.

7. Failure to Discharge KYC and Suitability Obligations

[128] Finally, with respect to KYC and suitability obligations, Casale gave evidence that many of the investors Staff refer to were "inherited" by the Applicants and had invested pursuant to the private issuer exemption. Casale reviewed Staff's list of 45 investors and provided responses to Staff's concerns. Casale states that the revised Sterling KYC form will remove potential ambiguity as it clearly identifies terms relating to income, net financial assets and risk tolerance. Casale began drafting the new form prior to the Compliance Review.

8. Conduct After the OTBH

(a) Investor Alert

[129] Casale gave evidence that her cover letter for the OTBH notified the Commission that she would be seeking a stay if the Director accepted Staff's recommendations. Nevertheless, Casale states, on November 19, 2013, the Commission issued an investor alert on the front page of its website which alerted investors not to purchase securities from the Applicants (the "**Investor Alert**"). This remained on the Commission's web page for nine days until the Stay Decision ordered its removal. Casale notes that only 5 other investor alerts were posted on the Commission's website in 2013 and the others appear to involve boiler rooms and fraud, which can be distinguished from her situation. Further, Casale's review of the Commission's investor alerts indicates that the Commission issued a total of 5 to 6 alerts each year in 2010, 2011 and 2012. Casale states that the Commission's posting of the Investor Alert has harmed the Applicants' business and reputation and, coupled with the Compliance Review, has caused Casale tremendous stress. Casale notes that she was recently turned away for a personal mortgage from a lender who declined based on the Director's Decision.

(b) Proposed Transaction - Sale of Sterling

[130] The Applicants tendered into evidence a letter of intent dated February 13, 2014, which recorded the intended sale of 90 percent of issued and outstanding common shares of Sterling to a Mr. Woods and Mr. Gentile for a consideration of $35,000 and indicated that Mr. Woods would act as CCO and UDP. The Applicants then provided notice to Staff, pursuant to section 11.10 of NI 31-103, of the Proposed Transaction.

[131] On February 28, 2014, counsel for Sterling gave notice to Staff of a proposed sale in which Mr. Woods was no longer a party and was replaced by Mr. Jackson as CCO and UDP. In the second proposed sale, Sterling was to be acquired by Mr. Gentile and Mr. Jackson for consideration of $20.

[132] On March 21, 2014, Casale wrote to Staff with a revised structure for the Proposed Transaction. In this third proposed sale, Mr. Gentile and Mr. Jackson were no longer parties and 90 percent of common shares of Sterling would be purchased by Business Owners Support Services Network Inc. owned by Ms. Nixon for consideration of $40,000. In this third proposed sale, Mr. Jackson would continue to act as CCO and Ms. Nixon's husband, a lawyer in British Columbia would act as UDP. On March 25, 2014, counsel for the Applicants advised Staff that Mr. Huras, would replace Mr. Jackson as CCO of Sterling under the most recent proposed sale.

[133] As noted above at paragraph [21], we have been advised that the Applicants are no longer pursuing an application, pursuant to section 11.10 of NI 31-103, in furtherance of the Proposed Transaction.

E. Applicants' Witness - Investor M.B.

[134] M.B. testified that she met Casale in 2006 or 2007 through business contacts and invested in a medical company that Casale was representing at that time. M.B. confirmed in cross-examination that although they did not start out as friends, she became a long-standing friend and investor with Casale.

[135] M.B. made three investments with Sterling and testified that she had a generally positive experience. M.B. further testified that Casale understood the products she was selling, could answer M.B.'s questions and if she could not answer the question Casale would write it down and get back to M.B. She also testified that Casale did due diligence on products, knew a lot about them, would "arrange meetings with CEOs or other representatives of the investee company, and […] she really went out of her way to make sure that we were very comfortable with the investment." (Hearing Transcript dated February 19, 2014 at p. 78).

[136] M.B. first invested in Redstone on March 25, 2011, in the name of her company, directly through So. So put M.B. in contact with Casale to complete her second investment in Redstone. M.B. testified that she and Casale met and completed a Sterling KYC form together and M.B. signed the form on July 2, 2012. M.B. explained that her Sterling KYC form indicated her investment objective was "capital security" and that she had a risk tolerance of "moderate" because it reflected her overall profile, which was something she discussed with Casale.

[137] In respect of Redstone, Casale reiterated what So had told M.B. about Redstone's loan portfolio and stated that Redstone was a high risk investment. M.B. recalled discussing the AI requirements in the context of her second Redstone investment and confirmed that she checked the option indicating that she had net financial assets exceeding $1,000,000 because it was true at the time. M.B. confirmed that she signed a Risk Acknowledgement Form, which she had discussed with Casale, and understood it to mean that she could lose all her money in this investment. M.B. testified that she got all her principal and interest back on her Redstone investment.

[138] M.B. signed a letter tendered at the Hearing and Review, which confirmed that she qualified as an AI and had been made aware of the high risk associated with her Redstone Investment. M.B. explained:

> I've always known Ms. Casale to be a person of great integrity, and she's always, you know, gone out of her way to do the utmost to provide me with a level of information with all the investments that I have gotten into with her…[and by comparison to other financial advisors, she is] far superior.
>
> (Hearing Transcript dated February 19, 2014 at pp. 81-82).

[139] M.B. testified that Staff did not call her or review her Sterling KYC form with her.

VI. ANALYSIS

A. Legal Framework for Registration

1. Public Interest Jurisdiction

[140] In exercising its discretion to review the decision of a Director, the Commission must act in the public interest with regard to its mandate and purpose as articulated under section 1.1 of the Act:

> **1.1 Purposes** – The purposes of this Act are,
>
> (a) to provide protection to investors from unfair, improper or fraudulent practices; and
>
> (b) to foster fair and efficient capital markets and confidence in capital markets.
>
> (See *Re Michalik* (2007), 30 O.S.C.B. 6717 ("***Michalik***") at para. 44; *Sawh, supra* paras. 150-151)

[141] Section 2.1 of the Act provides fundamental principles for the Commission to consider in pursuing the purposes of the Act, including the primary means for achieving those purposes. These include "requirements for the maintenance of high standards of fitness and business conduct to ensure honest and responsible conduct by market participants" (subsection 2.1(2)(iii) of the Act). One of these requirements is to be found in section 2.1 of the OSC Rule 31-505, which provides that a registered dealer and its representatives "shall deal fairly, honestly and in good faith with its clients". It is in the public interest for the Commission to ensure that these overarching principles of registrant conduct are adhered to, given the important role of registrants in the capital markets.

[142] In *Mithras*, the Commission acknowledged that its discretion in the public interest is to be exercised prospectively to protect the public and the integrity of the capital markets. The Commission stated that:

> … the role of this Commission is to protect the public interest by removing from the capital markets – wholly or partially, permanently or temporarily, as the circumstances may warrant – those whose conduct in the past leads us to conclude

> that their conduct in the future may well be detrimental to the integrity of those capital markets. We are not here to punish past conduct; that is the role of the courts…We are here to restrain, as best we can, future conduct that is likely to be prejudicial to the public interest in having capital markets that are both fair and efficient. In so doing we must, of necessity, look to past conduct as a guide to what we believe a person's future conduct might reasonably be expected to be; we are not prescient, after all.
>
> (*Mithras, supra* at pp. 1610-1611)

[143] These principles are relevant to our consideration of the Applicants' requests for continued registration under the Act.

2. Registration under the Act

[144] The registration requirement for an individual or firm seeking to act as a dealer or dealing representative is set out in subsection 25(1) of the Act:

> **25. Registration – (1) Dealers** – Unless a person or company is exempt under Ontario securities law from the requirement to comply with this subsection, the person or company shall not engage in or hold himself, herself or itself out as engaging in the business of trading in securities unless the person or company,
>
> (a) is registered in accordance with Ontario securities law as a dealer; or
> (b) is a representative registered in accordance with Ontario securities law as a dealing representative of a registered dealer and is acting on behalf of the registered dealer.

[145] It is well established that registration is a privilege, not a right, that is granted to individuals and entities that have demonstrated their suitability for registration (see *Re Trend Capital Services Inc*. (1992), 15 O.S.C.B. 1711 at p. 1765 ("***Trend***"); *Istanbul, supra* at para. 60; *Sawh, supra* at para. 142).

[146] Section 28 of the Act permits the Director to revoke or suspend, or to impose terms and conditions upon, a registration under the Act, if certain considerations are met. Specifically, section 28 of the Act provides:

> **28. Revocation or suspension of registration or imposition of terms and conditions** – The Director may revoke or suspend the registration of a person or company or impose terms or conditions of registration at any time during the period of registration of the person or company if it appears to the Director,
>
> (a) that the person or company is <u>not suitable</u> for registration or has <u>failed to comply with Ontario securities law</u>; or
>
> (b) that the registration is <u>otherwise objectionable</u>. [emphasis added]

[147] On its face, section 28 of the Act provides three bases for determining whether revocation or suspension of registration or imposition of terms and conditions are appropriate. The first basis is a determination that the person or company is not suitable for registration. The second is

a determination that the person or company failed to comply with Ontario securities law. The third and last ground is a determination that the registration is otherwise objectionable. These three tests, if met, are separate bases for a remedy. Thus, a finding that one of these bases has been met is sufficient grounds for revocation or suspension of registration or imposition of terms and conditions, though the decision is ultimately a discretionary one.

(a) Suitability for Continued Registration

[148] Section 28 of the Act does not define how a registrant could be determined to be "not suitable". Therefore, in determining whether an individual or company is unsuitable for registration pursuant to subsection 28(a) of the Act, we are guided by the terms of section 27 of the Act, which addresses the test to be applied to an application for registration. Section 27 of the Act states:

> **27. (1) Registration, etc.** – On receipt of an application by a person or company and all information, material and fees required by the Director and the regulations, the Director shall register the person or company, reinstate the registration of the person or company or amend the registration of the person or company, unless it appears to the Director,
>
> (a) that, in the case of a person or company applying for registration, reinstatement of registration or an amendment to a registration, the person or company is not suitable for registration under this Act; or
>
> (b) that the proposed registration, reinstatement of registration or amendment to registration is otherwise objectionable.
>
> **(2) Matters to be considered** – In considering for the purposes of subsection (1) whether a person or company is not suitable for registration, the Director shall consider,
>
> (a) whether the person or company has satisfied,
>
> (i) the requirements prescribed in the regulations relating to proficiency, solvency and integrity, and
>
> (ii) such other requirements for registration, reinstatement of registration or an amendment to a registration, as the case may be, as may be prescribed by the regulations; and
>
> (b) such other factors as the Director considers relevant. […]

[149] We accept that the three criteria of proficiency, solvency and integrity for determining whether a person or company is "not suitable" for registration, which have been codified in subsection 27(2) of the Act, have been applied by the Director in other cases when assessing suitability for continued registration under section 28 of the Act and are appropriately considered in this case to determine whether a registrant is not suitable for the purposes of revocation, suspension or the imposition of terms and conditions upon a registration (*Waterview, supra* at paras. 18-20).

[150] Requirements of proficiency are prescribed in Part 3 of NI 31-103. Section 2.1 of the OSC Rule 31-505 provides that a registered dealer and its representatives "shall deal fairly, honestly and in good faith with its clients" and section 1.3 of 31-103CP provides further guidance with respect to integrity and solvency.

[151] Our analysis of the Applicants' suitability for registration begins at paragraph [157].

(b) Failure to Comply with Ontario Securities Law

[152] As noted above, section 28 of the Act permits the Director to revoke or suspend, or to impose terms and conditions upon a registration under the Act, if it appears to the Director that the registrant has failed to comply with Ontario securities law. Accordingly, if the Director finds non-compliance, a registration may be revoked or suspended or terms and conditions may be placed upon it. Whether the Applicants have failed to comply with Ontario securities law is determined by analysis of whether on a balance of probabilities, the conduct of the registrants was not in compliance with the provisions or orders falling within the scope of Ontario securities law.

[153] The definition of "Ontario securities law" in subsection 1(1) of the Act includes: (a) the Act, (b) regulations made under the Act, and (c) a decision of the Commission or a Director to which a person or company is subject. We note that this definition on its face is not confined to the provisions of the Act governing registration. However, compliance with those provisions would be expected as an aspect of the obligations of registration.

[154] Our analysis of whether the Applicants failed to comply with Ontario securities law begins at paragraph [262].

(c) Whether Continued Registration is Otherwise Objectionable

[155] Section 28 of the Act does not define the concept of "otherwise objectionable". We adopt the view from *Sawh* that a purposive approach should be taken to the analysis of whether registration would be "otherwise objectionable" in light of the Commission's mandate, as expressed in section 1.1 of the Act to: (a) provide protection to investors from unfair, improper or fraudulent practices; and (b) foster fair and efficient capital markets and confidence in capital markets (*Sawh, supra* at para. 289).

[156] We address whether the continued registration of the Applicants is otherwise objectionable at paragraph [277].

B. Are the Applicants Suitable for Continued Registration?

[157] The three criteria for determining suitability for registration for the purpose of section 28 of the Act are codified in subsection 27(2) of the Act. These are whether the person or company has satisfied the requirements prescribed in NI 31-103 and OSC Rule 31-505 relating to proficiency, solvency and integrity (Subsection 27(2)(a)(i) of the Act).

[158] Staff's submissions did not focus on whether the Applicants currently lack financial solvency. The analysis of whether the Applicants are suitable to continue being registered will therefore focus on the application of both the proficiency and integrity criteria, established by

subsection 27(2) of the Act and interpreted by previous case law (see for example, *Istanbul*, *supra* at para. 65), to the Applicants.

[159] In determining whether the Applicants are suitable for continued registration, their past conduct is relevant because it assists in determining whether the Applicants are likely to meet the standards of suitability imposed by Ontario securities law now and in the future (*Mithras*, *supra* at pp. 1610-1611; *Sawh, supra* at para. 157). Accordingly, the past conduct of the Applicants will be assessed against the statutory requirements existing at the time of the conduct. This analysis of past conduct will form one of the bases for determining whether the Applicants are suitable for registration under the current regulatory regime. In addition, the Applicants' evidence tendered at the Hearing and Review provides us with additional grounds for making the determination as to the Applicants' continued suitability for registration.

1. Characterizing Issues of Proficiency and/or Integrity

[160] The Applicants urge the panel to consider this to be a case of proficiency only. Specifically, the Applicants submit that four of the seven alleged compliance deficiencies, those relating to conflicts of interest, failure to report capital deficiencies, misrepresentation and trading without registration, are matters of proficiency rather than integrity. Staff disagrees with the Applicants characterization of these four issues. Both sides agree that the remaining three of the alleged compliance deficiencies relate to proficiency.

[161] Based on our review of the conduct at issue, we disagree with the Applicants' view that matters of integrity are not implicated in this case. We also do not agree that Staff has incorrectly identified matters of proficiency as matters of integrity.

[162] Many of the compliance deficiencies raised by Staff in this case may be accurately characterized as matters involving both proficiency and integrity. The two criteria for determining suitability need not be mutually exclusive or considered strictly in watertight compartments.

[163] Certain fact situations engage considerations of both proficiency and integrity. For instance, the inability to identify a conflict of interest may be a proficiency issue because proper identification requires the application of judgment in relation to the potentially competing interests of dealers and clients. The ultimate handling of a conflict may reflect on both proficiency in the application of the registered firm's compliance policies and the integrity of the registrant in their dealings with clients and appropriately responding to conflicts. The choice not to disclose a conflict of interest, particularly once it has been brought to a registrant's attention, may raise questions about a registrant's integrity.

[164] Whether an issue is characterized as a matter of proficiency, of integrity or both, the Commission may consider the circumstances and issue an appropriate remedy. The Applicants take the position that only matters of integrity merit periods of suspension to serve purposes of general and specific deterrence (citing *Istanbul, supra* at paras. 72-73 and 79-80; *Obasi, supra* at paras. 1, 30-32; *DiPronio, supra*). The Applicants' submissions seem to imply that issues of proficiency can always be addressed with education and supervision and, therefore, should not trigger suspension of a registration. We do not agree with the submission that only matters of

integrity merit periods of suspension. In appropriate circumstances, a lack of proficiency may require regulatory responses beyond that of education and supervision.

[165] We find that the Director accurately noted that in this case "many of the issues were both integrity and proficiency issues" (Director's decision, *supra* at para. 4). We will address the alleged compliance deficiencies in turn and, if necessary, expand further on the appropriate characterization of each in our analysis below.

2. Legal Frameworks relating to Integrity and Proficiency

(a) Integrity

[166] The term integrity is not defined under the Act. It is not disputed that the Commission has adopted the view that analysis of the integrity requirement involves consideration of "the honesty and character of the applicant" (*Istanbul*, *supra* at para. 66, citing *Wall*, *supra* at para. 23). The Commission in *Istanbul* stated that an assessment of integrity should be "guided by the criteria set out in paragraph 2.1(1)(iii) [now 2.1(2)(iii)] of the Act" (*Istanbul*, *supra* at para. 68). Subsection 2.1(2)(iii) of the Act states that the Commission shall have regard to fundamental principles, including "the maintenance of high standards of fitness and business conduct to ensure honest and responsible conduct by market participants".

[167] OSC Rule 31-505 imposes a standard of integrity on registered dealers. Specifically, section 2.1 of OSC Rule 31-505 provides that:

> **2.1 General Duties** – (1) A registered dealer or adviser shall deal fairly, honestly and in good faith with its clients.
>
> (2) A representative of a registered dealer or registered adviser shall deal fairly, honestly and in good faith with his or her clients.

[168] We agree with the Applicants that section 1.3 of 31-103CP provides guidance on the matter of integrity requirements for registrants. It states that:

> ***(b) Integrity***
> Registered individuals must conduct themselves with integrity and have an honest character. The regulator will assess the integrity of individuals through the information they are required to provide on registration application forms and as registrants, and through compliance reviews. For example, applicants are required to disclose information about conflicts of interest, such as other employment or partnerships, service as a member of a board of directors, or relationships with affiliates, and about any regulatory or legal actions against them.

[169] In our view, the regulatory framework contemplates an assessment of whether or not a firm has acted with integrity (*Waterview*, *supra* at para. 22, citing *Re Carter Securities Inc.* (2010), 33 O.S.C.B. 8691 at para. 87 ("***Carter***")). Although a firm may show its integrity in different ways, it has the capacity to demonstrate its integrity through, among other things, its compliance with Ontario securities law, its internal policies, and the attributes of persons carrying out specific roles within the firm. Thus, it is appropriate to consider in this case whether Sterling has demonstrated an appropriate level of integrity to remain registered. For the purposes

of this analysis, the actions of Casale are attributable to Sterling. Given Casale's positions as UDP, CCO, dealing representative, sole shareholder and directing mind of Sterling, we were unable to distinguish between the Applicants.

[170] In assessing the integrity of applicants for registration, the Commission has considered factors including, the person or company's dealings with clients, compliance with Ontario securities laws and the use of prudent business practices (*Wall, supra* at para. 23; cited in *Istanbul, supra* at para. 66 and *Sawh, supra* at para. 257). In our view, those considerations are equally applicable in matters of whether a registration should be suspended or revoked or whether it is appropriate to impose terms and conditions upon it. We agree that an individual's honesty and candour in their dealings with the Commission is also a relevant consideration with respect to integrity (*Pyasetsky Director's Decision, supra* at paras. 17-18).

[171] We agree with the finding of a director of the Alberta Securities Commission in *John Doe* that the concept of integrity invoked in the registration regime is broader than dishonesty. Rather, it encompasses a duty of care and while a registrant may not be dishonest, he or she may "be reckless or lackadaisical over whether one complies with the rules or requirements of one's industry" (*Re John Doe* (2010), 33 O.S.C.B. 1371 at para. 37, citing *Re Doe* (2007), ABASC 296).

(b) Proficiency

[172] Registrants have an important function in the capital markets and proficiency requirements are established to ensure that the public deals with qualified persons or companies (*Michalik, supra* at para. 48). Proficiency requirements also support, promote and enhance the purposes of the Act, which include protecting the investing public by maintaining high standards of fitness and business conduct (*Sawh, supra* at para. 158).

[173] Subsection 3.4(1) of NI 31-103 sets out the proficiency requirement that: "[a]n individual must not perform an activity that requires registration unless the individual has the education, training and experience that a reasonable person would consider necessary to perform the activity competently". In *Michalik*, the Commission noted in reference to section 1.5 of OSC Rule 31-505, the precursor to subsection 13.2(2) of NI 31-103, that registrants are required to apply the "know your client" and "suitability" standards in carrying out their functions and, therefore, that they must meet the proficiency requirements to apply these standards (*Michalik, supra* at para. 23).

[174] In their submissions, Staff does not contest that the Applicants have enough education or experience to be considered suitable for registration. However, the evidence presented at the Hearing and Review raises the issue of whether Staff has satisfied us that the Applicants are lacking proficiency in fulfilling the know-your-client, suitability or know-your-product obligations required of an EMD as well as appropriate reliance on permissible exemptions from prospectus requirements.

[175] Consistent with our analysis above at paragraph [169], for the purposes of our assessment of proficiency the actions of Casale are attributable to Sterling, as she is and was the directing mind of the firm. Our conclusions on proficiency below are applicable to Sterling as a registered firm and Casale as a dealing representative.

3. Analysis of the Continued Suitability of the Applicants

[176] We now consider the alleged compliance deficiencies relevant to the determination of the Applicants' suitability for continued registration, including: (a) conflicts of interest, (b) failure to report capital deficiencies, (c) misrepresentations to Staff, (d) unregistered trading, (e) know-your-client and suitability obligations, (f) reliance on the accredited investor exemption and (g) know-your-product obligations.

[177] We acknowledge that Casale is not seeking to maintain her registration as UDP and CCO. In light of our ultimate order however, we make findings in respect of Casale's suitability to be UDP and CCO separately below.

(a) Conflicts of Interest

[178] We find that there are two relevant conflicts of interest that exist or existed at the time that the Applicants sold securities of Redstone and Genwealth. On the basis of our review of the facts surrounding these sales in light of section 13.4 of NI 31-103 below, we find that both were conflicts that ought to have been identified, managed and disclosed by the Applicants.

[179] Section 13.4 of NI 31-103 requires registrants to identify existing and potential material conflicts of interest and respond to them accordingly. The section provides:

> **13.4 Identifying and responding to conflicts of interest - (1)** A registered firm must take reasonable steps to identify existing material conflicts of interest, and material conflicts of interest that the registered firm in its reasonable opinion would expect to arise, between the firm, including each individual acting on the firm's behalf, and a client.
> **(2)** A registered firm must respond to an existing or potential conflict of interest identified under subsection (1).
> **(3)** If a reasonable investor would expect to be informed of a conflict of interest identified under subsection (1), the registered firm must disclose, in a timely manner, the nature and extent of the conflict of interest to the client whose interest conflicts with the interest identified.

[180] The companion policy at section 13.4 of 31-103CP describes conflicts of interest "to be any circumstance where the interests of different parties, such as the interests of a client and those of a registrant, are inconsistent or divergent." In *Istanbul*, the Commission found that "registrants should be able to identify and avoid conflicts of interest that result from a non-arm's length relationship" (*Istanbul*, *supra* at para. 73).

[181] The Sterling "Policies and Procedures Manual" (also referred to as "**Compliance Manual**") expressly cites section 13.4 of NI 31-103 and identifies examples of conflicts as follows:

> Examples of conflict of interest situations include:
> - Connected or related issuers, where the Firm might be tempted to recommend the issuer to a client to bolster the trading or price rather than because it is a good investment for the client;

- Director positions of an issuer held by an employee of the Firm, where the individual may receive confidential or market sensitive information […]

(Exhibit 16 to the OTBH - Sterling "Policies and Procedures Manual" at p. 11)

[182] We find it telling that the Sterling Compliance Manual expressly cites section 13.4 of NI 31-103 and has clear provisions relating to the management of conflicts of interest, including:

4.3 Conflicts of Interest

The Firm expects that all employees will avoid any activity, interest or association which might interfere or appear to interfere with the independent exercise of their judgement in the best interests of the Firm, its clients and the public. Employees must avoid any situation in which their personal interests conflict with their duties at Sterling.

(Exhibit 16 to the OTBH - Sterling "Policies and Procedures Manual" at p. 11)

[183] The Sterling Compliance Manual goes on to state that once identified, the CCO must manage the conflict or perceived conflict in one of three ways: (a) disclose the conflict to the client; (b) supervise to ensure the party with the conflict acts only in the client's best interests; or (c) refrain from conducting business that results in the conflict (Exhibit 16 to the OTBH - Sterling "Policies and Procedures Manual" at p. 13). In practice, given that Casale acted as UDP, CCO and a dealing representative, she could not have relied upon supervision to manage a conflict of interest pertaining to herself. Therefore, in accordance with Sterling's own protocol, the Applicants should have either disclosed the conflicts or refrained from engaging in the conduct that gives rise to the conflict.

[184] The Applicants were indebted to Redstone, and a company controlled by Redstone's principal, in the aggregate amount of $98,000 (the "**Redstone Loans**"). In our view, the existence of the Redstone Loans created a situation in which the Applicants' interests potentially conflicted with their clients' interests in circumstances where the clients bought Redstone securities from the Applicants. The conflict arises from the EMD's dependence on the issuer for loans that acted as a lifeline to Sterling to rectify its working capital deficiency and thereby maintain its registration while selling the issuer's securities to its clients.

[185] We also find that sales of Genwealth securities by M.L., as a dealing representative of Sterling, at a time when M.L. managed the venture capital fund, is a conflict of interest (the "**Genwealth Conflict**"). Even if we accept that M.L. sold securities only to family and friends who knew of his involvement with Genwealth, we are concerned that Casale did not initially perceive a conflict of interest with respect to the firm's distribution of Genwealth securities.

[186] In our view, a reasonable investor would consider the Redstone Loans to be a motivation for Casale to sell Redstone securities. Further, in our view, a reasonable investor would also consider M.L.'s role in Genwealth's management to be a motivation for M.L. to sell Genwealth securities. Therefore, a reasonable investor would expect the Redstone Loans and the Genwealth Conflict to be disclosed as identified conflicts of interest resulting from the relationships of these issuers to the EMD.

[187] In *Sawh*, the Commission found that continued denial of the need to disclose or otherwise manage conflicts of interest prevented the panel from concluding that the applicants would comply with the integrity requirements of registration in the future (*Sawh, supra* at para. 284). In *White Capital*, an EMD received four financial payments from an issuer whose securities it sold to investors (*White Capital*, *supra* at paras. 8-11). The applicant's failure to disclose those payments was considered to be a conflict of interest and one of the primary reasons for the Director's suspension of its registration (*White Capital*, *supra* at para. 13).

[188] Casale does not appear to appreciate her obligations to disclose conflicts of interest to investors. First, Casale's reliance on So's counsel for the explanation that the Second Loan of $73,000 was not material because of its size relative to the size of the Redstone fund shows a continued misunderstanding of how a conflict of interest could arise between the Applicants and the Applicants' clients. Second, Casale's Affidavit demonstrates that her position continues to be that an amendment to the Redstone OM is an adequate response. Even when Staff brought the conflict to her attention, Casale determined that it was for So to manage. This response by Casale of delegating the management of the conflict to So does not meet her obligation as a registrant to deal fairly and in good faith with Sterling's clients (section 2.1 of the OSC Rule 31-505). Casale's Affidavit demonstrates an ongoing failure to appreciate her obligations in this regard.

[189] Despite her evidence that So was going to amend the Redstone OM, we were not referred to evidence confirming that the Applicants took steps to address the conflict of interest, such as evidence that disclosure was made to clients. In the absence of evidence that Casale disclosed and discloses the Redstone conflict of interest to investors, we infer that she did not. In the circumstances, we are not persuaded that the Applicants conducted themselves in a manner that a reasonable investor would expect.

[190] The fact that the Applicants did not identify, respond or disclose the conflicts of interest as required by section 13.4 of NI 31-103 raises, in our view, both proficiency and integrity concerns in circumstances where it appears that the registrants do not appreciate their responsibilities to their clients. Moreover, despite clear examples of conflicts of interest provided in Sterling's Compliance Manual, the Applicants failed to respond in an appropriate manner, which raises concerns of integrity and reflects lack of judgment and good faith in considering the interests of clients. Further, the Applicants' failure to provide evidence that they disclosed the Redstone conflict of interest independently to clients and that they continued to sell the product after being notified by the Commission of the existence of that conflict reinforces that this is an integrity concern.

[191] Despite recognition by Casale that she may need independent legal advice, we find the Applicants' submission that in future they would seek legal advice with regard to conflicts of interest is insufficient to satisfy our concerns. It is not clear to us how Casale could seek legal counsel effectively when she has failed to demonstrate an ability to identify relevant conflicts in the first place. The identification and management of conflicts is an integral obligation of registration in a context where Casale is a dealing representative, who communicates directly with clients. Furthermore, given that we have found that the Applicants lack the requisite integrity, we are not satisfied that independent legal advice could ensure that the Applicants would respond to a conflict in the manner required by section 13.4 of NI 31-103.

(b) Failure to Report Capital Deficiencies

[192] We find that the Applicants' failure to be forthright with Staff concerning Sterling's capital deficiencies does not meet the high standards of fitness and business conduct expected of honest and responsible market participants.

[193] Subsection 12.1(1) of NI 31-103 expressly requires a registered firm to report excess working capital less than zero. Specifically, subsection 12.1(1) of NI 31-103 states that "[i]f, at any time, the excess working capital of a registered firm, as calculated in accordance with Form 31-103F1 *Calculation of Excess Working Capital*, is less than zero, the registered firm must notify the regulator[…] as soon as possible". Subsection 12.1(3)(b) of NI 31-103 indicates that for the purpose of completing Form 31-103F1 the minimum capital is $50,000, for a registered dealer that is not also a registered investment fund manager. By implication, the registered firm must maintain its excess working capital at the standard set by the legislation.

[194] On November 18, 2011, after Sterling had rectified a previous capital deficiency, Casale consented to the imposition of terms and conditions on Sterling's registration for a period of six months, including a requirement for specified monthly financial reporting to the Commission from October 2011 to March 2012. Immediately after the monthly reporting ceased, Sterling's excess working capital became deficient for two months and Staff was not notified.

[195] In her affidavit, Casale assures us that the capital deficiency issue was rectified in June 2012 and that Sterling has been in full compliance with its capital obligations since then. Further, Casale states that she had no intention of hiding the April and May 2012 deficiencies from Staff and that she knows her obligation to report capital deficiencies.

[196] Section 11.5 of NI 31-103 contains general requirements with respect to records. We note that section 11.5 of 31-103CP provides guidance that certain required records must be maintained to help registered firms determine their capital position, including excess working capital, and to demonstrate compliance with capital requirements. An EMD must exercise caution to maintain its working capital and it appears that Casale either did not fully understand her obligations to report deficiencies promptly or simply chose not to do so.

[197] We have difficulty accepting as credible Casale's evidence as presented in her affidavit prepared for the Hearing and Review. After months of managing Sterling's working capital for the purpose of meeting Staff's terms and conditions in the course of the Compliance Review, she should have known of the capital deficiencies of April and May 2012 at that time. This is supported by the fact that Casale was able to immediately provide Staff with monthly Form 31-103F1 *Calculation of Excess Working Capital* reports for June and July 2012. Further, Casale admitted she was aware of the requirement to notify Staff of any capital deficiencies and she gave evidence that in 2012 her accountant was preparing the Forms 31-103 on a monthly basis. Finally, there is a discrepancy between what Casale says in the Casale Interview and Casale's Affidavit tendered for the Hearing and Review. At the Casale Interview in April 2013 the following questions were posed and answers given:

> MS. HUI: Did you notify the OSC about the capital deficiency?
>
> THE DEPONENT: I did not. We rectified it before anything. So I did not.

BY MR. SKUCE:

Q. But the obligation is to notify the OSC as soon as it happens. It doesn't say --

A. I understand.

Q. -- within -- okay. So you understand the obligation?

A. Yes, I do.

(Exhibit 20 of the Hearing and Review - Transcript of Interview with Grace Casale dated April 16, 2013 at pp. 180-181)

Casale's Affidavit for the Hearing and Review states that she "had no intention of hiding the April and May 2012 deficiency from Staff" and "did so when [she] became aware of the issue" (Exhibit 4 of the Hearing and Review - Affidavit of Casale sworn on February 4, 2014 at para. 51). Either Casale did not tell Staff because she rectified the issue or she only became aware of the issue in early February 2013 when she advised Staff about it during the course of the Compliance Review. In considering the evidence before us, we find that Casale not only failed to report Sterling's capital deficiency, but also chose not to be forthright with the regulator. Casale's assurance that a new CCO would be responsible for maintenance of the firm's capital position if we overturn the Director's Decision does not provide us with sufficient comfort in light of our assessment of her personal suitability for continued registration.

[198] There were at least two occasions before the suspension of registration when Staff notified Casale of concerns about failure to maintain working capital and the parties worked towards rectifying the matter. Casale also acknowledged knowing her obligation to report the capital deficiency. We agree with Staff that the manner in which Casale dealt with the April and May 2012 capital deficiencies raises concerns. Her omission speaks to Casale's honesty and candour in her dealings with the Commission and therefore her integrity and suitability for continued registration.

[199] Finally, we note that maintaining adequate working capital at all times is a basic obligation of continuing registration. Failure to maintain a minimum working capital amount raises concerns about lack of proficiency.

(c) Misrepresentations to Staff

[200] We find that Casale made misrepresentations to Staff concerning her involvement in sales of Gingko securities to the 22 Investors.

[201] As stated above, we agree that an individual's honesty and candour in their dealings with the Commission is a relevant consideration of integrity (*Pyasetsky Director's Decision, supra* at paras. 17 and 18).

[202] On June 19, 2012, Casale confirmed the accuracy of a letter which affirmed that Sterling was not involved in the distribution of Gingko securities to the 22 Investors. Further, on July 17, 2012, Staff sent an email to Casale, among others, summarizing the contents of a telephone call of the previous day, which included the statement that "Sterling was not involved in the private placement that took place during March 2012 to May 2012 to an additional 22 investors and has

not performed KYC or suitability reviews for these investors or received any fees…for these investments" (Exhibit 21 of the Hearing and Review - Supplementary Brief of documents at Tab 10). The email offered its recipients an opportunity to explain if the summary was inaccurate or incomplete. It is not disputed that Casale did not contact Staff for that purpose.

[203] During the Compliance Review, Staff obtained 20 client files pertaining to the 22 Investors. Six of these included Sterling KYC forms signed by clients and dated prior to June 19, 2012. We accept that two of the six Sterling KYC forms appear also to have been signed by Casale on the same day as the client. In our analysis, the signatures on two other Sterling KYC forms relied upon by Staff are either too faint to be reliable or do not include Casale's signature (Exhibit 16 of the Hearing and Review – 3rd Affidavit of Zolis sworn on August 20, 2013 at para. 18; Tabs K and L).

[204] Casale's evidence is that subsequent to Staff's inquiry she was retained by Gingko to act in a purely administrative manner and, as a result, she reviewed the subscription agreements of the 22 Investors after they had already invested (Exhibit 4 of the Hearing and Review - Affidavit of Casale sworn on February 4, 2014 at para. 56). Casale states that in April 2013, at the Casale Interview, she candidly responded in the affirmative to Staff's question concerning her receipt of compensation in respect of the 22 Investors. She further responded that the six investors, whom Staff identified as having Sterling KYC forms dated prior to June 19, 2012, were exempt under the private issuer exemption and she did not effect the sale of securities to any of them or determine if they were qualified to purchase under the exemption.

[205] Casale's correspondence with Staff of July 17, 2012 explicitly states that "Sterling will review its procedures in relation to issuer and dealing filing obligations in relation to private placements to ensure future filings are made in accordance with the requirements of securities law" (Exhibit 21 of the Hearing and Review - Supplementary Brief of documents at Tab 10). Accordingly, we find that the Applicants knew Staff was concerned about their role in the Gingko distributions and at the very least her responses to Staff in the summer of 2012 were not complete. Casale herself signed Sterling KYC forms for investors that were dated before her communications with Staff in June and July of 2012.

[206] Casale offered no explanation for the signatures and dates on the Sterling KYC forms that predated her June 19, 2012 communications with Staff. We could not find an alternative explanation that would be acceptable. It is fundamentally inconsistent for Casale to say that she had no involvement with the 22 Investors before June 2012 and for forms to be signed and dated by her on March 14, 2012 and March 28, 2012. It concerns the Panel that accepting Casale's submission would imply that she backdated documents, which is itself an issue related to her integrity.

[207] As stated above, honesty and candour in dealings with the Commission are a relevant consideration with respect to a registrant's integrity. We find that Casale made misrepresentations to Staff, which impugns her integrity.

(d) Unregistered Trading

[208] In our view, a failure of oversight over trading activities, considered in the totality of the circumstances of this case, bolsters our concerns about the extent to which the Applicants engaged in the responsible conduct expected of registrants.

[209] As stated above, unless exempt, a person or company in Ontario cannot engage in or hold themselves out as engaging in the business of trading in securities unless the person or company is registered and is acting on behalf of a registered dealer (subsection 25(1)(b) of the Act). We note that in *Blueport*, the director suspended an EMD for conduct that was discovered through a compliance review, including trading in securities before being registered (*Blueport* at paras. 15 and 18-19).

[210] At least six clients purchased securities of Redstone from M.L., acting on behalf of Sterling, prior to his being registered with Sterling. At least one of those sales is evidenced by a subscription agreement signed by the investor and M.L. on February 1, 2012, at a time where it appears M.L. was not registered at all (Exhibit 17 of the Hearing and Review - 4th Affidavit of Zolis sworn on August 20, 2013 at para. 7; Tab D).

[211] Between January 1, 2011 and February 2, 2012, at least 11 residents of Alberta and British Columbia completed a Sterling KYC form and their names appeared on Sterling's trade blotter as having invested in Redstone (Exhibit 17 of the Hearing and Review - 4th Affidavit of Zolis sworn on August 20, 2013 at paras. 18 and 19(a); Tabs G and M-W). Sterling was not registered in Alberta or British Columbia until February 2, 2012.

[212] In relation to the trades in Alberta and British Columbia, Casale's evidence is that her role was only administrative, implying that registration was not required, and that she no longer accepts administrative mandates. Casale does not deny that the trades appear on her trade blotter. By her own admission, she allowed others to use Sterling's KYC forms (Exhibit 20 of the Hearing and Review - Transcript of Interview with Grace Casale dated April 16, 2013 at pp.72-73).

[213] We agree with the Director's Decision that both M.L. and Sterling traded in securities without being registered to do so and that some, if not all, of the activities that the Applicants described as administrative, were in fact registerable (Director's Decision, *supra* at paras. 46 and 47). We acknowledge that, as the Applicants remind us, this particular example of non-compliance with Ontario securities law may be distinguishable, in terms of investor harm, from a fraudulent investment scheme. Nonetheless, dealing representatives must be connected to an appropriate compliance structure to ensure that a responsible party has appropriate oversight of the trades conducted. Despite Casale's recognition that ipowerBroker and So sometimes used Sterling's KYC forms, her dismissive approach towards the need to abide by regulatory requirements for oversight of dealers' trading activity with investors is concerning.

[214] In our view, Casale's acceptance of a "dealer after the fact" role shows disregard for regulation and a lack of judgment and responsibility, which impugns her integrity. It is not acceptable to simply hand out Sterling's KYC forms and essentially delegate the suitability assessment obligations of a registrant.

(e) Know-Your-Client and Suitability Obligations

[215] The Commission has repeatedly recognized that the know-your-client and suitability requirements are essential to the investor protection purpose of the Act and "a basic obligation of a registrant" (*Re Daubney* (2008), 31 O.S.C.B. 4817 ("***Daubney***") at para. 15, citing *Re E.A. Manning Ltd.* (1995), 18 O.S.C.B. 5317 at p. 5339). We note that in this section of our decision the term "suitability" refers to a registrant's assessment of whether an investment is suitable for a client and ought not be confused with the overall analysis of the Applicants' suitability for continued registration.

[216] In *Daubney*, the Commission recognized that "KYC" and "suitability" obligations are conceptually distinct, but so closely connected and interwoven that the terms are at times used interchangeably (*Daubney, supra* at para. 16 citing *Re Lamoureux* (2001), ABSECCOM 813127 at p. 10). In that matter, the Commission accepted the Alberta Securities Commission finding in *Lamoureux* that:

> 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.
>
> (*Ibid.*)

[217] The know-your-client requirements are found in subsection 13.2(2) of NI 31-103, which provides:

> **13.2 Know your client** – […]**(2)** A registrant must take reasonable steps to
>
> (a) establish the identity of a client and, if the registrant has cause for concern, make reasonable inquiries as to the reputation of the client,
>
> (b) establish whether the client is an insider of a reporting issuer or any other issuer whose securities are publicly traded,
>
> (c) ensure that it has sufficient information regarding all of the following to enable it to meet its obligations under section 13.3 or, if applicable, the suitability requirement imposed by an SRO:
>
> (i) the client's investment needs and objectives;
>
> (ii) the client's financial circumstances;
>
> (iii) the client's risk tolerance, and
>
> (d) establish the creditworthiness of the client if the registered firm is financing the client's acquisition of a security.

[218] The Companion Policy, 31-103CP, indicates that registrants act as gatekeepers of the integrity of the capital markets and are required to establish the identity of, and conduct due diligence on, their clients.

[219] Subsection 13.3(1) of NI 31-103 describes the suitability obligation as follows:

> **13.3 Suitability –** (1) A registrant must take reasonable steps to ensure that, before it makes a recommendation to or accepts an instruction from a client to buy or sell a security, or makes a purchase or sale of a security for a client's managed account, the purchase or sale is suitable for the client.

[220] It is well established that the Commission has 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 at para. 52; cited in *Daubney, supra* at para. 17, *Sawh, supra* at para. 165 and *North American, supra* at para. 274)

[221] It is worth noting that guidance in section 13.3 of 31-103CP expressly states that registrants may not "delegate their suitability obligations" or "satisfy the suitability obligation by simply disclosing the risks involved with a trade."

[222] The consequence of the requirements in subsection 13.3(1) of NI 31-103 is that a registrant cannot fulfill these obligations by conducting an assessment of suitability after the trade has occurred. Not only does section 13.3 of NI 31-103 expressly say this, but to assess suitability after the securities are sold would undermine the goal of the suitability analysis because the registrant would not actually be matching the product to the client's circumstances, objectives and risk tolerance at the appropriate time. The obligation on the registrant is to make a suitability assessment. The approach employed by the Applicants prevents the application of appropriate judgment in matching a product to a client's circumstances when the investment decision is made.

[223] The Compliance Report indicates at Appendix E that Sterling sold securities of Redstone or Gingko to at least 45 investors in circumstances where the investment may not have been suitable or there was insufficient information to demonstrate suitability. We consider issues raised by the Compliance Report in the following paragraphs.

[224] In her responses to Appendix E of Staff's Compliance Report, which lists 45 investors to whom Sterling sold securities of Redstone or Gingko in circumstances where the investment may not have been suitable or there was insufficient information to demonstrate suitability, Casale repeatedly described how the investors qualified for an exemption as opposed to why the investment was suitable (Exhibit 4 of the Hearing and Review - Affidavit of Casale sworn on February 4, 2014 at para. 89; Tab U). Appendix E is entitled "Failure to meet investment

suitability obligations". We note that the use of the private issuer exemption, for example, does not absolve the registrant of the requirement to conduct a suitability assessment with regard to the investment. For example, in the case of investor P.C., Casale responded to Staff's concerns as follows: "Private Issuer Exemption. Good friend of Edmond So. He has cashed out" (Exhibit 4 of the Hearing and Review - Affidavit of Casale sworn on February 4, 2014 at Tab U). For investor M.R., Casale stated "He owns a gold mine in Africa (Guyana). He owns gold stocks, securities and cash totalling over $1 million and is most definitely accredited" (Exhibit 4 of the Hearing and Review - Affidavit of Casale sworn on February 4, 2014 at Tab U). We agree with the Director's Decision that Casale does not seem to appreciate the importance of determining the suitability of an investment for an investor as a separate process from determining that the investor qualifies for an exemption (Director's Decision, *supra* at para. 46).

[225] We accept that there was at least one instance in which Casale turned away potential LTP investors because she felt that the investment would not be suitable for them. We also accept that Casale has taken steps to update her KYC form and has submitted that she no longer allows others to use the Sterling form, so as to improve her compliance with the KYC requirements.

[226] However, Casale acted as a dealing representative for a number of trades in circumstances where the investors either did not speak to her until after they had made the investment or never spoke to her at all. Such conduct shows a repeated disregard for the purpose of the KYC and suitability obligations of a registrant, and a breach of the duty imposed by section 2.1 of the OSC Rule 31-505 to deal fairly, honestly and in good faith with clients. Clients have a reasonable expectation that registrants are abiding by requirements of registration when they deal with those registrants.

[227] By her own admission Casale misunderstands KYC and suitability obligations. Casale states repeatedly that she acted in a "purely administrative manner" and acted as a "dealer after the fact" (Exhibit 4 of the Hearing and Review - Affidavit of Casale sworn on February 4, 2014 at para. 58; Exhibit 20 of the Hearing and Review - Transcript of Interview with Grace Casale dated April 16, 2013 at pp. 199-200 and 216). What Casale refers to as "taking on historic clients" or "dealer after the fact" is, at best, documenting completed trades of securities without completing a suitability analysis and without regard to the substance of the exercise that the KYC form is intended to accomplish. By her own admission, Casale fulfilled this role of acting as a dealer after the fact in distributions to the 22 Investors and the 19 Investors of Gingko and to the distributions of Redstone securities in Alberta and British Columbia.

[228] Generally, we find Casale's evidence purporting to demonstrate her understanding of how to assess the suitability of an investment to be inadequate. Although the Applicants appear to have cooperated with Staff and made attempts to rectify some deficiencies, such as their undertaking to avoid the practice of acting as "dealer after the fact", we find that their actions demonstrate an insufficient understanding of the regulatory requirements, which is necessary to enable the Applicants to meet them. Filling in a form after the fact does not fulfill the purpose of the legislation, as demonstrated by the Applicants' focus on form over substance with regard to the KYC and suitability requirements. The letters from investors provided to us by Casale acknowledge that those investors were aware that the product sold to them was high risk, but the letters do not speak to her ability to assess the suitability of an investment. As a result, the Applicants lack the requisite proficiency to continue to be registered. We are not confident that the Applicants can meet the KYC and suitability obligations of a registrant at this time.

(f) Reliance on the Accredited Investor Exemption

[229] The Applicants are registered in the category of EMD. Subsection 7.1(2)(d) of NI 31-103 outlines the permissible conduct of an EMD and provides:

> **7.1 Dealer categories –** […] **(2)** A person or company registered in the category of […] (d) exempt market dealer may
>
> (i) act as a dealer by trading a security that is distributed under an exemption from the prospectus requirement, whether or not a prospectus was filed in respect of the distribution,
> (ii) act as a dealer by trading a security that, if the trade were a distribution, would be exempt from the prospectus requirement,
> (iii) receive an order from a client to sell a security that was acquired by the client in a circumstance described in subparagraph (i) or (ii), and may act or solicit in furtherance of receiving such an order, and
> (iv) act as an underwriter in respect of a distribution of securities that is made under an exemption from the prospectus requirement;

[230] In this case, the evidence shows that the Applicants relied heavily on the application of the AI exemption in NI 45-106. Therefore, the legal framework for selling securities pursuant to that exemption is also relevant to our consideration of the Applicants' proficiency for registration. Section 2.3 of NI 45-106 articulates the AI exemption as follows:

> **2.3 Accredited Investor** – (1) The prospectus requirement does not apply to a distribution of a security if the purchaser purchases the security as principal and is an accredited investor.

[231] An "accredited investor" is defined in section 1.1 of NI 45-106 to include, among others:

> (j) an individual who, either alone or with a spouse, beneficially owns financial assets having an aggregate realizable value that before taxes, but net of any related liabilities, exceeds $1 000 000,
>
> (k) an individual whose net income before taxes exceeded $200 000 in each of the 2 most recent calendar years or whose net income before taxes combined with that of a spouse exceeded $300 000 in each of the 2 most recent calendar years and who, in either case, reasonably expects to exceed that net income level in the current calendar year, […]

[232] Importantly, for the purposes of the AI exemption, "financial assets" is considered net of liabilities and does not include real estate holdings. The term "financial assets" is defined in section 1.1 of NI 45-106 to mean:

> (a) cash,
> (b) securities, or
> (c) a contract of insurance, a deposit or an evidence of a deposit that is not a security for the purposes of securities legislation;

[233] Section 1.9 of 45-106CP provides guidance to a person trading in securities as to the availability of the accredited investor exemption:

> In determining whether an exemption is available, a person may rely on factual representations by a purchaser, provided that the person has no reasonable grounds to believe that those representations are false. However, the person distributing or trading securities is responsible for determining whether, given the facts available, the exemption is available. Generally, a person distributing or trading securities under an exemption should retain all necessary documents that show the person properly relied upon the exemption.
>
> […]
>
> Likewise, under the accredited investor exemptions, the seller must have a reasonable belief that the purchaser understands the meaning of the definition of "accredited investor". Prior to discussing the particulars of the investment with the purchaser, the seller should discuss with the purchaser the various criteria for qualifying as an accredited investor and whether the purchaser meets any of the criteria.
>
> It is not appropriate for a person to assume an exemption is available. For instance a seller should not accept a form of subscription agreement that only states that the purchaser is an accredited investor. Rather the seller should request that the purchaser provide the details on how they fit within the accredited investor definition.

[234] Staff referred us to prior decisions in which the director suspended a registration where evidence had shown, among other things, that registrants sold securities pursuant to the AI exemption in circumstances where it did not apply (*FCPF*, *supra* at para. 20; *White Capital*, *supra* at paras. 20 and 34; *Blueport*, *supra* at paras. 14 and 18-19).

[235] As outlined in *Sawh*, an exempt market dealer "should conduct appropriate due diligence on the financial circumstances of a prospective investor prior to making a determination of whether a product can be sold pursuant to the accredited investor exemption" (*Sawh*, *supra* at para. 176).

[236] The Compliance Report states at Appendix D that Sterling sold securities to at least 22 investors on the basis of improper reliance on the AI exemption to the prospectus requirement. For example, investor A.G. did not have relevant information on his KYC form to support reliance on the AI exemption, and when interviewed by Staff he confirmed that he was not an AI and had not spoken to anyone from Sterling prior to investing. Casale's evidence is that investor A.G. cashed out of his investment upon her recommendation as his mental faculties are declining, he has difficulty recalling his financial situation and he now lives in a seniors home, but that nevertheless he is "very much an accredited investor with assets over 1 million dollars" (Exhibit 4 of the Hearing and Review - Affidavit of Casale sworn on February 4, 2014 at Tab P). Casale requests that the Panel recognize that in some instances she has refused to accept investment renewals, because investors did not meet the AI requirements.

[237] Having reviewed Staff's list of 22 investors, who Staff allege either do not qualify for the AI exemption or for whom there is insufficient information to assess qualification, it appears to us that in some cases Casale attempted to ascertain if investors qualified for the exemption, but she fell short. The Sterling KYC form in use at the time of the Compliance Review was not conducive to capturing appropriate AI information because it included real estate as a relevant asset category. We acknowledge that the revised Sterling KYC form may allow for improved information collection as to whether a client is an AI. Nevertheless, the information provided by Casale herself shows repeated examples of Casale confusing the concepts of "net financial assets" required for the application of the AI exemption with an individual's "net worth" as well as the inclusion of real estate as a relevant category for calculation of the financial asset threshold.

[238] We find that Staff's witness at the Hearing and Review, investor D.H., was not forthcoming with Casale. D.H. also admitted that he never told Casale that he had a "side deal" with Van Benthem for his LTP investment funds to flow back to him by way of a loan to his yoga business. We find that D.H. was coached by Van Benthem as to what to say to Casale concerning his assets. Nevertheless, we accept that D.H. did tell Casale about his real estate holdings, which she appears to have counted towards his net financial assets calculation for reliance on the AI exemption. Further, D.H.'s and D.L.'s lack of income should have raised red flags for Casale and she should have followed up on D.L.'s Sterling KYC form, which was incorrectly completed by the investors. Casale's conduct suggests a careless approach to qualifying investors for exemptions. We find that the investors D.H. and D.L. did not qualify for the AI exemption and that Casale did not fulfill her obligation to obtain the necessary detail to support the investors' qualification for the exemption.

[239] The Applicants submitted at the Hearing and Review that, for example, investor P.C. qualified for the AI exemption. They submit that the evidence, which suggests that he qualifies on the basis of owning a company, supports Casale's assessment of his qualification. Casale also collected letters from 18 investors confirming that they were AIs at the time they made their investments through Sterling, at least nine of whom Casale notes were also investors listed in Staff's chart of 22 with respect to improper AI exemption reliance. Although it appears that the investors who provided Casale with letters qualify for the AI exemption, those letters do not address whether the Applicants had sufficient information to assess the investors' qualification for the exemption at the time of the investment.

[240] We find that the Applicants' routine misapplication of the criteria for the AI exemption falls far short of the standards expected of EMDs. While the updated KYC form may mitigate proficiency concerns in some respects, it does not remedy a lack of understanding about which exemptions apply or provide comfort about the ability to correctly apply any new exemptions that may become available. In our view, the evidence shows that Casale is either unable to fully comprehend the AI exemption requirements or unable to apply them consistently with appropriate judgment. Either of these possibilities demonstrates a lack of proficiency.

(g) Know-Your-Product Obligations

[241] We are not satisfied on the evidence that the Applicants fell below the standard required of an EMD with respect to their KYP obligations.

[242] Section 3.4 of NI 31-103 requires registrants to understand the structure, features and risks of each security the registrant recommends. Section 3.4 of 31-103CP describes the know-your-product obligations as follows:

> The requirement to understand the structure, features and risks of each security recommended to a client is a proficiency requirement. This requirement is in addition to the suitability obligation in section 13.3 and applies even where there is an exemption from the suitability obligation such as, for example, the exemption in subsection 13.3(4) in respect of permitted clients.

[243] CSA Staff Notice 33-315 provides additional guidance to registrants on how to meet their suitability and know-your-product obligations. Among other factors registrants should consider when assessing investment products, CSA Staff Notice 33-315 lists consideration of the issuer's financial position and the qualifications, reputation and track record of the fund manager or portfolio manager.

[244] The ability to fulfill the KYP obligation is directly relevant to a registrant's proficiency. In the exempt market, product due diligence is particularly important because securities sold under an exemption "do not benefit from the same transparency and liquidity characteristics or regulatory oversight as other products" (*Sawh, supra* at para. 238).

[245] The Applicants are the conduit through which investors get information about products such as Redstone and Genwealth. Therefore, EMDs such as the Applicants are required to do an independent analysis of the product.

[246] We accept Casale's evidence regarding her knowledge of the Redstone portfolio and the due diligence she exercised in relation to it. In December 2012, Casale was aware that some companies had missed interest payments on their loans from Redstone. By April 2013, Casale had inquired about the status of the loan portfolio and her understanding was that there were two Redstone loan defaults since she had spoken with Staff in 2012. We accept Casale's evidence that she spoke and met regularly with So and asked him how the loans were performing, including whether any were in default.

[247] We also find the evidence of investor M.B. to be credible that: Casale understood the products she was recommending to M.B., could generally answer M.B.'s questions and, if not, Casale would endeavor to obtain the information and inform M.B. (Hearing Transcript dated February 19, 2014 at p.73). M.B. reiterated that Casale did her due diligence on products, knew a lot about them, arranged meetings with Chief Executive Officers and went out of her way to make sure investors were comfortable with the investment (Hearing Transcript dated February 19, 2014 at p. 78). Further, Casale provided us with letters from a number of investors, which confirmed that they acknowledged the products sold by Casale to be high risk.

[248] We are also not persuaded by Staff's submission that Casale did not meet her KYP obligations in respect of Genwealth. Staff's position is based entirely on representations in Genwealth's OM. We received no evidence that supported the submission that Casale misunderstood the structure, features and risks of the product. We also do not have satisfactory evidence that Casale was not aware of the qualifications, reputation and track record of M.L., the fund manager.

[249] In sum, we are not satisfied that the Applicants fell below the required standard of understanding the structure, features and risks of the Redstone and Genwealth securities. In the circumstances, Staff has not satisfied their onus to demonstrate that the Applicants failed to meet their KYP obligations.

(h) UDP and CCO Suitability

[250] We acknowledge that Casale is not seeking to maintain her registration as UDP and CCO. In light of our ultimate order, we make findings in respect of Casale's suitability to be UDP and CCO here.

[251] A UDP is designated pursuant to section 11.2 of NI 31-103, which provides:

> **11.2 Designating an ultimate designated person**
>
> **(1)** A registered firm must designate an individual who is registered under securities legislation in the category of ultimate designated person to perform the functions described in section 5.1 [*responsibilities of the ultimate designated person*].
>
> **(2)** A registered firm must designate an individual under subsection (1) who is one of the following:
>
> (a) the chief executive officer of the registered firm or, if the firm does not have a chief executive officer, an individual acting in a capacity similar to a chief executive officer;
>
> (b) the sole proprietor of the registered firm;
>
> (c) the officer in charge of a division of the registered firm, if the activity that requires the firm to register occurs only within the division and the firm has significant other business activities.
>
> **(3)** If an individual who is registered as a registered firm's ultimate designated person ceases to meet any of the conditions listed in subsection (2), the registered firm must designate another individual to act as its ultimate designated person.

[252] It is explained at section 11.2 of 31-103CP that the intention of the designation requirements for a UDP is to ensure that responsibility for the firm's compliance system rests at the very top of the firm's organizational structure.

[253] The responsibilities of a UDP are found in section 5.1 of NI 31-103, which provides:

> **5.1 Responsibilities of the ultimate designated person -** The ultimate designated person of a registered firm must do all of the following:
>
> (a) supervise the activities of the firm that are directed towards ensuring compliance with securities legislation by the firm and each individual acting on the firm's behalf;
>
> (b) promote compliance by the firm, and individuals acting on its behalf, with securities legislation.

[254] Subsection 11.3 of NI 31-103 similarly provides for designation requirements with regard to the CCO, including that the registered person so designated must be an officer or partner or

the sole proprietor of the registered firm. The responsibilities of a CCO are listed in section 5.2 of NI 31-103 as follows:

> **5.2 Responsibilities of the chief compliance officer –** The chief compliance officer of a registered firm must do all of the following:
>
> (a) establish and maintain policies and procedures for assessing compliance by the firm, and individuals acting on its behalf, with securities legislation;
>
> (b) monitor and assess compliance by the firm, and individuals acting on its behalf, with securities legislation;
>
> (c) report to the ultimate designated person of the firm as soon as possible if the chief compliance officer becomes aware of any circumstances indicating that the firm, or any individual acting on its behalf, may be in non-compliance with securities legislation and any of the following apply:
>
> (i) the non-compliance creates, in the opinion of a reasonable person, a risk of harm to a client;
>
> (ii) the non-compliance creates, in the opinion of a reasonable person, a risk of harm to the capital markets;
>
> (iii) the non-compliance is part of a pattern of non-compliance;
>
> (d) submit an annual report to the firm's board of directors, or individuals acting in a similar capacity for the firm, for the purpose of assessing compliance by the firm, and individuals acting on its behalf, with securities legislation.

[255] Consequently, the UDP and CCO roles are critical to securities law compliance oversight. Subsection 3.4(1) of NI 31-103, which sets out the proficiency requirements to be registered, establishes that a registrant must not engage in registerable activity unless he or she has "education, training and experience that a reasonable person would consider necessary to perform the activity competently" [emphasis added]. As a result, a registrant should not assume the role of UDP and/or CCO unless he or she is able to exercise the diligence and judgment required to fulfill the specific requirements of these roles. While the legislation accommodates different sizes of firms and levels of resources, including instances where one person fulfills multiple roles, that should not be used as an excuse for non-compliance with the regulatory requirements.

[256] At the very least, the UDP and CCO of a registered firm should be familiar with the regulations and the compliance policies and procedures of his or her own firm in order to adequately monitor registerable activities. Despite the clear procedure for dealing with conflicts of interest outlined in the Sterling Compliance Manual, Casale, in her capacity as CCO and UDP, did not identify Sterling's indebtedness to Redstone or M.L.'s active participation in Genwealth's management as potential conflicts at a time when Sterling was selling both of those securities. Similarly, Casale also acquiesced in the firm's "dealer after the fact" role in documenting sales of securities after they had been completed and without regard to the necessary suitability assessment requirements which should have preceded the sales.

[257] As the UDP, CCO, sole dealing representative, sole shareholder and directing mind of Sterling, Casale failed to create and maintain an appropriate compliance regime that demonstrated she understood the substance of the regulatory requirements. Although Sterling did have a Compliance Manual, she either did not apply or implement the policies and procedures set

out therein, or applied them in a cursory fashion, apparently without regard to the regulatory objectives sought to be achieved. In addition, the responsibility to maintain and report regulatory capital and to ensure appropriate registrations of the firm and its employees, the failures of which we have already addressed at paragraphs [192] to [198] and [208] to [214] above, falls squarely within the roles of UDP and CCO. This leads us to doubt Casale's ability to understand and comply with Ontario securities law requirements on an ongoing basis.

[258] In addition, the fact that Casale assumed the roles of UDP and CCO without appreciation for how to fulfill these roles is evidence of her lack of proficiency and, therefore, suitability for continued registration in these roles. Furthermore, having concluded in paragraphs [259] and [260] that Casale lacks integrity and proficiency as a dealing representative, we are unable to foresee a situation in which she would be sufficiently proficient to supervise the compliance of others.

4. Findings on the Continued Suitability of the Applicants

[259] We find that the Applicants' failure to appropriately identify and disclose the conflicts or potential conflicts of interest resulting from their relationships with issuers on whose behalf they sell or have sold securities does not meet the "high standards of fitness and business conduct to ensure honest and responsible conduct by market participants" (subsection 2.1(2)(iii) of the Act) and does not fulfill the requirement to deal fairly, honestly and in good faith with clients (section 2.1 of the OSC Rule 31-505). The Applicants' failure to report and be forthright with Staff about their working capital deficiencies demonstrates a lack of integrity. Furthermore, Casale impugned her integrity by making misrepresentations to Staff with respect to (i) Sterling's capital deficiencies in April and May 2012, as well as (ii) the Applicants' involvement in the Gingko distribution to the 22 Investors. Finally, the Applicants' lack of compliance with the requirement to be appropriately registered to engage in trading activities is a further example of a lack of responsible conduct, which contributes to our concerns about the Applicants' integrity. Taken as a whole, these issues cause us significant concern with regard to the Applicants' suitability for continued registration.

[260] The Applicants failed to demonstrate an adequate understanding of the proper fulfilment of KYC and suitability obligations or how to assess whether investors qualified for exemptions. As a result of the Applicants' failure to meet their know-your-client and suitability obligations and failure to properly apply the AI exemption, some of their clients invested in high risk exempt products that were either not suitable or for which the Applicants had insufficient information to determine suitability. We find that these failures were not isolated or purely administrative, but reflected a lack of comprehension about the purpose and objectives of the regulations and therefore a lack of proficiency. This concern is exacerbated by the willingness of Casale and Sterling to perform "dealer after the fact" roles, which amounts to an abdication of the investor protection objectives of Ontario securities law. We find that the Applicants do not have the proficiency to continue being registered.

[261] Viewed in its entirety, the evidence shows that the Applicants fell below the standards required of registrants. The testimony of M.B. and the investors' letters of risk acknowledgement reveal that Casale, on behalf of Sterling, had successfully developed professional relationships with a number of clients. Unfortunately, neither of the Applicants exercised the required level of judgment and responsibility to consistently uphold the regulatory requirements concerning the

obligations of registrants to their clients. In sum, we find that the Applicants lack the integrity and proficiency to continue being registered.

C. Have the Applicants Failed to Comply with Ontario Securities Law?

1. The Law and Analysis on Compliance of Applicants with Ontario Securities Law

[262] As noted in paragraph [147], section 28 of the Act provides, as an independent basis for revoking or suspending or imposing terms and conditions upon registration, the fact that a registrant has failed to comply with Ontario securities law. This ground therefore focuses on an inquiry into compliance or non-compliance with the law, rather than into dimensions of the integrity or proficiency of the registrant. The regulatory objective is that compliance with Ontario securities law is to be expected of those who are suitable for continued registration.

[263] In particular, the legislature has directly turned its attention to the importance of compliance by registrants in section 32 of the Act, which articulates in detail a registrant's duty to comply with Ontario securities law. Section 32 of the Act provides:

> **32. (1) Duty to comply with Ontario securities law –** Every person and company registered under this Act shall comply at all times with Ontario securities law, including such regulations that apply to them as may be made relating to,
>
> (a) proficiency standards;
>
> (b) business conduct;
>
> (c) in the case of a registrant that is a registered dealer, registered adviser or registered investment fund manager, submission of information respecting ownership, management, directors, officers and any other persons or companies exercising control of the registrant;
>
> (d) opening accounts and reporting trades;
>
> (e) record-keeping;
>
> (f) custody of clients' assets;
>
> (g) conflicts of interest;
>
> (h) tied selling and referral arrangements;
>
> (i) client complaints;
>
> (j) appointment of auditors and preparation and filing of financial information;
>
> (k) procedures to be followed when a relationship is terminated between a representative and a registered dealer or registered adviser or when the representative commences a new association with a different registered dealer or registered adviser; and
>
> (l) reinstatement of registration.

[264] As stated above, "Ontario securities law" includes the Act, regulations made under the Act, which include rules, and a decision of the Commission or of a Director to which a person or

company is subject (subsection 1(1) of the Act). On September 18, 2009, by Ministerial approval, NI 31-103 became a Rule under the Act and therefore forms part of Ontario securities law (Approval of NI 31-103, *supra*; subsection 1(1) of the Act).

[265] Registration is a privilege, not a right, that is granted to individuals and entities that have demonstrated their suitability for registration (see *Trend*, *supra*; *Istanbul*, *supra* at para. 60; *Sawh*, *supra* at para. 142). Upon being granted registration by the Commission, the registrant assumes the duty to comply articulated in section 32 of the Act and should conduct him or herself accordingly to ensure continual maintenance of the standards expected of a registrant.

[266] It should be noted that pursuant to section 31 of the Act, the Director shall not impose terms and conditions or suspend or revoke the registration of the person or company under section 28 of the Act without giving that person or company an OTBH. The standard of proof is the civil standard on a balance of probabilities. Section 28 of the Act itself contains the remedies that are available following a finding of non-compliance, i.e. revoking or suspending registration or imposing terms and conditions.

[267] The Compliance Report cited a number of instances of non-compliance with Ontario securities law. Staff did not make detailed submissions on the application of this aspect of section 28 of the Act. Nonetheless, counsel for the Applicants acknowledged that non-compliance was a ground for a remedy pursuant to section 28 of the Act and the Director's Decision makes findings of non-compliance concerning conduct relating to conflicts of interest and unreported capital deficiencies (Director's Decision, *supra* at paras. 43 and 44). We consider two examples of non-compliance with Ontario securities law below.

(a) Conflicts of Interest

[268] The Applicants were required to comply with section 13.4 of NI 31-103. This provision requires a registered firm to take reasonable steps to identify material conflicts of interest between the firm and a client, to respond to and to disclose such a conflict of interest to the client in a timely manner, if a reasonable investor would expect to be informed of the conflict. In our view the Redstone Loans and the Genwealth Conflict were material conflicts of interest between Sterling and its clients. Redstone provided loans to Sterling that enabled it to remedy a capital deficiency at the same time that Sterling was selling Redstone securities to its clients. Similarly, M.L.'s role in Genwealth created a potential for conflict of interest with respect to his sale of Genwealth securities to Sterling's clients. Both of these were conflicts that a reasonable investor would expect to be informed of when purchasing Redstone or Genwealth securities and ought to have been identified, responded to and disclosed by the Applicants. We find that the Applicants did not do so and, therefore, we agree with the Director's Decision that the Applicants failed to comply with section 13.4 of NI 31-103 and section 2.1 of OSC Rule 31-505 (Director's Decision, *supra* at para. 43).

(b) Failure to Report Capital Deficiencies

[269] As stated above, subsection 12.1(1) of NI 31-103 expressly requires a registered firm to report excess working capital less than zero. Subsection 12.1(2) of NI 31-103 requires that excess working capital, calculated in accordance with Form 31-103F1 *Calculation of Excess Working Capital*, must not be less than zero for two consecutive days. The purpose of the

reporting requirement is for a registrant to maintain the expected minimum capital prescribed by subsection 12.1(3) of NI 31-103, which in this case is $50,000.

[270] On October 11, 2011, Staff informed the Applicants that Sterling was capital deficient by $97,512, based on the firm's audited financial statements as at December 31, 2010. On October 21, 2011, Staff notified the Applicants that it had recommended that Sterling's registration be suspended due to its capital deficiencies as of December 31, 2010 and September 30, 2011 and its failure to report those deficiencies to Staff as required by law. On October 24, 2011, Staff and Casale agreed that if she injected the requisite funds into Sterling, Staff would withdraw its recommendation and Casale did so.

[271] On November 18, 2011, after Sterling rectified the above mentioned capital deficiency, Casale consented to the imposition of terms and conditions on Sterling's registration for a period of six months, including a requirement of specified monthly financial reporting to the Commission from October 2011 to March 2012.

[272] On March 30, 2012, Sterling filed audited financial statements and a Form 31-103, required within 90 days of its fiscal year end. These show that Sterling had a working capital deficiency of $7,403 as at December 31, 2011. On July 31, 2012, Staff informed Casale of Sterling's December 31, 2011 capital deficiency. Casale responded that Sterling had met working capital requirements from January through March 2012.

[273] Immediately after the terms and conditions requiring monthly reporting ceased in March 2012, Sterling's excess working capital became deficient for two months and Staff was not notified. During the Compliance Review, on February 6, 2013, Casale informed Staff that Sterling had been capital deficient in April (-$12,687) and May (-$20,040) 2012. In our view, given the previous terms and conditions imposed on Sterling by Staff in November 2011, Casale had been given ample opportunity to build a process at Sterling for reporting capital deficiencies as required by NI 31-103.

[274] We find that she failed to disclose Sterling's capital deficiencies as required. Therefore, we agree with the Director's Decision that the Applicants failed to comply with 12.1 of NI 31-103 (Director's Decision, *supra* at para. 44). We find that the Applicants' repeated failures to disclose capital deficiencies demonstrate a troubling pattern of non-compliance with Ontario securities law.

2. Findings on the Applicants' Failure to Comply

[275] We find that the Applicants' failure to appropriately identify, respond to and disclose conflicts or potential conflicts of interest and their repeated failure to report capital deficiencies demonstrate a pattern of non-compliance with Ontario securities law, which is not appropriate for registrants (*Waterview, supra* at para. 22, citing *Carter, supra*).

[276] In light of our findings on the unsuitability of the Applicants for continued registration and our analysis of non-compliance by the Applicants in relation to conflicts of interest and failure to report capital deficiencies, we do not find it necessary to embark upon further analysis of other potential examples of failure to comply with Ontario securities law.

D. Is Continued Registration of the Applicants Otherwise Objectionable?

[277] Staff submits, in addition to its argument that the Applicants are not suitable for continued registration and did not comply with Ontario securities law, that the Applicants' registrations should be suspended because their registrations would be "objectionable". Staff argues that in light of the compliance deficiencies, continued registration of the Applicants runs counter to the Commission's mandate to protect investors and foster fair and efficient capital markets (section 1.1 of the Act). Therefore, continued registration of the Applicants is otherwise objectionable pursuant to subsection 28(b) of the Act (*Sawh, supra* at para. 289). The Applicants did not make detailed submissions on this issue.

[278] In light of our findings with respect to the Applicants' lack of suitability to be registered and their failure to comply with Ontario securities law, it is not necessary, in our view, to deal with the issue of whether the continued registration of the Applicants is otherwise objectionable.

E. What is the Appropriate Remedy?

[279] In coming to our decision, we considered the previous Commission decisions referred to us by the Applicants and Staff, which, they argue, involve conduct similar to the circumstances of this case. We are mindful that our discretion in the public interest is to be exercised prospectively to protect the public and the integrity of the capital markets and not to punish (*Mithras, supra* at pp. 1610-1611). In our view, our findings above provide a firm basis to take steps to protect the public interest.

[280] Our findings that the Applicants are not suitable for continued registration are premised upon a lack of integrity demonstrated by: (a) lack of judgment and good faith in considering the interests of clients in identifying and disclosing conflicts of interest; (b) the Applicants' failure to be forthright with Staff about their capital position; (c) Casale's misrepresentations to Staff concerning her involvement in sales of Gingko securities to the 22 Investors; and (d) the Applicants' disregard for regulation by accepting a "dealer after the fact" role that essentially delegated their investment suitability obligations to others. Furthermore, we found that the Applicants failed to meet their KYC and investment suitability obligations, and routinely misapplied the AI exemption. Also, the evidence supports a pattern of non-compliance by the Applicants with Ontario securities law. All this contributes to our conclusion that the Applicants are not suitable for continued registration and are factors for consideration in determining appropriate remedies.

[281] The Applicants put forward the Commission's decision in *Kingsmont* as a factually similar matter. In *Kingsmont*, Staff identified compliance deficiencies from their review of the EMD, including: insufficient collection of KYC information, insufficient KYP due diligence, unsuitable investments and trading without registration (*Kingsmont, supra* at para. 14). *Kingsmont* was also a one-person firm with the dealing representative, Mr. Warner, serving as CCO and UDP; both positions he proposed to surrender (*Kingsmont, supra* at paras. 10 and 16-17). The director reduced Staff's recommended advising representative suspension period to six months because, in her opinion, the majority of the integrity deficiencies raised by Staff were related to proficiency of the UDP and CCO, which was outside the scope of the Opportunity to Be Heard (*Kingsmont, supra* at paras. 8, 30 and 42). Therefore, in *Kingsmont* the director imposed a suspension of registration solely on integrity grounds.

[282] We find that the present case may be distinguished from *Kingsmont* because the scope of the ultimate decision in *Kingsmont* was considerably narrower than the one here. In our view, the issues and findings in the present matter are more numerous and significant that in *Kingsmont*. In this matter we made findings which addressed both the proficiency and integrity of the Applicants, as well as examples of non-compliance with Ontario securities law, and determined that they were not suitable for continued registration on several grounds. In *Kingsmont*, the director considered only two issues relating to the registrant's integrity; a failure to disclose a complaint during the compliance review and an inappropriate disclaimer of liability. Neither of those issues assist us in this matter. The *Kingsmont* decision also did not consider continued registration of the firm or of the principal's status as a dealing representative.

[283] *White Capital* was also a matter in which the owner, Mr. White, acted as UDP, CCO and a dealing representative of the registered firm (*White Capital*, *supra* at para. 5). Staff submits that the remedies recommended in this case are consistent with those agreed to in *White Capital*, in circumstances where there were similar compliance deficiencies by an EMD. These include findings in relation to conflicts of interest and failure to meet KYC and suitability obligations (*White Capital, supra* at paras. 13, 19 and 21). In *White Capital*, the director prohibited the individual registrant from becoming a dealing representative for a period of 18 months based on the joint recommendation of Staff and the registrant (*White Capital, supra* in Addendum). However, the present case involves multiple serious examples of unsuitability for registration and failure to comply with Ontario securities law. In our view, our findings support a longer ban for Casale as compared to the principal in *White Capital*.

[284] We acknowledge that no losses sustained by investors were brought to our attention and a considerable number of supportive statements were provided to us from the Applicants' clients. In considering the Applicants' position that previously acknowledged failures have been or will be rectified in the future, including revisions to the Sterling KYC form and Casale's willingness to relinquish the UDP and CCO roles, we find that the Applicants had ample opportunity over the course of several years to properly remedy concerns raised by Staff and they did not. Staff provided the Applicants with opportunities to address non-compliance on at least two occasions. First, on November 18, 2011, after Sterling rectified a previous capital deficiency, Casale consented to the imposition of terms and conditions on Sterling's registration for a period of six months. Second, Staff refrained from recommending that additional terms and conditions be imposed on Sterling for the December 31, 2011 capital deficiency because Casale demonstrated that Sterling met working capital requirements in January, February, March and June 2012. The repeated failure to address certain significant deficiencies undermines the Applicants' submissions that they will change their behavior to conform to requirements of Ontario securities law.

[285] We recognize that the Applicants also made submissions on the impact of the Investor Alert in assessing appropriate regulatory responses and we have taken her submissions about the impact of the Investor Alert into account in considering the appropriate response in this case. We note that five of the investor alerts pointed to by Casale are similar in content to the Investor Alert and notify the public that the Commission has suspended the registration of one or more persons or entities, notwithstanding Casale's position that the other investor alerts focus on boiler rooms and fraud (Exhibit 4 of the Hearing and Review - Affidavit of Casale sworn on February 4, 2014 at para. 26, Tab I).

[286] Mindful of the prospective nature of our public interest discretion and upon considering the factors and cases above, we find that Sterling's registration and Casale's registration as UDP and CCO should be permanently suspended. We have serious concerns about the firm's integrity, proficiency and pattern of non-compliance with Ontario securities law. Likewise, we agree with Staff that Casale is not suitable to act as UDP or CCO of a registrant.

[287] Further, in light of our concerns surrounding Casale's integrity and proficiency to act as a registrant and her failure to comply with Ontario securities law, we agree with the outcome of the Director's Decision. We find that Casale' registration as a dealing representative should be suspended and she should not be permitted to apply for reinstatement for a period of two years. Before applying for reinstatement of her registration, Casale must successfully complete the *Conduct and Practices Handbook Course*. In the event that Casale's registration is reinstated, her registration ought to be subject to terms and conditions requiring her strict supervision for a period of one year. Lastly, Casale shall not be a permitted individual of a registered firm for a period of five years.

[288] A "permitted individual" is defined at section 1.1 of NI-33-109 as:

> "permitted individual" means an individual who is
>
> (a) a director, chief executive officer, chief financial officer, or chief operating officer of a firm, or who performs the functional equivalent of any of those positions, or
>
> (b) an individual who has beneficial ownership of, or direct or indirect control or direction over, 10 percent or more of the voting securities of a firm;

[289] In our view, the remedies identified above are protective and preventive in nature, appropriate in the circumstances and are in the public interest.

VII. CONCLUSION

[290] Pursuant to section 28 of the Act, the Director may revoke, suspend or impose terms and conditions on a registration if it appears that the person or company is not suitable or has failed to comply with Ontario securities law or that the registration is otherwise objectionable. Staff has satisfied the Panel on a balance of probabilities that the Applicants are not suitable for registration. We were also satisfied that the Applicants failed to comply with Ontario securities law. Therefore, the Director appropriately exercised her discretion pursuant to subsection 28(a) of the Act.

[291] In coming to our decision, we considered the Commission decisions referred to us and find that the evidence presented to us at the Hearing and Review warrants the exercise of the Commission's jurisdiction to suspend the Applicants' registrations and impose terms and conditions upon them.

[292] Accordingly, we dismiss the Application and order the following:

(a) the registration of Sterling is permanently suspended;

(b) the registration of Casale as UDP and CCO is permanently suspended;

(c) the registration of Casale as dealing representative is suspended and she is not permitted to apply for reinstatement for a period of two years;

(d) Casale shall successfully complete the *Conduct and Practices Handbook Course* before applying for reinstatement of registration;

(e) in the event that Casale's registration is reinstated, her registration is subject to terms and conditions requiring her strict supervision for a period of one year; and

(f) Casale shall not be a permitted individual of a registered firm for a period of five years.

DATED at Toronto this 3rd day of September, 2014.

"Mary G. Condon"

Mary G. Condon

"Judith N. Robertson"

Judith N. Robertson

"Deborah Leckman"

Deborah Leckman