



Ontario
Securities
Commission
3S8

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**IN THE MATTER OF
QUESTRADE WEALTH MANAGEMENT INC.**

STATEMENT OF ALLEGATIONS

(Subsection 127(1) and Section 127.1 of the *Securities Act*, RSO 1990 c S.5)

A. ORDER SOUGHT

1. Staff of the Enforcement Branch (“**Enforcement Staff**”) of the Ontario Securities Commission (the “**Commission**”) request that the Commission make an order pursuant to subsection 127(1) and (2) and section 127.1 of the *Securities Act*, RSO 1990 c S.5 (the “**Act**”) to approve the settlement agreement dated November 20, 2018 between Enforcement Staff and Questrade Wealth Management Inc. (the “**Respondent**”).

B. FACTS

(a) Overview

2. It is essential to investor protection and market integrity that registered Portfolio Managers (“**PMs**”) diligently identify and respond to conflicts of interest pursuant to their obligations under section 13.4 of National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*. PMs must have in place proper procedures to anticipate and respond in advance to conflicts of interest that may arise. They must take reasonable steps to identify and respond to a conflict of interest before investing client money so as to ensure that they are acting in the best interest of their clients. PMs who are not able to demonstrate that they took appropriate steps to identify and respond to conflicts of interest will face regulatory consequences.

3. On July 27, 2017 Questrade Wealth Management Inc. (“**Questrade**”) and WisdomTree Asset Management Canada, Inc. (“**WisdomTree**”) announced that they and their affiliates had entered into three strategic agreements.

a. WisdomTree agreed to purchase eight exchange-traded funds (“**ETFs**”) managed by Questrade (the “**Transaction**”).

- b. As part of the Transaction WisdomTree's affiliate was to become a consultant for Questrade's Portfolio IQ ("**PIQ**"), a managed online investment service. At the time, Questrade acted as PM with discretionary authority to invest over \$60 million entrusted to it by its PIQ clients. One Capital Management LLC ("**OCM**") acted as a registered sub-advisor to Questrade and provided investment advice for managing the PIQ portfolios.
 - c. Finally, WisdomTree was announced as the premier provider of ETFs offered by Questrade's affiliate, which agreed to jointly market WisdomTree's ETFs to investors pursuant to a Joint Marketing Agreement.
4. The day after the announcement, Questrade purchased approximately \$15 million in WisdomTree ETFs for the PIQ portfolios (the "**July Trade**"). In the context of the Transaction, this significant purchase of WisdomTree ETFs required Questrade to determine if a conflict of interest existed between Questrade and its clients.
 5. During the negotiation of the Transaction, WisdomTree had advised that it wanted Questrade's agreement that WisdomTree ETFs would be purchased for the PIQ portfolios before it would finalize the Transaction. Questrade refused, telling WisdomTree that the WisdomTree ETFs would not be included in the PIQ portfolios unless OCM determined that such a purchase was, as described by Questrade, "in the best interest" of the PIQ clients.
 6. Before the Transaction was finalized, OCM advised WisdomTree that it would recommend including significant amounts of WisdomTree ETFs for the PIQ portfolios. At the time of this recommendation, however, OCM's PM had not documented why it believed the WisdomTree ETFs were in the best interest of the PIQ clients. Questrade's senior management was advised of OCM's recommendation but did not obtain any supporting documentation about the suitability of the WisdomTree ETFs at this time.
 7. The day that the Transaction was finalized, WisdomTree asked that the July Trade be carried out. The next day, OCM sent instructions asking Questrade to execute the July Trade before the end of the day. Aside from its senior management, none of Questrade's staff had any prior knowledge that OCM was planning to recommend such a significant trade.

8. As PM of the PIQ portfolios, Questrade was ultimately responsible for determining whether the July Trade was suitable and that it did not conflict with the interests of its PIQ clients. To that end, Questrade relied upon OCM's recommendation of the WisdomTree ETFs for the PIQ portfolio.

9. Given OCM's request to execute the trade quickly, Questrade's staff did not wait to receive any due diligence documents from OCM and relied only upon OCM's oral assurances. Questrade also failed to document why it determined no conflict of interest arose from the July Trade until approximately a month after the July Trade, contrary to its own policies.

10. In the context of the Transaction, Questrade's review of the July Trade failed to meet the high standard of conduct that is expected of a registrant in taking appropriate steps to ensure that the July Trade was suitable for its clients, and that it did not create a conflict of interest, which potentially put its PIQ clients at risk and was contrary to the public interest.

(b) The Parties

11. Questrade is an Ontario corporation with its head office in Toronto, Ontario. It is registered with the Commission as an Investment Fund Manager ("IFM"), an Exempt Market Dealer ("EMD") and a PM. As a PM, Questrade has discretionary trading authority over the accounts of its PIQ clients.

12. Questrade was the trustee, manager and PM of eight ETFs, which were established under the laws of Ontario. Each of the Questrade ETFs was an exchange-traded mutual fund.

13. Before it sold the Questrade ETFs, Questrade's two primary lines of business were managing the Questrade ETFs and acting as the PM for PIQ.

14. Questrade, Inc. is an Ontario corporation with its head office in Toronto, Ontario. It is registered with the Commission as an Investment Dealer. Questrade, Inc. is a member of the Investment Industry Regulatory Organization of Canada.

15. Questrade and Questrade, Inc. are wholly owned subsidiaries of Questrade Financial Group Inc.

16. OCM is a corporation formed pursuant to the laws of Nevada, with its head office in Westlake Village, California. It is registered with the Commission as a PM in Ontario, subject to terms and conditions as a foreign advisor.

17. OCM has been engaged by Questrade to act as sub-advisor for the PIQ portfolios since PIQ's inception in 2014. OCM was also the sub-advisor to one of the Questrade ETFs that were the subject of the Transaction.

18. WisdomTree is an Ontario Corporation with its head office in Toronto, Ontario. WisdomTree is a wholly-owned subsidiary of WisdomTree Investments, Inc., a U.S. public company. WisdomTree is registered as an IFM and EMD in Ontario.

19. As a result of the Transaction, WisdomTree became the IFM for the Questrade ETFs as of December 6, 2017. Seven of the Questrade ETFs merged into existing ETFs managed by WisdomTree, and WisdomTree became the trustee and manager for one of the Questrade ETFs. Questrade is no longer the trustee or manager for any of the Questrade ETFs.

(c) Management of PIQ

20. In late 2013, Questrade began its search for a sub-advisor to provide sub-advisory services for its new PIQ. Ultimately, Questrade engaged OCM, pursuant to a sub-advisory agreement dated October 3, 2014, having determined that OCM had the requisite expertise and performance history to manage and make investment decisions in the best interest of the PIQ clients.

Pursuant to the sub-advisory agreement, OCM provides day-to-day sub-advisory services to Questrade, which includes regularly monitoring and assessing the portfolios' constitution, the appropriateness of holdings within each respective portfolio, as well as determining any proposed changes to the model portfolio and communicating such changes to Questrade.

21. Questrade is ultimately responsible for determining whether trades are suitable for its investors in regard to the PIQ portfolios for which OCM provides sub-advisory services. Questrade is also ultimately responsible for identifying and responding to conflicts of interest related to the PIQ portfolios. OCM instructs Questrade on changes to be made to the PIQ portfolios. Questrade supervises OCM's portfolio management and investment decisions, and a Questrade PM evaluates all trades before they are executed.

(d) The Negotiation and Agreements with WisdomTree

22. From November 2016 to July 2017, Questrade and WisdomTree negotiated the terms of the Transaction.

23. Questrade and WisdomTree agreed that prior to concluding the Transaction, WisdomTree would meet with OCM to discuss the potential purchase of WisdomTree ETFs in the PIQ portfolios. WisdomTree expected that, should the WisdomTree ETFs' methodology and/or performance merit inclusion, the WisdomTree ETFs would be included in the PIQ portfolios.

24. WisdomTree's representative advised that he needed OCM's confirmation about a purchase of WisdomTree ETFs before he could sign the Transaction agreements.

25. In May 2017, there was a call between OCM, Questrade and WisdomTree to discuss the Transaction. During that call, there was some discussion about including WisdomTree ETFs in the PIQ portfolios. OCM indicated to WisdomTree that they would "make it work" as long as including the WisdomTree ETFs was in the "best interests" of the PIQ clients.

26. In July 2017, following discussions between OCM and WisdomTree about the WisdomTree ETFs, OCM advised WisdomTree that it intended to hold 94% of PIQ's fixed income assets and 70-75% of its equity assets in WisdomTree ETFs. WisdomTree's fixed income exchange traded funds had been launched only one month earlier. OCM's PM did not produce any written analysis explaining why it asserted each of the WisdomTree ETFs was in the best interest of the PIQ clients.

27. By July 19, 2017, Questrade's senior management was advised that OCM would recommend significant investments in WisdomTree ETFs. However, Questrade's ordinary compliance process was not followed as Questrade's senior management did not obtain any analysis prior to the July Trade as to why the recommended WisdomTree ETFs were suitable, and the PM was not advised of OCM's intention to make these significant changes to the PIQ portfolios until July 27, 2017.

28. Three agreements were ultimately concluded on July 26, 2017 and announced in press releases the following day:

- (a) a Purchase and Sale Agreement whereby WisdomTree agreed to acquire the rights to act as a trustee and manager of the eight Questrade ETFs for approximately \$2.4 million;
- (b) a Consulting Agreement pursuant to which a WisdomTree affiliate would provide educational and related information to OCM and Questrade would facilitate quarterly meetings between the WisdomTree affiliate and OCM;
- (c) a Joint Marketing Agreement pursuant to which WisdomTree and Questrade Inc. would jointly market WisdomTree ETFs to investors.

29. Under the provisions of the Joint Marketing Agreement, Questrade, Inc. was to be reimbursed for a portion of certain joint marketing expenses. The amount of these reimbursements was conditional on, among other things, the amount of WisdomTree ETFs held by Questrade, Inc. clients or PIQ clients. As well, Questrade, Inc. agreed to repay these reimbursements if certain growth targets for holdings of WisdomTree ETFs were not met (the “**Reimbursement Provisions**”). Questrade Inc. has not received any reimbursements pursuant to the Joint Marketing Agreement.

(e) The July Trade: PIQ Portfolios’ Investments in WisdomTree ETFs

30. On Tuesday, July 25, 2017, two days before the press releases were issued, the parties had agreed upon the final form of the Transaction agreements.

31. On the same day, WisdomTree emailed Questrade’s management and asked Questrade to start the July Trade on July 26, 2017 or July 27, 2017. The email advised that OCM and WisdomTree’s teams were both on standby to help execute the trades.

32. Aside from its senior management, none of Questrade’s staff had any prior knowledge that OCM was planning to recommend the trade.

33. Questrade agreed to get the trade started the next day, and to this end, an internal email was sent confirming that the Transaction agreements were finalized and asking Questrade’s in-house counsel to prepare for the trades “tomorrow first thing.” Questrade’s PM was not copied on this internal email.

34. On Thursday, July 27 at 2:35 pm, OCM sent instructions for the July Trade to Questrade's PM, which it requested be executed by the end of the day. This involved selling iShares fixed income ETFs and replacing them with approximately \$15 million in WisdomTree ETFs, which represented 23% of the PIQ portfolio. Given the size and nature of the trade, Questrade's PM emailed his supervisor about the trade immediately after receiving the request from OCM.

35. When Questrade's PM's supervisor did not respond, the Questrade PM notified Questrade's CCO, flagging the Transaction and noting that the management expense ratios for the new WisdomTree ETFs were higher and the spreads were wider than those of the iShares fixed income ETFs. The Questrade PM then arranged two calls with the OCM PM to get more information about the July Trade and to understand its rationale.

36. The Questrade PM reviewed the trade for suitability. He had another call with OCM's PM regarding the rationale for the trade.

37. Questrade had not received any due diligence documents from OCM by the time OCM gave instructions to make the July Trade. The Questrade PM requested due diligence documents supporting the trade.

38. OCM assured the Questrade PM over the phone that OCM had a research note prepared. Although the research note was requested, this document was not provided to Questrade until July 30, 2017, after the July Trade had been executed. At the time of the July Trade, Questrade did not have any written analysis as to why the trade was suitable.

39. On July 28, 2017, Questrade's CCO reviewed the proposed trade and OCM's stated rationale for it, and discussed it with Questrade's CEO and CFO. The CCO obtained OCM's confirmation that the recommendation was coming independently from OCM and that it would have been made regardless of the Transaction. Questrade relied on the experience and expertise of OCM and its explanation for the trade in reaching its conclusion that the July Trade was in the best interest of PIQ clients. Questrade concluded that OCM's rationale for the request was an appropriate basis for the trade.

40. Having concluded that the instruction for the July Trade had been made independently by OCM and that it was not influenced by the Transaction, Questrade's CCO determined that there

was no conflict of interest. Questrade approved the July Trade but the reasons for the determination that there was no conflict of interest were not documented until August 22, 2017.

41. The July Trade was executed on the afternoon of July 28, 2017.

(f) Withdrawal of Proposed August Trades

42. On August 3, 2017, OCM sent Questrade instructions for a PIQ trade replacing iShares equity ETFs with WisdomTree equity ETFs (the “**Proposed August Trade**”), which it asked to be executed by the end of the day. This trade would have resulted in a significant increase in WisdomTree ETFs in the PIQ portfolios, which would have represented 39% of the total PIQ portfolio. Prior to receiving this direction, Questrade’s PM had no prior knowledge that the Proposed August Trade was being planned.

43. In light of the July Trade, Questrade’s PM requested the rationale behind the Proposed August Trade. The request was escalated to Questrade’s CCO, who reviewed the request and expressed concerns over the timing and size of the Proposed August Trade. Given how quickly OCM was recommending the change, and in light of the recent July Trade and the increased concentration in Wisdom Tree ETFs after the Transaction, the CCO had a concern that the Proposed August Trade could have the appearance of a conflict of interest. She discussed her concern with OCM, and based on those discussions, OCM withdrew the instructions for the Proposed August Trade.

44. The Proposed August Trade caused Questrade to review how it assessed the July Trade. On August 4, 2017, at the request of Questrade, OCM completed a compliance certification with respect to the July Trade, certifying it had acted in the best interests of clients and fulfilled its obligations of fair dealing.

45. On August 22, 2017, Questrade completed a post-trade review of the July Trade and provided a written opinion that the July Trade was “completed in the normal course of business achieving [Questrade’s] obligation to act in the best interest of its clients”.

(g) Reimbursement under the JMA

46. On January 23, 2018 and April 10, 2018, Questrade, Inc. and WisdomTree held joint educational webinars pursuant to the JMA. Aside from these two webinars, no other educational or marketing initiatives have taken place pursuant to the JMA.

47. On or about March 31, 2018, Questrade, Inc. sent WisdomTree an invoice for reimbursement of its staff and overhead costs incurred for the first webinar for \$1,629, inclusive of taxes. Under the Reimbursement Provisions, these reimbursements would have to be repaid if the specified growth targets for holdings of WisdomTree ETFs were not met. When Questrade, Inc. recognized that the costs invoiced were not permissible reimbursements under National Instrument 81-105 *Mutual Fund Sales Practices* (“**NI 81-105**”), Questrade, Inc. withdrew the invoice and did not pursue any reimbursement for those costs.

48. Questrade, Inc. has not received, and does not intend to receive, any reimbursement from WisdomTree for any payment that would be contrary to NI 81-105. Questrade, Inc. has provided an undertaking to Staff that it will not seek nor accept any reimbursement payments contemplated under the Joint Marketing Agreement that would be contrary to NI 81-105.

C. CONDUCT CONTRARY TO THE PUBLIC INTEREST

49. Questrade acted contrary to the public interest by failing to take appropriate steps to determine whether a conflict of interest existed before investing client money. As a result, Questrade failed to meet the high standards of conduct expected of a registrant when identifying and responding to conflicts of interest, which potentially put its PIQ clients at risk that the July Trade was not in the best interests of the client.

DATED this 22nd day of November, 2018.

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