

Staff successfully appeals decision of its own self-regulatory organization

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Last month, staff of the Mutual Fund Dealers Association of Canada (MFDA staff) successfully appealed a [decision](#) of its own self-regulatory organization hearing panel (SRO Hearing Panel). The ruling of the Ontario Securities Commission (Commission Panel) in *Mutual Fund Dealers Assn. (Re)*, 2021 ONSEC 24, which came out in October, found that the SRO Hearing Panel had erred in its decision not to order financial sanctions against the respondent mutual fund representative who had misappropriated client funds. According to the Commission Panel, financial sanctions were warranted in the public interest.

While an appeal by MFDA staff of its own SRO Hearing Panel is not unprecedented, it is also not particularly common. The success of MFDA staff's appeal invites discussion about the ability of staff to appeal decisions of their own SROs, as well as enforcement staff of the OSC. This is particularly germane to the latter, given the current and ongoing regulatory overhaul to Ontario's capital markets sector.

Historical look at appeals by SRO staff

SRO staff appeals of their own SRO Hearing Panel decisions are not common and those that have taken place have not always been successful. For instance, in *Jeffrey Bradford Kasman et al*, 2009 ONSEC 22, staff of the Investment Dealers Association of Canada (the IDA, predecessor of the Investment Industry Regulatory Organization of Canada, or IIROC) unsuccessfully appealed a decision of the IDA hearing panel to a Commission Panel. In a case involving "manipulative and/or deceptive trading," IDA staff argued that the SRO Hearing Panel in that case erred by imposing "a less stringent sanctions and costs order" than what staff had requested.

The Commission Panel (to which the appeal was taken) dismissed IDA staff's review application, deferring to the SRO Hearing Panel's discretion. The Commission Panel found there was IDA precedent for "a conservative approach to costs" and the SRO Hearing Panel did not err in deciding that the costs warranted a lesser fine. According to the Commission Panel, while costs are compensatory and fines serve a deterrence function, the SRO did not err in ordering a lesser fine so that the combined impact of both was "meaningful, yet appropriate." The Commission Panel concluded that the IDA SRO Hearing Panel had appropriately considered factors like the ability to pay, subsequent compliance, and the relatively short duration of the misconduct. The Commission Panel therefore took "a restrained approach" to reviewing the IDA's decision and did not intervene, "[a]lthough IDA Staff would have preferred a different order for sanctions and costs".

More recently, however, IIROC staff *successfully* appealed a decision of its SRO Hearing Panel in *Mark Allen Dennis*, 2012 ONSEC 24. The underlying 2011 decision, *Dennis (Re)*, 2011 IIROC

35, rendered by the IIROC SRO Hearing Panel concerned a former broker who had allegedly misappropriated \$1.4 million from a client and was alleged to have failed to co-operate with IIROC's investigation. In that case, the SRO Hearing Panel imposed a permanent ban as well as financial penalties of \$1 million for misappropriating client funds, \$25,000 for failing to provide information to IIROC, and \$7,500 in costs. Like the IDA's appeal a few years prior, these fines were significantly less than those requested by IIROC's enforcement counsel, who had requested disgorgement of the funds plus an additional fine. In its reasons, the SRO Hearing Panel stated it did not have authority to impose a sanction related to disgorgement in these circumstances since there was no "true profit" made by the former broker's activity. The SRO Hearing Panel saw the relevant sections of its rules as penal in nature and so gave them this strict construction.

On appeal, the Commission Panel found that the IIROC SRO Hearing Panel erred, holding that the panel's sanctioning powers are not penal but regulatory, its strict construction was incorrect, and it should have been understood to allow disgorgement in this case. The Commission Panel ordered a fine in the amount of \$1.45 million, representing full disgorgement of the misappropriated funds, as well as an additional fine of \$50,000, as requested by IIROC staff. The Commission Panel did not disturb any of the SRO Hearing Panel's other sanctions.

A recent success story

As we have stated, more recently, MFDA staff successfully appealed a decision of its own SRO Hearing Panel. In *Mutual Fund Dealers Assn.*, MFDA staff appealed the decision of the MFDA SRO Hearing Panel concerning a former mutual fund representative who admitted to misappropriating nearly \$40,000 from a client's line of credit. While the SRO Hearing Panel ordered a permanent ban, it did not impose a fine since — according to the panel — the primary purpose of securities regulation is to protect investors and prevent future harm, not to punish past conduct. To this end, the SRO Hearing Panel decided a permanent ban and the payment of \$2,500 (costs) was sufficient. In reaching its decision, the SRO Hearing Panel also considered several mitigating factors, including the following:

- the respondent was not previously subject to MFDA disciplinary proceedings
- the respondent was struggling financially and used the funds to pay his bills, not to support a lavish lifestyle
- the respondent was co-operative and remorseful
- the client was ultimately compensated by the bank for the misappropriated funds

MFDA staff appealed the SRO Hearing Panel's decision to a Commission Panel, seeking a fine of over \$50,000. The Commission Panel in that case agreed with MFDA staff and found that the MFDA SRO Hearing Panel erred by deciding not to order disgorgement or any financial penalty against the member. In reaching this decision, the Commission Panel explained that disciplinary penalties are meant to be "protective and preventative" since they restrain future harmful conduct. Disgorgement, in particular, is an important tool to advance these aims and ensure "specific and general deterrence of misconduct" and maintain public confidence in capital markets by making it clear that contravening securities regulations does not pay. The SRO Hearing Panel, therefore, erred in not imposing a financial penalty. In particular, according to the Commission Panel, it erred by overemphasizing the respondent's inability to pay and by treating both the bank's reimbursement of the client and the respondent's motivation for the aforesaid misappropriation as mitigating factors.

For these reasons, the Commission Panel ordered that the respondent disgorge his wrongfully obtained gains of \$32,270 (the respondent had already repaid \$7,000 to the bank) and imposed a \$20,000 administrative penalty.

Notably, the MFDA appeal has a great deal in common with the 2012 IIROC appeal. In both of these cases, SRO staff appealed the financial penalties in decisions of their own respective SRO Hearing Panels and in both cases the underlying conduct involved the misappropriation of client money. In so doing, SRO staff were prepared not only to exercise their discretion to seek substantial financial penalties to deter misappropriation of client funds, but also to challenge decisions of their own SRO Hearing Panels where they asserted that the financial penalties imposed fell short. The recent successful staff appeals also highlight the willingness of reviewing Commission Panels to intercede in order to achieve an appropriate level of specific and general deterrence.

What does this mean for staff appeals of OSC decisions?

These recent decisions invite a discussion about staff's ability to appeal decisions of administrative tribunals, particularly in the context of the OSC. Under section 9 of the *Ontario Securities Act*, currently only a *respondent* in an enforcement proceeding can appeal an OSC decision to the Divisional Court of the Ontario Superior Court of Justice. This legislation, however, is under review and a draft of the new proposed *Capital Markets Act* (CMA) is now out for comment.

Importantly, along with providing for the establishment of a separate tribunal to facilitate the adjudicative functions at the OSC, the legislation specifically opens the door to an OSC staff appeal right. Section 136 of the draft CMA, in particular, contemplates an appeal mechanism for the chief regulator of decisions of the newly constituted tribunal.

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