



Financial and
Consumer
Affairs Authority

IN THE MATTER OF
THE SECURITIES ACT, 1988, S.S. 1988, C.S-42.2
AND
IN THE MATTER OF
DEREK SCOTT AND DEEDS FINANCIAL GROUP INC.
(collectively referred to as the Applicants)

DECISION

Hearing held: January 13, 2015
Before: Dean Murrison, Director, Securities Division
Appearances: I. R. Bergerman for the Applicants
D.A. Smith for Staff, Securities Division
Date of decision: December 7, 2015

Introduction

The Applicant, Deeds Financial Group Inc (Deeds) applied for registration under section 27 of *The Securities Act, 1998* (the Act) as an adviser in the category of portfolio manager and the Applicant, Derek Scott (Scott) applied for the registration as Ultimate Designated Person (UDP), Chief Compliance Officer (CCO) and advising representative with Deeds.

Staff recommended that the Director deny these applications because they think the Applicants are not suitable for registration and that the proposed registration is objectionable as set out in section 28(1) of the Act.

The Applicants requested to be heard on the matter before the Director issued his decision on the applications as allowed for under section 28(3) of the Act.

Preliminary Decision and Process Matters

I. R. Bergerman represented the Applicants and D. A. Smith represented Staff, Securities Division.

The parties filed by consent two binders (A-1 Application and A-2 Correspondence) as evidence in this matter.

There were also affidavits of Curtis Reed, Keith Banton and Douglas Taylor filed by consent.

Scott testified on behalf of the Applicants and Curtis Brezinski (Brezinski), Compliance Auditor, Securities Division testified on behalf of the Staff.

There were no preliminary matters dealt with.

The Law

Sections 28 of the Act read as follows:

28(1) On receiving an application for registration, reinstatement of registration or amendment of registration, the Director shall grant the registration, reinstatement or amendment unless it appears to the Director that:

- (a) an applicant is not suitable for registration, reinstatement of registration or amendment of registration; or
 - (b) the proposed registration, reinstatement of registration or amendment of registration is objectionable.
- (2) The Director may, at any time, restrict a registration by imposing terms and conditions on the registration and, without limiting the generality of the Director's powers, may do any of the following:
- (a) restrict the duration of the registration;
 - (b) restrict the registration to trades in certain securities or exchange contracts or a certain class of securities or exchange contracts;
 - (c) restrict the registration to providing advice with respect to the investing in or the buying or selling of certain securities or exchange contracts or a certain class of securities or exchange contracts.
- (3) The Director shall not refuse to grant, reinstate or amend a registration or impose terms and conditions on it without giving the registrant or applicant an opportunity to be heard.

I note there are no education or experience requirements for an UDP.

Section 3.11 and 3.13 of National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (NI 31-103) read as follows:

3.11 Portfolio Manager – Advising Representative

An advising representative of a portfolio manager must not act as an adviser on behalf of the portfolio manager unless any of the following apply:

- (a) the individual has earned a CFA Charter and has gained 12 months of relevant investment management experience in the 36-month period before applying for registration;
- (b) the individual has received the Canadian Investment Manager designation and has gained 48 months of relevant investment management experience, 12 months of which was gained in the 36-month period before applying for registration.

3.13 Portfolio Manager – Chief Compliance Officer

A portfolio manager must not designate an individual as its chief compliance officer under subsection 11.3(1) [designating a chief compliance officer] unless any of the following apply:

- (a) the individual has
 - (i) earned a CFA Charter or a professional designation as a lawyer, Chartered Accountant, Certified General Accountant or Certified Management Accountant in a jurisdiction of Canada, a notary in Québec, or the equivalent in a foreign jurisdiction,
 - (ii) passed the PDO Exam or the Chief Compliance Officers Qualifying Exam and, unless the individual has earned the CFA Charter, the Canadian Securities Course Exam, and
 - (iii) either
 - A) gained 36 months of relevant securities experience while working at an investment dealer, a registered adviser or an investment fund manager, or
 - B) provided professional services in the securities industry for 36 months and also worked at a registered dealer, a registered adviser or an investment fund manager for 12 months;
- (b) the individual has passed the Canadian Securities Course Exam and either the PDO Exam or the Chief Compliance Officers Qualifying Exam and any of the following apply:
 - (i) the individual has worked at an investment dealer or a registered adviser for 5 years, including for 36 months in a compliance capacity;
 - (ii) the individual has worked for 5 years at a Canadian financial institution in a compliance capacity relating to portfolio management and also worked at a registered dealer or a registered adviser for 12 months;
- (c) the individual has passed either the PDO Exam or the Chief Compliance Officers Qualifying Exam and has met the requirements of section 3.11 [portfolio manager – advising representative].

Issues

Applicants for registration must meet various requirements under the Act and NI 31-103.

Both parties agree that the only issue I need to consider in this matter is whether Scott meets the experience requirement set out in NI 31-103 to be registered as a CCO and an advising representative of a portfolio manager. As Deeds has no other person to register in these categories and these individual registrations are necessary for the Deeds to become registered, if Scott is not successful then Deeds cannot not be registered as well.

As there is no experience requirement for registration as an UDP of a portfolio manager, there is no issue with Scott's registration in that category. I therefore do not deal with this registration in this decision.

The parties agree that all other registration requirements for the Applicants are met.

Facts

Scott testified about many things and I have no doubt that he has the education to carry out the duties of the registrations he has applied for. Staff did not take issue with this. But the requirements for registration as a CCO and an advising representative require more than education, they require experience. So let me attempt to set out the factual information I have before me on the experience of Scott.

The application for registration and supporting correspondence in Exhibits A-1 and A-2 while not always the clearest seem to indicate in so far as they relate to issue at hand the following:

- As education cannot be totally ignored when talking about experience I note that Scott has the following courses and designations:
 - Canadian Investment Manager Designation
 - Wealth Management Essentials Course (3)
 - Partners, Directors and Senior Officers Course
 - Canadian Investment Funds Course
 - Conduct and Practices Handbook Course
 - Portfolio Management Techniques
 - 90 day Training Program
 - Canadian Securities Course
 - LLQP Training Program
 - Life and Segregated Funds License
 - Certified Financial Advisor Training Course
 - Labour Sponsored Investment Funds Course
 - Certified Financial Planner Designation
 - Chief Compliance Officer Qualifying Examination
 - Retirement Investment Management Course (CSI)
 - Investment Management Techniques
 - Fellow of the Canadian Securities Institute
 - Investment Advisors Training Program (CSI)

- Scott currently has a number of jobs:
 - Since 2011 at Aunt Kathy's Homestyle Products Inc. he has been President, Secretary and Director. He is in charge of the oversight of the business and future planning.
 - Since 2011 at Deeds Investments LP. He owns the company that acts as general partner (Deeds Management Inc.) of this private equity investment limited partnership having assets of approximately \$ [REDACTED] and [REDACTED] limited partners. The general partner is responsible for business operations of the limited partnership and is actively involved the management of the businesses the partnership owns. This limited partnership grew out of a private investment club started in 2008 of which Scott was President. Scott does research for investments by the limited partnership.
 - Since 2010 at FG Food Group Inc. he has been President, Secretary and Director. He is responsible for the direction of the company and oversight of the managers.
 - Since 2002 at Deeds. He is now President, Director and Advisor in charge of research for the firm. This is currently an insurance firm. He is also in charge of the overall direction of the firm, various client services and the compliance and data management functions of the firm. There are approximately [REDACTED] clients serviced by Scott that total approximately \$ [REDACTED] in portfolio assets. [REDACTED] households have in excess of \$ [REDACTED] and [REDACTED] have in access of \$ [REDACTED] each.

- Scott's previous related employment consist of:
 - 2006 -2013 – Industrial Alliance Securities Inc. – Registered dealing representative of an investment dealer and authorized to do portfolio management effective 2011 for just under a year. He had approximately 80 clients with a total of \$8,000,000 in direct securities assets over the 7 years at this firm. I do note there was some difference between the parties in testimony as too these numbers. I should also note that the parties agree that Scott did no discretionary management of client assets while at this firm. The parties do not agree as to whether Scott did something more than the usual expected of a registered dealing representative of an investment dealer, that is provide non-

discretionary portfolio advise to clients. Scott indicates he was in a one man branch office during this time and largely responsible to running the office.

- o 2004-2006 – Berkshire Investment Group – registered dealing representative of a mutual fund dealer.
- o 2001-2006 – Canada Life – insurance data license - sold segregated funds and insurance risk management products. Still affiliated with this firm through Deeds.

Scott testified and confirmed and supplemented his past experience as set out in the application material. I have added some facts to the above I garnered from that testimony.

Scott testified that at Canada Life he sold not only insurance but took a more holistic approach to a client's needs. He would gather client information, analyze the information, develop strategies for the client and work with the client to implement the strategy to meet client goals. He would after implementation monitor and review the plan with the client. He indicated he developed a close relationship with clients.

He testified that at Berkshire his duties and approach to his clients did not change except his clients had access to a broader group of products, mutual fund products.

At Industrial Alliance he testified he was always interested in asset management and with this dealer he was able to make full range of products available to his clients, most particularly direct securities. He testified he took the same approach with clients that did in his prior employment. He then provided detail on what that approach was. It included:

- Meeting with clients to establish a personal relationship to get to know their personal situations and their families, things they like to talk about, their hobbies and if they were business people how they developed their businesses.
- Meeting with clients to discuss a business relationship and understand their financial situation. He would use his own list of questions he developed over the years and the firm's know your client (KYC) forms. This information was updated when the client had new life events and at least every three years as required by the firm (although he felt a good practice was every year). He knew about these life events as he kept in touch with most of his clients at least annually sometimes more often.
- Developing his own client net worth form which provided more details than the KYC form. It was updated for clients once a year.
- Developing his own risk tolerance questionnaire to help clients understand risk.
- Using a financial planning information form provided by the Financial Planning Standards Council to collect basic information to build a net worth statement. He updated most clients' information on this form annually.
- Developing an investment policy statement form used to work with clients on their asset allocation and their portfolio to develop a strategy for their investment account. Most clients' forms were updated annually.

All these forms were filed as exhibits in this hearing. Scott testified he met and went beyond his KYC obligations as a registered dealing representative of an investment dealer. He testified most of his clients are long term clients.

Scott then testified as to the process he used to identify securities for his clients:

- He used the internet, personal observations of daily life and trends, research reports, portfolio managers, subscription to various services to identify a potential security. He testified that Industrial Alliance did not give him a list of approved securities he had to work off of.

- Once he identified a security he then looked for earnings. He looked at what the company's assets are, what the liabilities are and the company's utilization of leverage.
- If the security passed his initial scrutiny he then performed a fundamental analysis. He digs into the company's financial statements. He looks at liquidity, working capital, type of debt, contracts between related parties. What is the real shareholders equity in the company. He looked at valuation ratios like price earnings. What's the company worth?
- He looked at what third parties think of the company and all information provided by the company to the public.
- He conducted profit margin calculations, asset turnover calculations, return of equity calculations.
- He looked at management of the company. He wants management to be invested in the company. He looks at any conflict they may have.
- He does competitive analysis.
- All this trying to discern whether the company will do well in the future.
- In addition to the above fundamental analysis he does a technical analysis to help determine the future value of the company. What makes the markets go up and down? This deals with looking at historical trends, prices, time, cycles, patterns, sentiment, volume and momentum to predict the future situation.
- Once a security is put in a client's portfolio he monitors the information continuously.

Scott believes his expertise with respect to understanding and analyzing a security is second to none he has met in the industry. He says he is doing nothing unique but he would stack up well to portfolio managers.

Scott testified that he did the following to analyze a client's portfolio:

- After an investment policy statement is completed for a client he with his client would look at where the client's portfolio is at. If there were any gaps they try to fill it as quickly as possible.
- This is updated at least annually for clients.
- He advises the client on rebalancing, either back to their original strategic plan somewhat automatically or on a more discretionary basis where a client wants to talk about the rebalancing regularly.
- Securities are recommended to client basically based on their risk tolerance. Clients are advised about the risk of a particular security and what the risk means.
- His clients in general tend to rely on his recommendations.

Scott then testified that his registration with Industrial Alliance allowed him to act as a portfolio manager 2010 -2011. I note that there is some disagreement in the testimony of Scott and Staff witness Brezinski as to why this status ended. Scott's testimony is clear he did no discretionary trading for clients and this was confirmed on cross examination by Staff Counsel. Scott testified that he felt his clients would have given him discretionary trading authority and refers to the three affidavits filed from clients that support this and his abilities as a registrant.

Cross examination confirmed that Scott had never worked as a research analysts in a research department of a firm although he did testify that he has done a lot of research over 14 ½ years. Cross examination made it clear that we need to look as the provisions of sections 3.11(b) and 3.13(c) of NI 31-103 for proficiency and experience requirements in this case.

In my questioning Scott testified that what he did at Industrial Alliance was more than what a registered dealing representative of an investment dealer would do.

Brezinski testified on behalf of Staff. He is the Compliance Officer with the Securities Division of the FCAA. He was involved in reviewing the Applicants' applications for registration in this case.

He discussed what he does when looking at an application for registration and more particularly when the application is for portfolio management registration. He discussed the experience requirement. He testified as to a registrant's know your product (KYP), KYC and suitability obligations.

Brezinski made it clear on his review of the Applicants' applications the only issue was the experience of Scott. It was not sufficient in his opinion to meet the requirements for a full advising representative of a portfolio manager. Scott never had discretionary authority over any accounts. He felt that Scott's research and analysis or KYP analysis never went beyond that of a typical dealing representative of an investment dealer. He also felt on a review of the application that Scott had no compliance experience. He worked in a satellite office of Industrial Alliance where he was supervised from an external office. Brezinski testified that Industrial Alliance told him that at the date Scott resigned from Industrial Alliance Scott had under \$5,000,000 assets under management. Brezinski testified that upon review of the records Scott never at any time had assets under management over this amount while at Industrial Alliance. This is a bit at odds with Scott's testimony. Neither party called corroborating evidence. He testified that this number is significant under IIROC rules to allow representatives to act as a portfolio manager. They need \$5,000,000 assets under discretionary management. I note everyone agrees that Scott had no assets under discretionary management while at Industrial Alliance.

When Brezinski was asked in this case what relevant investment experience he was looking for beyond the KYP standard for a typical dealing representative of an investment dealer representative he answered "you have to have an understanding of the risks, the type of product is, the costs associated with that product, and provide that information to your client if you aren't running discretionary accounts, so that they can make a fulsome decision on it". When further questioned on this he added "how it mixes with your portfolio". When asked again how this differs from the KYP standard for a dealing representative of an investment dealer Brezinski talked of sector analysis and comparing other similar securities.

Brezinski went on to say that because Scott was not a research analysis through an IIROC firm his research should not be given weight when considering the experience element in question. He testified it is not a black and white question and it is subjective. Then there was some testimony that Scott was registered to do portfolio management at Industrial Alliance in error. He testified that Scott did not meet IIROC's requirement to be registered as a portfolio manager. He goes on to testify that he considers in reviewing such applications the kind of portfolios that have been managed and whether it is a vast array of portfolios or whether it is in just one segment. Was their rebalancing of portfolios? He said you get credit for research and analysis you do in a capacity other than when at an IIROC firm although if it is all the experience there is he would recommend an associate portfolio manager category. When pressed by myself as to what is needed beyond the KYP standard of a dealing representative of an investment dealer to meet the standard for a portfolio manager representative Brezinski testified "they really need to demonstrate that they've – are able to review multiple products, maybe within the same sector and really demonstrate that the same products that they're recommending are within the investment objectives and risk tolerance of that particular individual". He testified that there needs to be more than just providing advice to a client as a dealing representative of an investment dealer representative. There needs to have been some mentorship.

Arguments of the Parties

The Applicants argued the only issue here is does Scott have the requisite 48 month relevant investment management experience. They suggest if I take an “open-minded, comprehensive and holistic view of Mr. Scott’s prior experience” he does. They confirm Scott carried out his KYP, KYC and suitability obligations when he was registered. They believe Scott went beyond his KYC obligations. They point out that Scott while at Industrial Alliance could offer any security to a client as long as it was not on a narrow restricted list. They did not argue all dealing representatives of investment dealers meet the criteria to be a portfolio manager but they believe Scott has gone beyond that standard especially that his analytical experience exceeds that of a typical dealing representative of an investment dealer. Also they argue consideration should be given to the wide range of securities he analyzed.

Staff agrees the only issue here is does Scott have the requisite 48 month relevant investment management experience for registration as a portfolio manager. Staff agrees there is more than one way to meet this experience test. One can look at discretionary account experience, which Scott does not have, or one can look at his research and analysis experience which needs to demonstrate an ability in and understanding of portfolio analysis and portfolio selection. Staff does not think he has any more of this experience that a dealing representative of an investment dealer would be expected to have. They feel that there was no evidence called to show processes and factors considered that would show Scott has the necessary analytical experience required for a portfolio manager. Staff indicates research experience does not need to come from being hired as a research assistant. It can come from other activities. Staff says Scott may be very good at analyzing a security but they do not see enough experience in creating portfolios, and analyzing and rebalancing portfolios. There needs to be a level of experience looking at portfolios as a whole and analyzing the way different securities play off of each other.

Decision

The Act in section 3.1 indicates that one purpose of Act is to protect investors. With that purpose in mind, I am in section 28 of the Act to register a firm or individual unless I find their registration not suitable or objectionable.

Given the education of Scott, all parties agree I am looking at section 3.11(b) of NI 31-103 for the advising representative criteria. There is no issue about the education requirements. The issue is does he have “48 month of relevant investment management experience”. No issue was raised that if I find this experience, it would not meet the 12 months in the 36 months before the date of the application test in that section.

I am also looking at section 3.13(c) of NI 31-103 when it comes to Scott meeting the requirements to be the CCO for Deeds. That section suggests that as long as he can meet certain educational requirements, which Scott does, all he needs to do is meet one of the arms of section 3.11 of NI 31-103.

I note that no party spoke to the overriding principles of section 3.4 of NI 31-103. I have therefore chosen not to invoke this section in this case.

There is no issue with Scott being the UDP of Deeds.

I note that each application must be considered on a case by case basis.

Turning now to the evidence I note that, other than a difference of opinion on the size of Scott’s assets under management and they reason why Scott ceased to be a portfolio manager with Industrial Alliance, Scott’s factual testimony was largely unchallenged. Brezinski’s testimony largely dealt with his approach

when accessing the experience on an application for registration from a potential portfolio manager. The written evidence filed by consent is largely consistent with the testimony of the parties.

I found Scott to be credible and passionate about working in the financial services industry. Staff agreed that he carried out his obligations as a registrant to date in an able manner and I would, based on the evidence, agree.

I also agree with the submission of Staff that you have to have some experience beyond carrying out the obligations placed on a dealing representative of an investment dealer to be a portfolio manager. The Applicants did not disagree with this.

I don't think anyone objected to the proposition that all experience of an applicant can be considered, not just experience from being in particular job at a registered firm. I also agree.

So does Scott have the experience needed to be a portfolio manager?

All parties agreed there is no discretionary account experience to consider.

So I need to consider if there is other experience that might meet the test.

Staff says there needs to be something beyond analyzing a security. There needs to be experience in creating portfolios, and analyzing and rebalancing portfolios. There needs to be a level of experience looking at portfolios as a whole and analyzing the way different securities play off of each other. I agree with this.

I have to say that based on the evidence before me this is a borderline case. Staff has suggested Scott would be more qualified for the supervised associate portfolio manager category.

I have to balance the needs to protect the public with the ability of someone to carry out their business activity.

I am struck by the fact that Scott at Industrial Alliance chose investments for his clients himself and not from a shelf approved by the firm. This seems to suggest that Scott would need to do the research on the investments not the firm, which I think is often the case. I also note Scott's work with the private equity firm for a number of years and his work with insurance also for a number of years. His testimony suggests that he did work on creating portfolios, analyzing and rebalancing them. Maybe his testimony could have had more detail in this area but there is enough evidence to suggest that he did this. I therefore find Scott has the necessary experience to be an advising representative of Deeds. But because he will be the only advising representative of Deeds and this is a borderline case I request that Staff do a compliance review of Deeds activities 6, 18 and 30 months after registration. It follows Scott also meets the requirements to be the CCO of Deeds and that Deeds itself can be registered.



Dean Murrison
Director
Securities Division