

IN THE MATTER OF THE SECURITIES ACT,  
S.N.B. 2004, c. S-5.5, AS AMENDED

AND

IN THE MATTER OF

**LEGACY ASSOCIATES INC.**  
(Respondent)

**FILED WITH/DEPOSÉ AVEC**  
the Secretary to the Commission  
le secrétaire de la Commission

OCT 07 2008

*File # 3500-03-L4*

**NBSC/CVMNB**

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**STATEMENT OF ALLEGATIONS**

(of Staff of the New Brunswick Securities Commission)

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**The Respondent**

1. Legacy Associates Inc. ("Legacy") is a corporation incorporated pursuant to the laws of the province of New Brunswick, and has its head office in Hampton. Legacy is registered with the New Brunswick Securities Commission ("NBSC") as a mutual fund dealer in the province of New Brunswick.
2. Legacy operates 3 branch offices in New Brunswick and has 38 registered mutual funds salespersons ("salespersons").
3. Legacy is also a registered mutual fund dealer in Prince Edward Island, Nova Scotia, Newfoundland and Ontario.

**Legacy's Corporate and Business Structure**

4. Legacy's business of mutual fund sales is largely based on commissions, the profits of which accrue to both Legacy and to the individual salesperson involved.
5. Legacy is owned and controlled by a group of 10 individuals, each of whom is also a mutual fund salespersons at Legacy. George Pattison, the largest shareholder, owns a significant interest in Legacy and is an active mutual fund salesperson.
6. Pursuant to section 9.4 of NBSC Local Rule 31-501, Legacy is required to employ a Compliance Officer ("CO") to oversee the compliance of the firm with New Brunswick securities law. At present, Robert Malcolm is the designated CO at Legacy.

7. This structure presents challenges with regulatory compliance at Legacy, as the CO must supervise the activities of various salespeople who are also the directing minds of Legacy. While there is nothing inherently wrong with such a structure (it exists in many dealerships without issue), it has the potential to cause issues if not properly handled.
8. Further, the nature of regulatory compliance is to restrict certain sales practices, which may reduce revenues for the firm and the individual salespersons, while at the same time incurring costs associated with compliance activities.
9. Regulatory compliance at Legacy is overseen by the NBSC and the Mutual Fund Dealers Association of Canada ("MFDA"), a self-regulatory organization of mutual fund dealers, recognized by the NBSC pursuant to section 35(1)(b) of the *Securities Act*, S.N.B. 2004, c. S-5.5 (the "*Securities Act*") on 23 July 2007.

### **The 2005 Compliance Review**

10. Compliance staff of the NBSC (Compliance Staff) conducted a compliance review at Legacy in March and April of 2005 (the "2005 compliance review"). The review revealed a number of deficiencies, which Compliance Staff relayed to Legacy by written report dated 29 April 2005.
11. The 2005 compliance review noted a number of deficiencies including:
  - (a) Lack of account opening documentation, contrary to section 54(d) of the *Securities Act* [six instances in a sample of 29 files reviewed];
  - (b) Missing or dated "Know-Your-Client" ("KYC") documentation, contrary to sections 54(d) and 54(e) of the *Securities Act*;
  - (c) Lack of policies and procedures relating to referral arrangements, contrary to MFDA Member Regulation Notice MR-0030;
  - (d) Improper referrals to Portus Alternative Asset Management ("Portus"), the presence of scripts containing misrepresentations as to the due diligence conducted in respect of such referrals, and the suitability of such referrals, contrary to sections 54(d) and 54(e) of the *Securities Act*;
  - (e) Failure to meet FINTRAC guidelines regarding client identification, pursuant to federal legislation;
  - (f) Failure to maintain accurate registration information on the National Registration Database ("NRD");
  - (g) Lack of procedures relating to the supervision of trades, contrary to section 54(b) of the *Securities Act*;

- (h) Failure to assign alternate branch managers;
  - (i) Failure to conduct an internal compliance review of the Hampton office;
  - (j) Failure to resolve past issues of general disclosure to clients with respect to leveraged investments; contrary to section 54(e) of the *Securities Act*;
  - (k) Lack of documentation of client instructions given under a Limited Trading Authorization, contrary to section 54(b) of the *Securities Act*;
  - (l) Failure to develop a written training program for new salespersons and to include this in the Policies and Procedures Manual ("PPM");
  - (m) Inadequate accounting systems, including one client account that had been grossly overstated.
12. Compliance Staff worked with Legacy to resolve most of these deficiencies by December of 2005. Certain issues relating to referrals to Portus were deferred to a larger investigation being conducted by the MFDA.

### **The 2007 Compliance Review**

13. The MFDA and Compliance Staff conducted a joint compliance review of Legacy during the summer of 2007 (the "2007 compliance review"). The review revealed a number of deficiencies, which the MFDA relayed to Legacy by written report dated 31 August 2007.
14. The 2007 compliance review noted a number of deficiencies including:
- (a) Approved Persons had access to the back office computer system and the ability to amend information, contrary to MFDA Rule 2.9;
  - (b) Lack of procedures to detect excessive trading, market timing or switching, contrary to MFDA Policy No. 2;
  - (c) Failure to supervise trades in a timely manner, contrary to MFDA Rule 2.2.1(c) and MFDA Policy No. 2 [13 instances in a sample of 40 trades reviewed];
  - (d) Lack of identification of leveraged and Limited Trade Authorization accounts, contrary to MFDA Policy No. 2;
  - (e) Inaccuracy of KYC information and resultant supervision of suitability issues, contrary to MFDA Rule 2.2.1(c) and MFDA Policy No. 2 [15 instances in a sample of 25 client files reviewed];

- (f) Failure to conduct due diligence on exempt products sold to clients, contrary to MFDA Member Regulation Notice MR-0048;
- (g) Insufficient branch review program, contrary to MFDA Policy No. 5;
- (h) Absence of timely approval of new accounts, contrary to MFDA Rule 2.2.3 [2 instances in a sample of 19 accounts reviewed];
- (i) Missing KYC and suitability information, contrary to MFDA Rules 2.2.1 and 2.2.2 [50 files reviewed, 2 missing required forms, 2 with incomplete forms and 13 with incoherent investment objectives or time horizons];
- (j) Failure to verify client identity [a single instance];
- (k) Redemption of Front End ("FE") funds or mature Deferred Sales Charge ("DSC") funds to purchase new DSC funds, thereby creating a risk of unnecessary fees in the event that the new DSC funds are redeemed before maturity, contrary to MFDA Rule 2.1.1 [28 instances identified, 11 involving accounts belonging to clients of George Pattison];
- (l) Failure to supervise and ensure suitability of investments, contrary to MFDA Rule 2.2.1(c) [11 instances];
- (m) Missing documentation of client instruction on trades, contrary to MFDA Rule 5.1(b) and Member Regulation Notice MR-0035 [2 instances in a sample of 40 trades reviewed].
- (n) Recurring issues in financial reporting, including a failure to correct issues from a 2004 MFDA compliance review;
- (o) An Approved Person lending money to a client, contrary to MFDA Rule 3.2.1 [a single instance];
- (p) Commingling of funds for mutual fund and non-mutual fund purchases, contrary to MFDA Rule 3.3.2(e);
- (q) Inability to provide supporting documents for assets under administration, contrary to MFDA Rule 5.1;
- (r) Trust accounts that did not bear interest, contrary to MFDA Rule 3.3.2(f);
- (s) Lack of timely preparation of bank reconciliations, contrary to MFDA Internal Control Policy 4;
- (t) A failure by management to review bank reconciliations, contrary to MFDA

Policy 4, Internal Control Policy Statement 4:

- (u) Lack of disclosure to clients on the conversion of DSC fund "fee-free" units to 0% FE units of the same fund, contrary to MFDA Member Regulation Notice MR-0041;
- (v) Missing Agreement of Approved Person, contrary to MFDA Rule 1.2.1(d) [1 instance in a sample of 13 files reviewed];
- (w) Missing Override Acknowledgement in certain Agent Agreements, contrary to MFDA Rule 1.1.5(k) [2 instances in 13 files reviewed];
- (x) Missing forms, or use of non-prescribed forms, concerning payments to non-registered entities, contrary to MFDA Rule 2.4.1 as modified by MFDA Bulletin #0234;
- (y) Lack of procedures regarding the approval of dual occupations of Approved Persons, contrary to MFDA Rule 1.2.1(d)(iii);
- (z) Lack of written disclosure to clients that dual occupations of Approved Persons are not the business nor responsibility of Legacy, contrary to MFDA Rule 1.2.1(d)(vi);
- (aa) Lack of authorization for the use of trade names by Approved Persons and a failure to notify the MFDA of such trade names [4 instances], contrary to MFDA Rule 1.1.7(c) and 1.1.7(d) and MFDA Member Regulation Notice MR-0032;
- (bb) Approved Persons carrying on securities business using business cards and letterhead with trade names not belonging to Legacy, contrary to MFDA Rule 1.1.7(a) and MFDA Member Regulation Notice MR-0032, which is a recurring deficiency noted in an MFDA review conducted in 2004;
- (cc) Failure of an Approved Person to have sales communication reviewed and approved prior to providing it to clients, contrary to MFDA Rule 2.7.3;
- (dd) Maintaining a referral arrangement with a mortgage broker, contrary to MFDA Rule 2.4.2(b)(i);
- (ee) Failure to disclose to clients invested in Retrocom Growth Fund that the fund was insolvent and redemptions suspended, and instead providing these same clients with account statements which reflected a historical valuation of the fund, contrary to MFDA Rule 2.8.2;
- (ff) Client statements categorizing holdings of segregated funds and exempt securities as "mutual funds", contrary to MFDA Rule 2.8.2;

- (gg) Use of portfolio summaries prepared by an Approved Person, without review or approval by Legacy, and without any explanation as to the calculation of the reported rate of return; contrary to MFDA Rule 2.9 and 2.8.3 and MFDA Member Regulation Notice MR-0024;
  - (hh) Use of portfolio summaries by an Approved Person that include assets held outside Legacy without the required disclosure, contrary to MFDA Member Regulation Notice MR-0024;
  - (ii) Inadequate written policies and procedures.
15. Legacy responded to the MFDA compliance report by way of a series of correspondence dated 27 September 2007, 29 October 2007, 5 November 2007, 23 November 2007, 4 December 2007, and 13 February 2008.
16. The MFDA compliance staff referred the issues involving excessive trading in DSC funds to its Enforcement Division, which eventually issued warning letters to Legacy and George Pattison.

#### **The February 2008 Compliance Review**

17. On 31 August 2007, the NBSC approved the registration by Legacy of an Approved Person named T.M. T.M. was previously an Approved Person at another registered mutual fund dealer, but was terminated for cause by the dealer as a result of certain compliance issues.
18. Legacy became aware of these issues with T.M.'s previous registration, but wished to continue with his registration at Legacy. Registration was granted by the NBSC, subject to Legacy agreeing to certain terms and conditions with respect to the registration of T.M. T.M.'s registration remained, at all times, subject to general securities law in New Brunswick.
19. Compliance Staff conducted a compliance review with respect to T.M. on 6 February 2008 (the "February 2008 compliance review"). This review revealed the following deficiencies in respect of T.M.'s accounts:
- (a) Lack of evidence of trade supervision, contrary to MFDA Rules 2.2.1(c) and MFDA Policy No. 2;
  - (b) New accounts were not consistently reviewed and approved in a timely fashion, contrary to MFDA Rule 2.2.3 and MFDA Policy 2;
  - (c) Lack of any documented record of supervision of T.M., contrary to the Terms and Condition imposed on 31 August 2007 and section 9.3 of Local Rule 31-

501("LR 31-501);

- (d) New accounts approved by supervisors when the corresponding applications were missing required KYC documentation, contrary to MFDA Rules 2.2.1 and 2.2.2, and Member Regulation Notice MR-0069;
  - (e) An apparent referral arrangement with the Bank of Nova Scotia without evidence of proper approval by Legacy, contrary to the Terms and Conditions imposed on 31 August 2007 and contrary to MFDA Rule 2.4.2(b) and Member Regulation Notice MR-0030;
  - (f) An incomplete registration file that was missing proof of proficiencies and current insurance license, contrary to National Instrument 33-109 ("NI 33-109") Part 6;
  - (g) Missing evidence of client instruction or authorization for trades conducted under a Limited Trading Authorization, contrary to MFDA Rules 2.3.2 and 5.1(b) and Member Regulation notice MR-0035.
20. Compliance Staff brought these deficiencies to the attention of Legacy by letter dated 12 February 2008.
21. On 14 February 2008, Legacy provided a response that admitted certain deficiencies. This response also disclosed that account opening and asset transfer procedures were deficient firm-wide, pursuant to the actual and intended procedures employed by Legacy (i.e. that the accepted firm procedure did not meet the required standards).
22. Compliance Staff advised Legacy on 19 February 2008 that the procedures relating to account opening and asset transfer were general requirements applicable to all Approved Persons and that Legacy must implement compliant procedures for all Approved Persons. Legacy requested further explanation in this regard on 28 February 2008, which Compliance Staff provided on 29 February 2008.
23. On 4 March 2008, Legacy refused to implement the required changes to its general procedures regarding account opening and asset transfers. Legacy subsequently agreed to the required changes on 7 April 2008, but only after the NBSC's Director of Market Regulation wrote to the Acting President of Legacy on 20 March 2008 and stated that the failure to remedy the situation would result in the matter being referred to the Enforcement division of the NBSC.

#### **National Registration Database (NRD) Issues**

24. During the compliance review conducted on 6 February 2008, Compliance Staff reviewed marketing material concerning an Approved Person registered at Legacy.

This material disclosed that the individual was involved in dual employment as a mortgage broker.

25. This dual employment was not reflected on NRD as required by National Instrument 33-109 Part 6, nor had such dual employment as a mortgage broker been approved by the NBSC in general, or with respect to this specific Approved Person.
26. This led Compliance Staff to conduct a general review of the records of Legacy on NRD. This review revealed significant deficiencies.
27. Compliance Staff advised Legacy on 19 February 2008 that it must conduct a general review of its records on NRD and resolve any issues by 10 April 2008.
28. Compliance Staff further required on 19 February 2008 that Legacy become compliant with Local Rule 31-501 section 2.2(1) in respect of the Approved Person dually engaged as a mortgage broker by 6 March 2008.
29. On 9 April 2008, Legacy's CO certified to Compliance Staff that he had reviewed all records relating to NRD and had made the necessary submissions to update the records of all Approved Persons. Compliance Staff reviewed these submissions and found many to be inaccurate or incorrectly submitted. Compliance Staff rejected inaccurate submissions. The process of updating NRD records remains ongoing.
30. On 21 April 2008, Legacy applied for an exemption with respect to the dual occupation of its Approved Person engaged as a mortgage broker. This application remains outstanding.

### **The June 2008 Compliance Review**

31. Compliance Staff conducted further compliance reviews of Legacy's head office and the Riverview, New Brunswick, branch office beginning 24 June 2008. This review revealed the following deficiencies:
  - (a) Trade blotters used by branch managers for daily trade supervision purposes lacked information concerning the type of account, accounts operating under a Limited Trade Authorization, and the Approved Persons requesting the trade, contrary to MFDA Rule 2.2.1(c) and MFDA Policy No. 2.
  - (b) Absence of records to confirm that branch managers reviewed all trades on the MRS Web Trading System on a daily basis, contrary to MFDA Rule 2.2.1(c) and MFDA Policy No. 2.
  - (c) Insufficient notes regarding trades made under Limited Trade Authorizations, contrary to MFDA Rules 2.3.2 and 5.1, and Member Regulation Notice MR-0035.



- (d) Insufficient notes or client acknowledgement supporting trades of fee-free units out of DSC funds to 0% Front End units of the same fund, contrary to MFDA Member Regulation Notice MR-0041.
- (e) Certain forms used to disclose commission rebates on trades involving transfer fees did not clearly address the information required for a client to make an informed decision, or to allow supervision for suitability.
- (f) One trade involving a Legacy client involved a commission rebate that was less than the amount the client had authorized.
- (g) Certain salespersons and all branch managers continued to have access to Legacy's back-office system, contrary to MFDA Rule 2.9 and MFDA Policy 4.
- (h) Failure to document, review, supervise and approve leveraged accounts and investments, including conflicting documentation involving such accounts, contrary to MFDA Policy 2.
- (i) Failure to obtain KYC information and account opening information for each account belonging to clients with multiple accounts, contrary to MFDA Policy 2.
- (j) Head office did not possess copies of certain account opening documentation, contrary to MFDA Policy 2.
- (k) The use of improper or inadequate forms to compile KYC information, contrary to MFDA Rule 2.2 and MFDA Policy 2.
- (l) Incomplete new account information, including forms approved by the CO and branch manager, contrary to MFDA Policy 2.
- (m) Failure to follow proper FINTRAC procedures for client identification, contrary to federal legislation.
- (n) Failure to conduct any review of a group RRSP plan held at Legacy, contrary to Rules 2.2 and 2.2.2.
- (o) Failure to monitor, supervise or report issues of dual employment, contrary to MFDA Rule 1.2.1(d)(i), 1.2.1(d)(iii) and 1.2.1(d)(iv).
- (p) Failure to properly disclose to clients issues of dual employment, contrary to MFDA Rule 1.2.1(d)(vi).
- (q) Failure to monitor and approve referral arrangements and to ensure proper disclosure to clients, contrary to MFDA Rule 2.4.2.

- (r) Failure to obtain consent with respect to the disclosure of personal information of clients to third party business conducted by the salespersons, contrary to MFDA Rule 2.1.3 (b).
  - (s) Failure to review and approve client sales communications and marketing, including a July 2007 newsletter that was dismissive of a required disclosure of client accounts, and a solicitation to purchase an exempt product not approved by Legacy, contrary to MFDA Rule 2.8.2.
  - (t) Failure to conduct and/or document internal audits on branch and sub-branch offices, contrary to MFDA Policy 5.
  - (u) Failure to comply with NI 33-109 in respect of NRD entries and supporting documentation.
32. The regulatory compliance demonstrated by Legacy from the year 2005 until present discloses an approach to compliance that is inconsistent with its obligations under New Brunswick securities law and contrary to the public interest.
33. Each of the deficiencies noted during the 2008 compliance reviews constitutes a contravention of New Brunswick securities law.

**Misrepresentation Regarding Documentation of Monthly Meetings with T.M.**

34. During the February 2008 compliance review, Compliance Staff discovered that the required close supervision of T.M. was not taking place, as described in paragraph 11 above. This issue was specifically addressed with Legacy in a letter from Compliance Staff dated 12 February 2008.
35. In response to this issue, the CO represented in a letter dated 14 February 2008 that the CO and the branch manager were instituting regular monthly meetings with T.M. and that written notes of the items discussed would be maintained in T.M.'s head-office file.
36. During the June 2008 compliance review, Compliance Staff requested a copy of the notes of the monthly meetings with T.M. Compliance Staff were initially told by the CO that notes of the meetings were not taken, but typewritten notes of the meeting were later proffered by the CO. The Compliance Staff asked the CO as to the origin of these notes, and he replied to the effect that they came from his computer.
37. On 11 September 2008, the CO emailed a copy of the Microsoft Word file from which the notes were printed to Compliance Staff at their request. The properties for the file reflect that it was created on 25 June 2008, during the time that Compliance Staff were conducting the June 2008 compliance review.

38. The statement by the CO that the notes came from the CO's computer was misleading to the extent that it would lead one to believe that the notes were prepared contemporaneous with the meetings.

### **Misrepresentations Regarding Dual Employment**

39. Pursuant to the Application for Exemptive Relief filed by Legacy in respect of the dual employment of an Approved Agent as a mortgage broker, the CO wrote to Neil Sandler, legal counsel of regulatory affairs, on 30 May 2008 and represented that:
- (a) Legacy had policies in place to address the conflicts of interest generated by dual employment, such as mortgage brokerage;
  - (b) Legacy reviews trades of its Approved Persons who are also mortgage brokers to determine the best interests of Legacy's clients.
40. Despite these representations, the June 2008 compliance review revealed that Legacy had not taken proper measures to identify and/or report which of its Approved Persons were involved in mortgage brokering, and it had adopted no procedures to conduct a proper review of trades conducted by such individuals. In such circumstances the statements in the 30 May 2008 letter constitute misrepresentations.

### **Relief Sought**

#### Motion

41. Staff requests that, upon the filing of this Statement of Allegations, the NBSC issue a Notice of Hearing of a Motion to determine whether it is in the public interest to issue a temporary order pursuant to section 184(1)(a) of the *Securities Act*, S.N.B. 2004, c. S-5.5, as amended (the "*Securities Act*") placing restrictions, terms and conditions on the registration granted to Legacy including, but not limited to:
- (a) Legacy be restricted from applying for the registration of any new Approved Persons;
  - (b) Legacy cease to open any new client accounts;
  - (c) that Legacy enter into no new referral arrangements;
  - (d) that Legacy terminate the registration of any Approved Persons wishing to remain dually employed as a mortgage broker;

- (e) that Legacy cease to solicit trades in exempt securities;
- (f) that Legacy cease redeeming mature DSC funds or units for re-investment into the same fund family; and
- (g) that Legacy cease accepting transfers that involve the client incurring a DSC or other significant transfer or redemption charge;

until a final determination in this matter, or otherwise ordered by the NBSC, such issues requiring resolution before the hearing on the merits.

- 42. The grounds for such Motion are that Legacy has been persistently and seriously deficient in the conduct of its systems of regulatory compliance, as described herein, and that the public interest requires that immediate, temporary measures be instituted to limit further non-compliance.
- 43. At the hearing of this Motion Staff will rely on the affidavit of Kelly Turcotte, NBSC Compliance Officer, served herewith, in addition to such other evidence as Staff may submit and the hearing panel may allow.

#### Hearing

- 44. Staff further requests that, at the conclusion of the hearing of the Motion, the NBSC issue a Notice of Hearing to determine whether:


(a) pursuant to section 184(1)(a) of the *Securities Act*, that the registration granted to Legacy be subject to the following conditions:

- I. that Legacy must appoint a qualified individual as its new Compliance Officer, and that such individual must be one of the current shareholders of Legacy;
- II. that Legacy must, at its own cost, submit to a review of its practices by a professional consultant, to be determined by the NBSC, and to implement recommendations within a timely fashion;
- III. that any temporary terms or conditions imposed on the registration of Legacy, or any new terms and condition as determined by the NBSC, be extended, made permanent or otherwise ordered.

(b) pursuant to sections 180 and section 186 of the *Securities Act*, Legacy should be ordered to pay an administrative penalty in respect of the contraventions of New Brunswick securities law set out in paragraphs 19, 25, and 31 herein;

(c) pursuant to section 185(2) of the *Securities Act*, Legacy should be ordered to pay hearing costs in this proceeding.

DATED at the City of Saint John this 7<sup>th</sup> day of October, 2008.

  
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