

IN THE MATTER OF:

**THE RULES OF THE INVESTMENT INDUSTRY REGULATORY
ORGANIZATION OF CANADA**

AND

JOSEPH ANTHONY THOMSON AND GERALD DOUGLAS MCRAE

NOTICE OF HEARING

An initial appearance (“Initial Appearance”) will be held before a hearing panel (“Hearing Panel”) of the Investment Industry Regulatory Organization of Canada (“IIROC”) pursuant to Sections 8203 and 8205 of the Consolidated Enforcement, Examination and Approval Rules of IIROC in this matter. The purpose of the Initial Appearance is to schedule a hearing (“Hearing”).

The Initial Appearance will be held on by way of teleconference August 17, 2020 at 10:00 a.m.

The Respondents must serve a Response (“Response”) to this Notice of Hearing and the Statement of Allegations dated June 16, 2020 (“Statement of Allegations”) in accordance with Section 8415 within 30 days from the effective date of service of this Notice of Hearing.

If the Respondents do not file a Response in accordance with Section 8415(1), the Initial Appearance may be immediately converted to a Hearing.

If the Respondents file a Response in accordance with Section 8415(1), the Initial Appearance will be immediately followed by an initial prehearing conference. In preparation for the prehearing conference, the Respondents must serve and file a prehearing conference form in accordance with Section 8416(5).

The purpose of the Hearing will be to determine whether the Respondents have committed the contraventions that are alleged by the staff of IIROC (“Staff”). The alleged contraventions are contained in the Statement of Allegations.

Pursuant to Section 8409, the Hearing will be conducted as an:

- ☒ Oral Hearing
- ☐ Electronic Hearing
- ☐ Written Hearing

The Initial Appearance, the Hearing and all related proceedings will be subject to the Rules of Practice and Procedure as set out in Section 8400.

Pursuant to the Rules of Practice and Procedure, the Respondents are entitled to attend the Hearing and to be heard, to be represented by counsel or by an agent, to call, examine and cross-examine witnesses, and to make submissions to the Hearing Panel at the Hearing.

If the Respondents fail to serve a Response at the Hearing the Hearing Panel may, pursuant to Section 8415(4):

- (a) proceed with the hearing as set out in this Notice of Hearing, without further notice to the Respondents;
- (b) accept as proven the facts and contraventions set out by Staff in the Statement of Allegations; and
- (c) order sanctions and costs against the Respondents pursuant to Sections 8210 and 8214.

If the Hearing Panel concludes that the Respondents did commit any or all of the contraventions alleged by Staff in the Statement of Allegations, the Hearing Panel may, pursuant to Sections 8210, impose any one or more of the following sanctions:

- (a) a reprimand;
- (b) disgorgement of any amount obtained, including any loss avoided, directly or indirectly, as a result of the contravention;
- (c) a fine not exceeding the greater of:
 - (i) \$5,000,000 per contravention; and
 - (ii) an amount equal to three times the profit made or loss avoided by the person, directly or indirectly, as a result of the contravention.

- (d) suspension of the person's approval or any right or privilege associated with such approval, including access to a Marketplace, for any period of time and on any terms and conditions;
- (e) imposition of any terms or conditions on the person's continued approval or continued access to a Marketplace;
- (f) prohibition of approval in any capacity, for any period of time, including access to a Marketplace;
- (g) revocation of approval;
- (h) a permanent bar to approval in any capacity or to access to a Marketplace;
- (i) permanent bar to employment in any capacity by a Regulated Person, and
- (j) any sanction determined to be appropriate under the circumstances.

If the Hearing Panel concludes that the Respondents did commit any or all of the contraventions alleged by the Staff in the Statement of Allegations, the Hearing Panel may assess and order any investigation and prosecution costs determined to be appropriate and reasonable in the circumstances pursuant to Section 8214.

DATED this 16 day of June, 2020.

"National Hearing Coordinator"

NATIONAL HEARING COORDINATOR
Investment Industry Regulatory Organization of Canada
Suite 2000, 121 King Street West
Toronto, Ontario, M5H 3T9

IN THE MATTER OF:

**THE RULES OF THE INVESTMENT INDUSTRY REGULATORY
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STATEMENT OF ALLEGATIONS

Further to a Notice of Hearing dated June 16, 2020, Enforcement Staff make the following allegations:

PART I – REQUIREMENTS CONTRAVENED

- (i) Between June 2017 and June 2019, Joseph Anthony Thomson (“Thomson”), the Ultimate Designated Person (the “UDP”) of PACE Securities Corp. (“PSC”) failed to identify and address existing and potential material conflicts of interest in a fair equitable and transparent manner, and consistent with the best interests of PSC’s clients, contrary to Dealer Member Rule 42.
- (ii) Between June 2017 and June 2019, Thomson failed to ensure that investments in two proprietary products, Pace Financial Ltd. (“PFL”) and First Hamilton Holdings Inc. (“FHHI”), for which he was the portfolio manager, were made in accordance with the objectives set out in the applicable Offering Memorandum, contrary to Consolidated Rule 1400.
- (iii) Between June 2017 and June 2019, Thomson, as UDP, failed to supervise the activities of PSC to ensure compliance with IIROC requirements and failed to use due diligence to

ensure that orders accepted and recommendations made were suitable for clients and within the bounds of good business practice, contrary to Dealer Member Rules 38.5(c), 1300.1(a), (o), (p), (q) and (s).

- (iv) Between June 2017 and June 2019, McRae, as the Chief Compliance Officer (the “CCO”) failed to monitor and assess compliance by PSC with the Dealer Member Rules and failed to adequately supervise Thomson’s securities-related activities, contrary to Dealer Member Rule 38.7.

PART II – RELEVANT FACTS AND CONCLUSIONS

Overview

1. Between 2017 and 2019, PSC offered preferred shares of PFL and FHHI to its clients. Thomson was the CEO and UDP of PSC and held multiple roles with PFL and FHHI, which generated potential material conflicts of interest. While PSC and Thomson’s relationships with PFL and FHHI were disclosed in the Offering Memoranda, Thomson did not take reasonable steps to identify the conflicts, failed to consider the implications of the conflicts or address them in a fair, equitable and transparent manner, and consistent with the best interests of PSC’s clients, as required by Dealer Member Rule 42.
2. These failures led to Thomson:
 - (i) approving the sale of PFL and FHHI, which he created and managed and from which PSC obtained fees, to PSC clients without evaluating the potential conflicts of interest that could arise;
 - (ii) executing Management Agreements, including fee arrangements, between PSC and PFL on behalf of both parties and amending these to the detriment of PSC clients;

- (iii) withdrawing funds from PFL's accounts in excess of those disclosed in the Offering Memorandum;
 - (iv) failing to disclose that he received additional payments from FHHI in excess of those disclosed in the Offering Memoranda; and
 - (v) investing FHHI funds in his own company.
- 3. In addition, as the portfolio manager of the underlying investments of PFL and FHHI, Thomson failed to ensure that the investments were made in accordance with the objectives set out in the respective Offering Memoranda.
- 4. PFL and FHHI were high-risk investments. Thomson failed to ensure that the sale of PFL and FHHI to certain PSC clients was suitable and matched the risk tolerances and objectives set out in the clients' account documentation.
- 5. McRae, as PACE's CCO, failed to monitor and assess compliance by PSC, Thomson and other individuals acting on PSC's behalf, with respect to the sale of PFL and FHHI to PSC's clients and failed to adequately supervise Thomson's activities related to PFL and FHHI, as described in greater detail below.

Background

- 6. PSC has been a Dealer Member since June 2013 and was a wholly owned subsidiary of PACE Savings & Credit Union Limited ("PACE Credit Union").
- 7. Thomson founded PSC and has always been its UDP and Chief Executive Officer (CEO). Thomson was also the Chief Financial Officer (CFO) of PSC from June 2013 until July 2019. Thomson was approved in the IIROC category "Registered Representative - Portfolio

Manager” from May 2015 to May 2020. As described below, Thomson also formed and controlled PFL and FHFI.

8. McRae was the CCO of PSC since 2013. McRae was responsible for overall regulatory compliance at PSC, including ensuring adequate policies and procedures, daily and monthly trade reviews, approval of new accounts, options supervision, and the supervision of managed accounts.
9. In July 2018, IIROC Enforcement opened an investigation on the basis of a referral from IIROC Debt Market Surveillance.
10. In May 2019, IIROC Business Conduct Compliance raised concerns with PSC about the firm’s governance and ability to comply with certain IIROC requirements. Shortly thereafter, PSC undertook to cease distributing FHFI to clients.
11. On May 14, 2020, PSC and PFL, along with two related companies, made an application to the Ontario Superior Court of Justice, and were granted, orders winding up the companies pursuant to the Business Corporations Act (Ontario) (OBICA) and the Canada Business Corporations Act (CBCA). Thomson and McRae, and all other employees, were terminated from PSC as a result of the order.
12. On May 21, 2020, FHFI made a similar application and was granted an order winding up the company pursuant to the OBICA and CBCA.
13. On May 21, 2020, PSC’s membership in IIROC was suspended as a result of its winding up.

The Issuers

(i) PFL

14. By Confidential Offering Memorandum (the “PFL OM”) dated June 27, 2017, PFL offered Series A 5% Cumulative Redeemable Retractable Non-voting Term Preference Shares (the “PFL Preference Shares”) as an exempt distribution without a prospectus. PFL had no capital other than the proceeds of sale from the PFL Preference Shares.
15. PFL was a wholly owned indirect subsidiary of PSC and, at the time, Thomson was the sole officer and director of PFL.
16. PFL’s business plan was to invest in debt instruments. The PFL OM stated that, among other things, PFL would invest in Canadian and US debt instruments with at least 50% of the portfolio rated “B” or better.
17. The PFL OM did not disclose the potential use of leverage or the potential use of options.
18. The PFL Preference Shares were offered at \$10 each (subsequently there was a 2 for 1 split) and had a fixed term of 5 ½ years, with limited liquidity provisions. The PFL Preference Shares paid base dividends of 5% with an additional 2% bonus dividend payable at the discretion of PFL depending on performance. PFL paid a commission of 3% for sales of PFL Preference Shares that were deducted from the proceeds of the offering.
19. The PFL Preference Shares were redeemable in December 2022.
20. The PFL OM described an investment in the PFL Preference Shares as “highly speculative” and suitable only for investors “who can afford a total loss of their investment”. The PFL OM also noted that PFL’s business “involves a high degree of risk, which a combination of experience, knowledge and careful evaluation may not be able to overcome.”
21. As per the PFL OM, PFL appointed PSC as the investment manager (the “Manager”) to manage the PFL investment portfolio. Thomson was the portfolio manager in charge of

the PFL investments and made all investment decisions in the PFL account. As Manager, PSC became entitled to asset management fees and performance fees.

- 22. PSC sold approximately \$16.3 million of PFL Preference Shares, including \$10.7 million to PSC clients. PFL has not issued any additional PFL Preference Shares since May 2018.
- 23. In November 2019, PSC reduced the price of the PFL Preference Shares shown on client statements to \$4.22 following a third-party valuation. In April 2020, the market price of the PFL Preference Shares was marked at \$1.62.

(ii) FHHI

- 24. On February 2, 2018, Thomson incorporated FHHI. Thomson was a director of FHHI, its CEO, and its majority owner.
- 25. By Confidential Offering Memorandum dated March 19, 2018, FHHI offered Series A 7% Cumulative Non-voting Preference Shares (the “FHHI 7% Preference Shares”) as an exempt distribution without a prospectus.
- 26. By Confidential Offering Memorandum dated April 30, 2018, FHHI offered 5% Cumulative Redeemable Retractable Non-voting Preference Shares (the “FHHI 5% Preference Shares”) as an exempt distribution without a prospectus.
- 27. The Offering Memoranda (the “FHHI OMs”) for both the FHHI 7% Preference Shares and the FHHI 5% Preference Shares (collectively, the “FHHI Preference Shares”) were substantially similar.
- 28. FHHI’s founding capital was \$10,001 and its only other assets were the proceeds of sale from the FHHI Preference Shares.

29. FHHI's primary business plan was to invest in debt instruments and, as profits were earned, and taxes and dividends paid, net retained earnings could be used for equity investments.
30. The FHHI OM's stated that, among other things, FHHI would invest in Canadian and US debt instruments with a weighted average rating of "B" or better.
31. Unlike the PFL OM, the FHHI OM's specifically disclosed that leverage could be used. The FHHI OM's did not disclose the potential use of options by FHHI, other than for hedging purposes.
32. The FHHI 7% Preference Shares OM provided for the possibility that they would be listed on a Canadian stock exchange by December 2020. However, if the FHHI 7% Preference Shares were not listed by December 2020, they became redeemable in December 2023.
33. The FHHI 5% Preference Shares were for a fixed term of 5 and 3/4 years and redeemable in December 2023.
34. The FHHI Preference Shares were offered as part of a unit priced at \$10 per unit, with \$9.50 allocated to each FHHI Preference Share and \$0.50 allocated to a warrant. FHHI 7% Preference Shares paid base dividends of 7% and FHHI 5% Preference Shares paid base dividends of 5%. FHHI paid a commission of 10% for sales of the FHHI Preference Shares that was deducted from the proceeds of the offering.
35. The FHHI OM's described the investment in the FHHI Preference Shares as "a risky investment", "highly speculative" and suitable only for investors "who can afford a total loss of their investment". The FHHI OM's also noted that FHHI's business "involves a high degree of risk, which a combination of experience, knowledge and careful evaluation may not be able to overcome."

36. As per the FHHI OM, FHHI appointed PSC as Manager to manage the FHHI investment portfolio. Thomson was the portfolio manager in charge of the FHHI investments and made all investment decisions in the FHHI account. As Manager, PSC became entitled to asset management fees and performance fees, in addition to selling commissions.
37. As of June 2019, FHHI had sold approximately \$29.8 million of FHHI Preference Shares, including \$12.8 million to PSC clients. FHHI has not issued any additional FHHI Preference Shares since July 2019.
38. In November 2019, PSC reduced the price of the FHHI Preference Shares shown on client statements to \$8.17 (Class A) and \$7.49 (Class B). In April 2020, the market price of FHHI Preference Shares was marked at \$0.84.

Conflicts of Interest

39. At the time PFL was established and its Preference Shares offered for sale to PSC clients, Thomson was its sole officer and director, the President and CEO and a promoter. PFL was, indirectly, a wholly owned subsidiary of PSC.
40. At the time FHHI was established and its Preference Shares offered for sale to PSC clients, Thomson was an officer and director, the President and CEO and a promoter. He was also the majority owner of FHHI common shares.
41. Thomson was also the President, CEO, UDP, and director of PSC, which was the Manager of the PFL and FHHI accounts, and he was the portfolio manager for the accounts. Thomson made all investment decisions in the PFL and FHHI accounts held at PSC.
42. PSC and Thomson's multiple roles in PFL and FHHI were disclosed in the Offering Memoranda. However, Thomson had a responsibility to take reasonable steps to identify

all potential material conflicts of interest and to ensure, whether disclosed or not, that conflicts of interest were addressed in a fair, equitable and transparent manner, and consistent with the best interests of PSC's clients.

(i) Approval of PFL and FHHI

43. Thomson and McRae approved the sale of PFL and FHHI Preference Shares to PSC clients without evaluating the potential conflicts of interest that could arise.
44. Thomson and McRae were the only members of PSC's New Product Review Committee (the "NPRC"). They met informally to consider the sale of PFL and FHHI to PSC clients. There is no documentation of any meetings regarding the consideration or approval of either PFL or FHHI for sale to clients.
45. As a member of the NPRC, Thomson was in a conflict of interest when he reviewed the products that he created, managed, and from which PSC obtained fees. Thomson did not recuse himself from consideration of these related issuers or take any steps to address the conflict of interest. PSC lacked sufficient policies and procedures to control conflicts of interest. Thomson and McRae were required to ensure that PSC had sufficient policies in place to supervise and monitor the approval of related issuers for sale to clients.

(ii) PFL Management Fees

46. Thomson's role at PFL created a potential material conflict of interest in that it was in PSC and Thomson's interests to generate fees from PFL, whereas payment of those fees was contrary to the interests of PFL and its preference shareholders.
47. The PFL OM provided for PFL to enter a Management Agreement with PSC as the Manager. The PFL OM stated that PFL expected to pay two types of fees to PSC:

- a. asset management fees of 0.25% per month or 3.0% per annum; and
 - b. performance fees of 50% of profits earned.
- 48. Both the asset management and performance management fees were to be reduced to the extent necessary, or waived, “in the event that [PFL] has a deficit (i.e. no profits or inadequate profits to provide for base dividends on the Preference Shares.” At no point did PFL report a profit on its annual audited financial statements.
- 49. PSC entered into three Management Agreements with PFL dated August 20, 2017, December 28, 2017, and March 16, 2018, respectively. Thomson signed all three Management Agreements on behalf of both PSC and PFL, determining the fees that PFL would pay to PSC. PSC was entitled to withdraw fees by debiting PFL’s account directly.
- 50. The first Management Agreement dated August 20, 2017 provided for fees similar to those outlined in the PFL OM. Specifically, the August 20, 2017 Management Agreement stated that “[t]he Management Fee will be based on the Net Asset Value of the account on each Valuation Day (last business day of the month)”. However, unlike as disclosed the in PFL OM, the first Management Agreement did not provide for either the management fee or performance fee to be reduced to the extent necessary for PFL to meet its dividend payment requirements.
- 51. The subsequent Management Agreements provided for fees that were not disclosed in the PFL OM, as follows:

Source	Asset Management Fee	Performance Fee
Offering Memorandum dated June 27, 2017	3.0% per annum (0.25% per month)	50% of profits earned, reduced if necessary to permit PFL to pay dividend obligations

Management Agreement August 20, 2017	3% of the value of the portfolio	50% of the increase in Net Asset Value of the account
Management Agreement December 28, 2017	\$60,000 per month	Net profit in excess of the amount required to be accrued for annual payment of the base dividend of 5% and the discretionary dividend of 2%
Management Agreement March 16, 2018	\$70,000 per month	30% of the net profit in excess of the amount required to be accrued for annual payment of the base dividend of 5% and the discretionary dividend of 2%

52. The information provided to PFL Preference Shareholders about the fees was set out in the PFL OM. The Management Agreements were not provided to PSC clients who purchased PFL Preference Shares and no notice of the above changes to the fees were provided to PSC clients prior to the changes. The revised fees were also not disclosed to PSC clients who purchased PFL Preference Shares after the changes had been made, even though these amounts were inconsistent with the information in the PFL OM.
53. Changes to the fees were referenced in notes contained in the PFL financial statements, which were issued in November 2019. This did not constitute prominent, specific, clear and meaningful disclosure of the conflict to PSC clients.
54. These changes had a significant impact on the fees paid by PFL (and by extension PSC clients) to PSC. In many cases, Thomson disregarded the PFL OM or Management Agreements and Thomson permitted PSC to charge fees in excess of the amounts that should have been owed.
55. Further, the various Management Agreements also increased the potential performance fees that could be paid to PSC.

56. In total, between September 2017 and May 2019, PSC charged and was paid fees of \$2,420,983. These fees exceeded the fees disclosed in the PFL OM and reduced the assets of PFL, contrary to the interests of the PFL Preference Shareholders.

(iii) Withdrawals of Funds from PFL

57. In addition to the “management fees” and “additional fees” withdrawals from the PFL account, PSC withdrew or transferred further funds from PFL’s account which were inconsistent with the terms of the PFL OM. This included the payment of a \$150,000 dividend to the sole common shareholder PACE General Partner Limited, a wholly owned subsidiary of PSC. These withdrawals were to the direct benefit of PSC and reduced the assets of PFL, contrary to the interests of the PFL Preference Shareholders.

(iv) Additional Undisclosed Payments from FHHI to Thomson

58. The FHHI OMs stated that FHHI intended to pay directors’, including Thomson, an annual fee of \$10,000 (\$15,000 for the chair). No additional fees or payments to directors or officers were disclosed. Beginning in May 2018, FHHI provided monthly draws of \$10,000 to Thomson. As of June 2019, Thomson had received draws of approximately \$330,000 from FHHI. These draws were to the direct benefit of Thomson and reduced the assets of FHHI, contrary to the interests of FHHI Preference Shareholders.
59. These additional payments created a conflict of interest between Thomson and PSC clients who purchased FHHI Preference Shares, and needed to be disclosed or otherwise addressed by Thomson.

(v) Investing FHHI funds in his own company

60. On November 27, 2018, Thomson caused FHHI to purchase 100,000 shares of First Hamilton Capital 2 LP (“FH Cap 2LP”) at \$10 each for a total investment of \$1 million.

Thomson was the sole director and officer of the corporation he established to be the general partner for FH Cap 2LP and was therefore its directing mind. PSC was the Manager of FH Cap 2LP and was entitled to a monthly management fee.

61. When Thomson caused FHHI to invest \$1 million in FH Cap 2LP he was in a conflict of interest that he failed to identify or address.

Failure to invest in accordance with the provisions of the Offering Memoranda

62. The PSC Management Agreements with PFL and FHHI incorporated the Offering Memoranda as the source of account objectives in lieu of preparing separate managed account agreements. Accordingly, all investments made by Thomson in each account were required to be in accordance with the provisions of the PFL and FHHI Offering Memoranda.

(i) Options

63. The PFL OM did not disclose the potential use of options in the portfolio. The FHHI OMs did disclose the potential use of options for only a limited purpose, namely for currency hedging. Nonetheless, as the portfolio manager of both the PFL and FHHI accounts, Thomson invested in options in both portfolios.
64. Between June 22, 2017 and May 31, 2018, PFL incurred losses on option trading of \$422,600 and further losses on option trading of \$253,223 between May 31, 2018 and May 31, 2019. Between February 21, 2018 and February 28, 2019, FHHI incurred losses on option trading of \$191,900.
65. The option positions in both the PFL and FHHI accounts were contrary to the disclosures contained in the Offering Memoranda. Further, the use of options in both PFL and FHHI

increased the potential risks associated with an investment in the PFL and FHHI Preference Shares.

(ii) Leverage

66. The PFL OM did not disclose the potential use of leverage. Nonetheless, Thomson used extensive leverage in the PFL account. At times, the margin borrowing in the PFL account was approximately 2.5 times the equity in the account. This use of leverage was contrary to the disclosure contained in the PFL OM.

(iii) Equity Investments

67. Section 2.3.2 of the FHHI OMs stated: “As profits are earned, taxes paid and dividends paid on the Preference Shares, net retained earnings held by the Issuer may be invested in additional Eligible Debt Instruments or used to acquire Equity Investments that fit within the Issuer’s investment strategy or may be paid as dividends on the Class A Restricted voting Shares and Class B Voting Shares issued and outstanding at the applicable time, or a combination of the foregoing.”
68. As set out above, on November 27, 2018, Thomson caused FHHI to invest \$1 million in FH Cap 2LP. FH Cap 2 LP was a limited partnership established to invest in securities. Its investment objectives were to “invest in debt and equity securities and options of non-investment grade and investment grade rated issuers, both publicly-traded and privately held” ...“by using the following investment strategies: High Yield Bond and Loan Trading, Long/Short Positions, Short Selling, Pairs Trading, Inter-Capital Arbitrage, Convertible Arbitrage and Volatility Arbitrage.”
69. In addition, in or around April 2019, Thomson caused FHHI to purchase 84,280 common shares of Grand River Commerce Inc. (“Grand River”), a Michigan based bank at a total cost of \$624,098.51USD.

70. At the time of the investment in FH Cap 2LP and Grand River, FHHI had no retained earnings. Financial statements for the year-end February 28, 2019 showed that FHHI had incurred a loss of \$967,863 and had a shareholder deficiency of \$957,692. Accordingly, the investments in FH Cap 2LP and Grand River were not made with retained earnings and were in contravention of the terms of the FHHI OMs.

Suitability

71. PFL and FHHI were high-risk investments. The Offering Memoranda referred to the Preference Shares as “highly speculative”, involving a “high degree of risk”, and suitable for investors “who can afford a total loss of their investment”.
72. The PFL OM stated that at least half of its portfolio would be invested in debt instruments rated with a “B” rating or better. Similarly, the FHHI OMs stated that the weighted average of its portfolio would be invested in debt instruments rated with a “B” rating or better.
73. The rating refers to rating scales used by industry-accepted bond rating agencies such as DBRS, Moody’s, S&P, and Bloomberg Composite Index. Each agency rates debt instruments along a spectrum of risk based primarily on the obligor’s capacity to meet its financial commitments.
74. The rating agencies rate “B” grade investments as highly speculative. Debt instruments rated BB are considered to be speculative and instruments rated CCC are considered to be substantially risky to extremely speculative. For example, S&P describes the risk associated with debt instruments rated BB, B, CCC, and CC as follows:

“Obligors rated ‘BB’, ‘B’, ‘CCC’, and ‘CC’ are regarded as significant speculative characteristics. “BB” indicates the least degree of speculation and ‘CC’ the highest. While such obligors will likely have some quality and protective characteristics, these may be outweighed by large uncertainties or major exposure to adverse conditions.”

75. The FHHI OMs indicated that as FHHI's retained earnings grew, it could make equity investments. There were no limitations on the equity investments in terms of sector, geographic location, or public and private. The open potential for equity investments increased the potential risks associated with an investment in the FHHI Preference Shares.
76. In addition, both the PFL and FHHI portfolios were highly leveraged. The use of leverage increased the potential risks associated with an investment in the PFL and FHHI Preference Shares.
77. Both the PFL and FHHI portfolios also used options, which again increased the potential risks associated with an investment in the Preference Shares.
78. Thomson and McRae considered PFL and FHHI to be medium-risk investments, even though they were aware of the holdings, use of leverage, the use of options and the clear description of the speculative nature of the investment made in the Offering Memoranda.
79. PSC advisors sold PFL and FHHI to a broad range of clients, many of whom had no, or inadequate, tolerance for risk as well as limited investment knowledge.
80. Of the approximately \$10.7 million of PFL Preference Shares sold to PSC clients, \$5.2 million was sold to clients that had no indication of high-risk tolerance on their account documentation. Of these, five clients whose risk tolerance was documented as 100% low purchased 16,767 PFL Preference Shares in their accounts, for total proceeds of \$167,670.
81. Of the approximately \$12.8 million of FHHI Preference Shares sold to PSC clients, \$7 million was sold to clients that had no indication of high-risk tolerance on their account documentation. Of these, three clients whose risk tolerance was documented as 100% low purchased 15,325 FHHI Preference Shares in their accounts, for total proceeds of \$153,250.

82. Thomson and McRae did not adequately supervise whether the purchases of PFL and FHHI were suitable for PSC clients, in particular:
- (a) they failed to appreciate the risks and erroneously considered PFL and FHHI to be medium-risk products when they were high-risk; and
 - (b) they failed to adequately consider whether purchases of PFL and FHHI were suitable for clients, having regards to their personal circumstances, stated risk tolerance, investment objectives or financial circumstances.

McRae's Failure to Supervise

83. McRae was responsible for the supervision of managed accounts at PSC, including the accounts of PFL and FHHI, which were managed by Thomson. He was also responsible for conducting suitability reviews of all client accounts.
84. As noted above, the PSC Management Agreements with PFL and FHHI incorporated the Offering Memoranda as the source of account objectives. Accordingly, McRae was required to ensure that Thomson managed the PFL and FHHI portfolios in accordance with the Offering Memoranda.
85. The PFL OM did not disclose the use of leverage or options. McRae signed leverage and options agreements for PFL and was aware it used those strategies, yet he never raised the issue or evidenced any supervision concerning whether their use was consistent with the PFL OM.
86. The FHHI OMs did not disclose the use of options, other than for hedging purposes, yet McRae signed options agreements for FHHI and was aware of options use in the account. He never raised the issue or evidenced any supervision concerning whether options use was consistent with the FHHI OMs.

87. Thomson's multiple roles with PFL and FHHI called for robust supervision of his management of the portfolios of PFL and FHHI, which in turn held the funds of numerous investors with no high-risk tolerance, many of whom were seniors with limited investment knowledge.
88. Similarly, McRae was aware or ought to have been aware of the disclosure contained in the PFL and FFHI OM's which described the Preference Shares as "highly speculative", involving a "high degree of risk", and suitable for investors "who can afford a total loss of their investment". Nonetheless, he did not question the purchase of these securities by clients with limited tolerance for risk.

DATED at Toronto, Ontario this 16th day of June, 2020.