**ALBERTA SECURITIES COMMISSION**

**DECISION**

**Citation: Re Rustulka, 2020 ABASC 93** **Date: 20200617**

**Kenton Roy Rustulka**

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| **Panel:** | Kari Horn<br>Kate Chisholm<br>Raymond Crossley |
| **Representation:** | Adam Karbani<br>for Commission Staff |
| **Submissions Completed:** | September 9, 2019 |
| **Decision:** | June 17, 2020 |

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## I. INTRODUCTION

[1] In a notice of hearing issued December 20, 2018 (**NOH**), Alberta Securities Commission (**ASC**) staff (**Staff**) alleged that Kenton Roy Rustulka (**Rustulka**) contravened s. 92(4.1) of the *Securities Act* (Alberta) (**Act**) by making misrepresentations to his investor clients, and contravened ss. 13.2 and 13.3 of National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (**NI 31-103**) by failing to comply with certain obligations applicable to registrants.

[2] A hearing into the merits of the allegations (**Hearing**) was held over five days, during which Staff tendered documentary evidence and called 10 witnesses: a member of ASC investigative Staff, a representative of the registered firm with which Rustulka once worked, and eight investors.

[3] Rustulka was not represented, and neither appeared on his own behalf nor participated in the Hearing in any manner. However, at the set-date appearance held on February 1, 2019, Staff tendered an Affidavit of Service that confirmed Rustulka was served with the NOH and acknowledged service by email on December 23, 2018. In addition, Staff counsel confirmed that disclosure was sent to Rustulka on January 2, 2019, and Rustulka confirmed receipt by email on January 9, 2019. As mentioned at the Hearing, we were later advised by the ASC Registrar that Rustulka had confirmed he did not intend to participate in the Hearing.

[4] In view of the foregoing, we are satisfied that Rustulka was served with the NOH, was aware of the Hearing, received disclosure (including Staff's pre-hearing disclosure as required by s. 7.1 of ASC Rule 15-501 *Rules of Practice and Procedure for Commission Proceedings*), had notice of the case against him, and had an opportunity to be heard. He was also given an opportunity to provide written submissions in response to Staff's written argument on the merits of the case (**Staff Submissions**) following the evidence portion of the Hearing. None were received.

## II. PRELIMINARY MATTERS

### A. Standard of Proof

[5] The applicable standard of proof in ASC enforcement proceedings is the balance of probabilities (*Re Arbour Energy Inc.*, 2012 ABASC 131 at para. 36). There must be "sufficiently clear, convincing and cogent evidence that the existence or occurrence of any alleged fact required to be proved is more likely than its non-existence or non-occurrence" (*Arbour* at para. 38; see also *F.H. v. McDougall*, 2008 SCC 53 at paras. 46, 49). In other words, Staff must show that it is more likely than not that the alleged misconduct occurred.

[6] In addition, while a hearing panel may "draw inferences from the evidence as a whole" (*Arbour* at para. 39) – including any circumstantial evidence – we must ensure that any such inferences are supported by the evidence led and are not speculative (*Walton v. Alberta (Securities Commission)*, 2014 ABCA 273 at paras. 26-28).

### B. Relevance and Use of Hearsay Evidence

[7] The Act provides at ss. 29(e) and (f) that hearing panels "shall receive that evidence that is relevant to the matter being heard", and that "the laws of evidence applicable to judicial

proceedings do not apply". Therefore, all relevant evidence – including hearsay evidence – is admissible. However, we retain discretion to determine the relevant evidence we will admit, subject to the rules of natural justice and procedural fairness (*Lavallee v. Alberta (Securities Commission)*, 2010 ABCA 48 at paras. 14-18; *Arbour* at para. 45).

[8] All evidence admitted is subject to the panel's assessment of the weight it will give to that evidence. In assessing weight, we consider various indicators of the reliability of the evidence, including the extent to which it is corroborated by other evidence (*Arbour* at paras. 46, 53-54).

### C. Witness Credibility

[9] Although their testimony was unchallenged, we were still required to assess the credibility of Staff's witnesses. We did so in accordance with the guidance provided by the British Columbia Court of Appeal in *Faryna v. Chorny* ([1951] B.C.J. No. 152 at para. 11; see also *R. v. Boyle*, 2001 ABPC 152 at para. 107):

> The credibility of interested witness[es,] particularly in cases of conflict of evidence, cannot be gauged solely by the test of whether the personal demeanour of the particular witness carried conviction of the truth. The test must reasonably subject his story to an examination of its consistency with the probabilities that surround the currently existing conditions. In short, the real test of the truth of the story of a witness in such a case must be its harmony with the preponderance of the probabilities which a practical and informed person would readily recognize as reasonable in that place and in those conditions.

[10] We considered the source of the evidence and its consistency with other evidence, including documents and the testimony of other witnesses. Generally, we found Staff's witnesses to be credible and reliable, especially where their evidence was consistent with other evidence and logical in the overall circumstances. Where some witnesses could not recall specific details, we found that it was attributable to the passage of time rather than to any dishonest intention.

## III. BACKGROUND AND ALLEGATIONS

[11] Rustulka is a resident of Edmonton, Alberta. During the period relevant to this matter, January 1, 2013 through June 3, 2016 (**Relevant Period**), he was registered as an exempt market dealing representative (**Dealing Representative**) in the provinces of Alberta, British Columbia, and Saskatchewan, having completed the exempt market products exam on October 23, 2010.

[12] WealthTerra Capital Management Inc. (**WealthTerra**) is a federal corporation that was extra-provincially registered in Alberta in January 2010. It became registered as an exempt market dealer firm (**EMD**) in Alberta on December 1, 2010. During the Relevant Period, Rustulka was under contract with WealthTerra as one of its Dealing Representatives. He joined WealthTerra in late 2012, but had been a registered Dealing Representative with other EMDs prior to that time.

[13] Staff alleged that during the Relevant Period, Rustulka sold approximately $6,500,000 in exempt market securities offered through WealthTerra, and earned approximately $460,000 in associated commissions.

[14] Staff also alleged that in the course of these sales, Rustulka made various statements to his clients with respect to the general and specific risks associated with exempt market securities that

he knew, or reasonably ought to have known, were materially misleading or untrue. Specifically, at para. 4 the NOH states that Rustulka told clients:

> 4.1 exempt market securities were inherently low risk, safe and secure, when in fact they were inherently high risk, unsafe and not secure;
>
> 4.2 securities in specific issuers were low risk, safe and secure, and in well-established companies, when in fact they were high risk, illiquid, and in start-up, speculative issuers with no proven records of revenue or operations;
>
> 4.3 securities in specific issuers were backed, protected by, vetted, and/or otherwise safeguarded by the Government of Alberta and/or the [ASC], when in fact they were not; and
>
> 4.4 the risk acknowledgement form (**RAF**) that was required to be signed by investors was procedural and that the "high risk nature" warning could be disregarded, when in fact the RAF was an integral part of client protection to guard against unsuitably high risk investments.

[15] Staff further alleged that Rustulka's clients were induced to invest in exempt market securities based on these representations, and that they believed he was "trustworthy and honest, based on his previous employment as an Edmonton police officer and as a senior pastor".

[16] In addition, Staff alleged that as a registrant, Rustulka failed to comply with his Know Your Client (**KYC**) obligations, as he failed to properly identify his clients' investment needs, objectives, financial circumstances, and risk tolerances. Staff alleged that he also reported false and misleading information on KYC forms, including with respect to client assets, income, investment knowledge, investment objectives, risk tolerances, and investment time horizons.

[17] Finally, Staff alleged that as a registrant, Rustulka failed to comply with his suitability obligations, as he failed to take reasonable steps to ensure that the exempt market securities he recommended to his clients were suitable for them. Staff alleged that he also recommended and assisted certain clients in borrowing money to make leveraged purchases of exempt market securities where that strategy was unsuitable in the clients' circumstances.

## IV. WITNESS EVIDENCE

### A. Dale Fisher

[18] Dale Fisher (**Fisher**) is a member of ASC investigative Staff, and was the primary investigator in this matter. He testified that issues with respect to Rustulka came to his attention from Staff in the ASC's Market Regulation division, who conducted a compliance review of WealthTerra commencing in April of 2015 and identified a number of potential breaches of NI 31-103 by Rustulka.

[19] Fisher indicated that through the investigation, he came to learn that Rustulka was formerly an officer with the Edmonton Police Service, and a pastor in the Edmonton area. As mentioned, Rustulka worked for several other EMD firms as a Dealing Representative prior to joining WealthTerra, but was with WealthTerra until he was "terminated with cause" in June 2016.

[20] Fisher referred to a spreadsheet in evidence that he obtained from WealthTerra during the investigation. It lists all of Rustulka's sales to clients while he was with WealthTerra, totalling $6,596,848.45 in exempt market securities. It also indicates that Rustulka received somewhere between $435,000 and $464,000 in commissions on those sales.

**B. Nadine Wellwood**

[21] During the Relevant Period, Nadine Wellwood (**Wellwood**) was the owner, ultimate designated person (**UDP**) and chief compliance officer (**CCO**) of WealthTerra. She explained that as UDP, she oversaw and managed all of WealthTerra's activities, and as CCO, she was responsible for WealthTerra's policies and procedures, and for monitoring its Dealing Representatives.

[22] Wellwood testified that Rustulka signed two Dealing Representative agreements with WealthTerra, the first dated December 10, 2012, and the second (which added reference to Rustulka's numbered company) dated January 1, 2014. She indicated that both contracts set out a "high-level overview" of Rustulka's duties and responsibilities. Each stipulated that as a Dealing Representative, he was "required to perform the services of an Exempt Market Deal[ing] Representative in accordance with national and provincial securities regulations and the [WealthTerra] Policies and Procedures Manual".

[23] WealthTerra's Policy and Procedures Manual (**PPM**) dated July 2010 was entered into evidence, as was a newer version updated as of May 2013. Both versions are substantially the same, and include sections with respect to general standards of conduct for Dealing Representatives, and sections with respect to dealing with clients, including KYC and suitability obligations. Wellwood confirmed that Rustulka was expected to be familiar with the contents of the PPMs, and to conduct himself accordingly.

[24] Much of the content of the PPMs replicates or paraphrases various requirements set out in the Act, NI 31-103, and certain associated policies and notices, which will be discussed later in these reasons. Examples include the following provisions:

- "Under securities legislation a registered firm and its registered representatives must deal fairly, honestly and in good faith with their clients. This includes not making false or misleading statements, or failing to state material facts in connection with a securities transaction."

- "KYC information forms the basis for determining whether trades in securities are suitable for investors. The client's investment objectives, and risk tolerance must be assessed based on the client's financial and personal circumstances including time horizon. The stated investment objectives and risk tolerance should be reasonable in light of those circumstances."

- "Representatives must update the client's KYC information as necessary to reflect any material changes to the account."

- "The suitability assessment obligations include a requirement to know and understand the risks, key features, and initial and ongoing fees associated with any

product recommended to clients. WealthTerra and its Representatives have the responsibility to assess the risks associated with the products that it sells. The Representative should understand, and be able to clearly explain to the client, the reasons that a specific security is appropriate and suitable for the client."

- "WealthTerra and its Representatives are required under s. 13.3(1) of NI 31-103 to take reasonable steps to ensure that a proposed trade is suitable for a client before making a recommendation or accepting instructions from the client. A client's investment objectives, risk tolerance, investment knowledge and financial situation must be considered when assessing suitability of trades and recommendations."

- "All communication with the public must be based upon traditional standards of truthfulness and fair dealing. Exaggerated, inaccurate, or misleading statements or claims are prohibited."

[25] Wellwood testified that the primary responsibilities of a Dealing Representative include knowing the client, knowing the exempt market product, and determining whether that product would be a suitable investment for that client. She further testified that this includes a duty to deal with clients honestly and fairly, and to present them with both the benefits and risks of any investment product accurately. Wellwood indicated that Dealing Representatives such as Rustulka received ongoing training at WealthTerra, including annual training on such things as new securities regulations or other changes in the applicable law, and periodic internal communications notifying Dealing Representatives of various regulatory issues.

[26] Some examples of the latter were in evidence at the Hearing. On June 4, 2013, Jason Brown, WealthTerra's Chief Operating Officer during the Relevant Period (**Brown**), sent a "High Priority" email to WealthTerra Dealing Representatives – including Rustulka – that attached a memorandum of the same date from Wellwood. The memorandum directed the Dealing Representatives to review the attached Ontario Securities Commission (**OSC**) Staff Notice 33-740 *Report on the results of the 2012 targeted review of portfolio managers and exempt market dealers to assess compliance with the know-your-client, know-your-product and suitability obligations* dated May 30, 2013 (**OSC Notice 33-740**).

[27] As is suggested by its title, this notice was issued to report on the common shortcomings OSC staff found on reviewing how a number of EMDs and other regulated entities in Ontario were performing their KYC, Know Your Product (**KYP**), and suitability obligations. The notice reminded readers that "[t]he KYC, KYP, and suitability obligations are among the most fundamental obligations owed by registrants to their clients, and are cornerstones of the OSC's investor protection regime". It also discussed issues of which registrants should remain mindful – such as investor over-concentration. The notice indicated that OSC staff had found instances of clients investing over 30% of their net financial assets in a single exempt market product, which raised suitability concerns "due to concentration".

[28] Rustulka acknowledged that he had received and reviewed the June 4, 2013 memorandum and staff notice in a return email he sent to Brown on June 5, 2013.

[29] In a similar vein, on June 10, 2013, Brown sent another "High Priority" email to WealthTerra Dealing Representatives – including Rustulka – that attached a June 10, 2013 memorandum summarizing some recent training that had been provided by certain ASC Staff. This included reminders such as, "'[a]cknowledgement on the part of an investor[. . .] of . . . awareness of the material negative factors or risk does not convert an unsuitable investment into a suitable one'", and "WealthTerra's policy is to ensure client allocation [i.e., in a single product or issuer, in a class such as the exempt market, or in a business sector such as real estate] does not exceed 20 to 30% of their overall portfolio".

[30] A May 7, 2015 "High Priority" email from Brown to WealthTerra Dealing Representatives – including Rustulka – attached a May 7, 2015 memorandum from Wellwood that reminded Dealing Representatives of other matters, such as the difference between an investor's "financial assets" and his or her "net assets", and that "[t]he use of **exaggeration, innuendo or ambiguity in an oral or written representation about a material fact, or other deceptive behaviour relating to a material fact, might be a misrepresentation**" [original emphasis].

[31] Wellwood also spoke to Canadian Securities Administrators (**CSA**) Staff Notice 31-336 *Guidance for Portfolio Managers, Exempt Market Dealers and Other Registrants on the Know-Your-Client, Know-Your-Product and Suitability Obligations* dated January 9, 2014 (**CSA Notice 31-336**). This notice was circulated via "High Priority" email from Brown to WealthTerra Dealing Representatives – including Rustulka – on the same date. Wellwood confirmed that Rustulka was expected to have read this document, which indicates that it was intended to provide guidance to registrants with respect to their KYC, KYP and suitability obligations under NI 31-103. We will return to some of the specific content of CSA Notice 31-336 later in these reasons.

[32] Generally, Wellwood explained that "knowing your client" includes knowing that person's financial circumstances, personal circumstances, investment goals, investment timelines, and risk tolerance. WealthTerra had a standard "know your client" or KYC form, which Wellwood stated was to be used by Dealing Representatives to collect information and facilitate the conversation between the Dealing Representative and the client, and then submitted to her as CCO for processing. Wellwood said that Dealing Representatives were trained on use of the KYC forms and were expected to fill them out accurately.

[33] WealthTerra also used "Suitability Assessment Forms", which Wellwood testified Dealing Representatives were to complete in order to confirm that they had concluded a certain product was suitable for a certain client, and to give the reasons why. The forms provided a space for written comments, following a section entitled "Suitability Considerations" that set out a series of questions, each with an associated check box allowing for either a "Yes" or a "No" answer. The questions included:

- "Does the time frame of the investment fit with the Client's current age?"
- "Does the investment fit within the Client's stated investment time horizon?"
- "Does the investment fit within the Client's stated risk tolerance?"
- "Does the investment fit within the Client's stated investment objectives?"
- "Based on your knowledge of the investment and your review of the above factors, do you believe the Investment is suitable for the Client?"

- "Based on your discussion with the Client about suitability, has the Client chosen to participate in the Investment?"

[34] According to Wellwood, every time a Dealing Representative concluded a sale to a client, an accurate Suitability Assessment Form was to be completed and submitted to her in her capacity as CCO for further review. She indicated that if she was not satisfied that a proposed investment was suitable for a given client, she could decline to approve the transaction.

[35] Wellwood further testified that Dealing Representatives were expected to have a thorough understanding of the securities products they were selling, by reading, understanding and knowing the offering memorandum (**OM**) for the product (when one was available), as well as any marketing materials or product training supplied by the issuer. Where an OM was available, she said Dealing Representatives were to provide a copy to interested clients and review it with them, especially the "Risk Factors" sections.

[36] In addition, Wellwood indicated that Dealing Representatives were to explain the RAF that accompanied the subscription agreement for the investment to their clients, and have them sign it to acknowledge that they understood the risks of the investment and were aware they could lose all their money. While Dealing Representatives could discuss projected returns on investments with clients, Wellwood said they were supposed to make it clear that they were merely projections, and were not to portray products as "safe" or "secure", or as backed or approved by any government or agency such as the ASC.

[37] Wellwood also noted that WealthTerra did not encourage clients to "leverage" or borrow money to make investments in the exempt market, as that "substantially" increases the risk of the investment. She testified that Rustulka "never disclosed that he had clients that had even brought up the use of borrowed money . . . he never disclosed to us in any way, shape or form that we ever had a client that was using borrowed money".

[38] Staff questioned Wellwood with respect to several specific products sold by WealthTerra during the Relevant Period, and OMs for some of those products were in evidence. The issuers included BestGrow Greenhouses Ltd. (**BestGrow**), a company that intended to develop a hydroponic greenhouse in southern Alberta, an oil and gas company called Western Lion Capital Inc. (**Western Lion**), and Valhalla Diamond Trust (**Valhalla**), organized to fund the acquisition and management of investment-grade diamonds.

[39] Wellwood indicated that while all exempt market products are considered high-risk investments, internally, WealthTerra identified or "ranked" some as riskier than others. She mentioned using a five-point scale with Dealing Representatives for training and discussion purposes, where "one" was the riskiest of risky investments, and "five" was the least risky – but still within the category of high-risk investments. She described BestGrow, for example, as a "one", or "probably one of the highest risk investments [they] had". She similarly described Western Lion as "highly speculative", and indicated that Valhalla was a "three".

[40] The OMs for the BestGrow, Western Lion, and Valhalla offerings reflect this, as they contain extensive risk warnings and disclaimers, including with respect to illiquidity, lack of

operating history, the lack of assurance regarding the prospect of positive (or any) returns on investment, risk of a total loss of the investment, industry risk, and lack of review by any securities regulatory authority. All three state that an investment in the issuer is only suitable for those who can bear a total loss of their invested funds.

[41] Finally, Wellwood testified concerning the circumstances that led to Rustulka's departure from WealthTerra. Some time in or around 2014, WealthTerra received a complaint about him from a referral agent with respect to him encouraging the use of borrowed funds for investment. Accordingly, Wellwood said she put "certain restrictions" around Rustulka's activities, and then later officially put him on terms and conditions that also restricted his activities. Eventually, she stated, he was not permitted to do any business outside her presence, so that she could be there to monitor what he was saying to his clients.

[42] Wellwood testified that as WealthTerra continued to monitor Rustulka's activities, other concerns came to light, although she noted that on speaking to a number of Rustulka's clients, most were "very happy" with him. She said WealthTerra eventually discovered that he had misrepresented information on a KYC form, so she ordered him to stop interacting with clients entirely and come up with a plan for moving forward. He "circumvented that order and went around [her]", so she finally concluded that he was either unwilling or unable to "comply with the rules". Accordingly, as she described it, she terminated Rustulka with cause.

[43] A June 21, 2016 letter from Wellwood to Rustulka was in evidence. The letter indicated that it related to WealthTerra's earlier submission of Form 33-109F1 *Notice of Termination of Registered Individuals and Permitted Individuals*, and recounted the issues that led to WealthTerra's decision to terminate him. The issues identified included failing to collect sufficient KYC information, failure to follow WealthTerra's PPM (including those sections addressing KYC and suitability obligations), and breach of his contract with WealthTerra by failing to adhere to securities laws. The letter also noted that Rustulka was experiencing "financial challenges", which Wellwood suggested may have affected his objectivity in assessing client suitability.

[44] It appears as though Rustulka attempted to characterize his departure from WealthTerra as voluntary – including in emails sent to his clients on or about May 31, 2016, advising that he was "stepping down" from WealthTerra "effective immediately" in order to pursue further education in financial planning. He also sent Wellwood an email on June 1, 2016 stating that he was resigning from WealthTerra effective that day. Wellwood was unable to explain the discrepancy between Rustulka's ostensible resignation on June 1, 2016 and her June 21, 2016 letter explaining the termination. However, the National Registration Database records in evidence, citing "Dismissal for Cause" as the reason for termination, appear to confirm that Rustulka's termination occurred on or about the date of his ostensible resignation.

## C. Investors

### 1. SA

[45] At the time of his appearance at the Hearing, SA was working in sales and account management. He has a high school education, as well as a certificate in oil and gas land administration.

[46] SA first discussed investing with Rustulka in approximately September 2014, when Rustulka came to his home to present various investment options.

[47] Rustulka completed a KYC form for SA and SA's spouse (sometimes referred to collectively in these reasons as the **As**) as joint applicants, which was signed by each of them and dated October 11, 2014. As of that date, SA was 39 years old, and his spouse was 36. They had one dependent. In addition, the KYC form indicated that:

- SA's annual income was $90,000 while his spouse's annual income was $5000 plus $2000 in "other" sources of income;
- including their primary residence, they had total net assets and a net worth of $246,500, and $166,400 in net liquid assets;
- their purpose in investing with WealthTerra was to make both long-term and short-term investments;
- they had "Good" investment knowledge, defined on the form to mean, "[y]ou have either traded in or have some knowledge of the basic characteristics of both fixed income securities and common shares, as well as basic understanding of the degree of risk and reward inherent in these types of securities";
- they had a "High" risk tolerance, defined on the form to mean, "can risk the possibility of losing some or all of your original investment and have no immediate liquidity needs";
- their investment objective was "[t]o start moving funds into the Exempt Markets", and they had an investment time horizon of "30+ years"; and
- their investments outside the exempt market were medium- and high-risk, and their investments outside WealthTerra were valued at $80,500.

[48] A Suitability Assessment Form for the As – also dated October 11, 2014 – had all check boxes marked "Yes". It stated that they had about $81,000 in equity in their home, and "could easily recover" from any losses of their invested funds. It further indicated that Rustulka had informed the As the exempt market was high-risk and they could lose all of their money, and they had informed him that "they [were] willing to take the higher risks for better returns".

[49] When questioned about these documents, SA testified that he did not think that the figures for the As' assets, net worth, and investments outside of WealthTerra were correct. While they did have approximately $80,000 in equity in their home at the time, apart from that, they had only two vehicles, a small RRSP, a small investment through SA's employer, approximately $25,000 in one or more tax-free savings accounts (or **TFSAs**), and a small amount of other savings. Further, SA described his knowledge of exempt market products as "[v]ery poor" at that time (having never invested in the exempt market previously), and his general investing knowledge as "[n]ot great".

[50] SA confirmed that he and his spouse had a high risk tolerance at the time, and were prepared to lose the funds that they invested. However, he disagreed that their investment time horizon was 30 years or more, and testified that they intended their investments with Rustulka to be short-term, with a time horizon of five years at the most.

[51] In December 2014, SA and his spouse invested $15,244 from their TFSA funds in BestGrow and $11,100 in Valhalla, for a total of $26,344 invested through Rustulka. The content of the Suitability Assessment Forms that accompanied each of these investments is nearly identical.

[52] SA recalled receiving an OM for BestGrow, and said he spent a few hours reviewing it before deciding to invest. He understood from the documentation that it was a high-risk investment, but also understood from Rustulka that despite what the documents said, it was "safe" and "would not be high risk".

[53] Similarly, SA recalled seeing Valhalla's OM before investing, but doubted he reviewed all 228 pages of it. Again, he understood from the documentation that it was a high-risk investment, but that was qualified by Rustulka's verbal assurance that while the risk level for exempt market products is high, he had never lost any of his clients' money and the likelihood of the As losing their money was "minimal".

[54] SA acknowledged that this advice was inconsistent with what he saw in the OMs. However, he pointed to an email he received from Rustulka at the end of August 2014, in which Rustulka stated, "Remember that not one of my clients have [sic] ever lost investment dollars because we choose winning companies that have longevity, great track records, accountability, and much more." SA further testified that despite what the investment documentation said, "the verbal acknowledgment by Mr. Rustulka indicating that he's never lost any money was of a significant influence in [their] decision to invest with him". SA also mentioned that he and his spouse trusted Rustulka at least in part because of Rustulka's past as a police officer and a pastor.

[55] According to SA, Rustulka suggested that the As use their line of credit or remortgage their home to make additional investments. Although this option was discussed in emails between Rustulka and SA in December 2014, SA and his spouse did not invest using any borrowed funds.

[56] With respect to the current status of the investments, SA testified that they have not received any returns or repayment of principal from BestGrow, and it "doesn't look too promising at this point". They have not received any returns or repayment of principal from Valhalla, either, and SA indicated that he had been told it will likely not pay returns for at least another eight to nine years. These financial losses set them back "for a few decisions in life", including the adoption of a second child.

### 2. DC

[57] At the time of the Hearing, DC was working in administration for a union. She has a grade 12 education.

[58] DC testified that she was introduced to Rustulka by a friend, whom documents in evidence disclose was fellow investor, TH (discussed later in these reasons). DC was 51 years old at the time and had a common-law spouse, but no dependents. Rustulka completed a KYC form for DC dated December 15, 2014. It contained the following information:

- her annual income was $60,000, and her spouse's annual income was $300,000;

- including their primary residence, they had total net assets and a net worth of $1,210,000, and $210,000 in net liquid assets;
- her purpose in investing with WealthTerra was to make both long-term and short-term investments;
- she had "Good" investment knowledge, defined as set out previously;
- she had a "High" risk tolerance, defined as set out previously;
- her investment objective was to prepare for retirement, with a time horizon of "15+ years"; and
- she had other medium- and high-risk investments outside of WealthTerra valued at $100,000.

[59] In addition, Rustulka marked all check boxes "Yes" on the accompanying Suitability Assessment Form, and noted that DC and her spouse owned a home with over $600,000 in equity and she wanted to invest $80,000 in cash. Given her $210,000 in liquid assets, he calculated that she could invest 20% of that amount – or $42,000 – in any individual project. He further commented that she did not intend to retire "any time soon", understood the high-risk nature of the exempt market, and was willing to take that risk.

[60] Staff counsel reviewed this information with DC. While she agreed that her income was $60,000 per year at the time as shown, she did not feel her common-law spouse's income should have been referenced because, as she explained to Rustulka, they kept their finances entirely separate and her spouse "should not be included in any of this, nor does he want to be". She also disagreed that her net assets including her residence were worth $1,210,000 as shown. Her evidence was that the home was worth less than $600,000, and she was only entitled to half of it. Therefore, her net assets included only that sum of $300,000, plus $210,000 in liquid assets (her RRSPs, TFSAs, and some cash) and the pension she had through her employer, although she was not sure of the latter's exact value.

[61] DC denied that her investment knowledge at the time was "Good", and said that it should have been shown as "Limited" – or, as she described it, "[m]y knowledge is limited . . . . Less than limited, obviously". She had never heard of nor invested in the exempt market prior to meeting Rustulka, and was unable to describe it clearly in her testimony other than to say that she understood it paid higher returns and you "needed to know people" in order to get into it. She believed Rustulka was aware that she had no prior experience investing in the exempt market, as she had told him she knew nothing about it.

[62] DC further disagreed that she had a "High" risk tolerance, and that the investments she had outside the exempt market were medium- and high-risk. To the contrary, she had a minimal risk tolerance, and her previous investments were all in low-risk products held in RRSPs and TFSAs. She also testified that while her investment objective was retirement planning, she told Rustulka she wanted to retire within six or seven years. Therefore, her investment time horizon was seven to eight years, not "15+".

[63] On Rustulka's recommendation, DC invested a total of $80,000 through WealthTerra between December 2014 and April 2015, including investments in BestGrow, Western Lion, and

two others. The content of the Suitability Assessment Forms submitted for each investment was the exact same.

[64] According to DC, Rustulka told her that his own son had recently invested in BestGrow, and her investment would be "very safe", paying returns of 18 to 25% "within three years" at most. She recalled that he downplayed the risk and pointed to the risk "WARNING" line on the RAF with some amusement. He spent little time reviewing the form with her. She was left with the understanding that executing an RAF was simply something she had "to go through" in order to close each exempt market transaction, and that the actual risk was minimal. She did not think she and Rustulka discussed the suitability of the investment for her, but remembered that he told her it was "a great company", his clients were "all" investing in it, and "it was supposed to do extremely, extremely well".

[65] Her understanding that BestGrow was a safe investment "played a huge role" in her decision to proceed. She also understood that she could sell the investment at any time.

[66] Similarly, DC testified that Rustulka told her Western Lion was a "well-known", "leading" oil and gas company that "all of his clients" were getting into. He led her to believe that there was only a short opportunity to invest in Western Lion, and that because it was "in high demand", she would be able to sell her investment at any time with ease. She recalled seeing Western Lion's December 18, 2013 OM, but said she did not read it in its entirety because she trusted Rustulka's recommendation. As with her other WealthTerra investments, Rustulka told DC an investment in Western Lion had either no risk or "very, very low risk", and she would not lose her money. Despite having her sign an RAF, DC said Rustulka would "chuckle at the severity of the high risk" warning it contained. Again, her understanding that it was a low-risk investment had a "great impact" on her decision to proceed.

[67] DC testified that she and Rustulka had several conversations during which she told him she "was not interested in high-risk anything". Her evidence regarding all of her conversations with Rustulka was consistent – he would downplay the risk by chuckling, rolling his eyes, and telling her that while he was required to warn her about risk, the exempt market products he was recommending actually carried minimal risk. DC said she would not have made any of the investments she did if she had known otherwise. She said she also relied on his indication that the investments had been reviewed by lawyers and were "backed" by the government or the ASC. She considered it "[v]ery important" that she not lose any of her money, as she was using her retirement funds.

[68] In that regard, DC also testified that Rustulka had at one point suggested she transfer her pension funds and remortgage her home to make further investments. She declined both suggestions because of her aversion to risk, and noted that this started to erode the trust she had originally had in Rustulka because of his past as a law enforcement officer, minister, and guidance counsellor.

[69] Unsurprisingly, DC indicated that although she has tried, she has been unable to re-sell her investments. She received a small return on one of the investments, but nothing on the others. None have repaid her principal.

[70] When asked about the impact of losing her money, DC said that it was going to take her much longer before she could retire. She also testified that the financial losses have been "very stressful", as she had not been in a position to withstand them. She has lost her ability to trust other people, including with respect to making any further investments in the Alberta capital market. It was also apparent that DC carries a significant amount of guilt over having referred her young adult daughter to Rustulka, with whom her daughter had invested what DC believed to be her entire savings.

### 3. TH and RH

[71] TH and RH (also referred to collectively in these reasons as the **Hs**) are married, and both testified at the Hearing.

[72] TH has a high school education, augmented by classes she took through the Northern Alberta Institute of Technology, or NAIT. At the time of the Hearing, she was self-employed, and ran her own bookkeeping and accounting business.

[73] RH has a grade 10 education, and at the time of the Hearing, he was working on a part-time or seasonal basis as a fuser helper or welder's helper.

[74] Both of the Hs have past experience working part-time as sales representatives for Primerica Life Insurance Company (**Primerica**), although TH only did so for a short time. They had to take a one-day training course and write an exam to become Primerica sales representatives, but were not registrants under securities laws. According to TH, they only became sales representatives because it allowed them to earn commissions on their own Primerica investments.

[75] The Hs were referred to Rustulka by a friend, and they first met him in 2013 when he came to their home to discuss investing in the exempt market through WealthTerra. Both TH and RH mentioned that Rustulka told them about his past as a police officer and a clergyman, which increased their level of trust in him.

[76] There were two WealthTerra KYC forms in evidence for the Hs as joint applicants. The first, dated May 3, 2013, contained the following information:

- at the time, RH was 58 years of age, TH was 62, and they had no dependents;
- RH's annual income was $75,000 and TH's was $30,000, plus $7760 in unspecified "other" income;
- although the math clearly does not add up, the "Financial Information" section of the form indicated they had total net assets (including their primary residence) of $585,000, net liquid assets of $627,429, and a net worth of $250,000;
- their purpose in investing through WealthTerra was to make long-term investments;
- their investment knowledge was "Good", defined as set out previously;
- they had a "High" risk tolerance, defined as set out previously;
- their investment objective was "[t]o move their investment dollars into the Exempt Markets";
- their investment time horizon was "15+ years"; and

- their investments outside the exempt markets were medium- and high-risk, and valued at $593,429.

[77] The accompanying Suitability Assessment Form indicated that it related to several investment products Rustulka proposed to sell to the Hs on May 3, 2013. It had all check boxes marked "Yes". The narrative portion stated that while RH was semi-retired, he was still working casually and earning $75,000 to $150,000 per year. It went on to say that TH was only working part-time and on a casual basis, and was looking to let go of her accounting clients within six to eight months. It also indicated that the Hs "d[id] not mind" the high risk of the exempt market, as they had other real estate and would be "diversifying" by investing in "many different opportunities in the Exempt Markets".

[78] The second KYC form for the Hs appeared to have been created in late May 2014, although it also appeared that some of the pages from the first KYC form – including the client signature page – were simply photocopied and inserted into the second.

[79] The second KYC included the following updated information:

- RH's annual income was still $75,000, but he also had $26,920 in unspecified "other" income;
- TH's annual income was still $30,000, but her "other" income increased to $13,820; and
- they had total net assets (including their primary residence) of $1,887,429, net liquid assets of $1,052,429, and a net worth of $1,887,429.

[80] The second KYC form was also accompanied by a Suitability Assessment Form. It was still dated May 3, 2013, and identical to the previous version, except that it indicated that it related to several additional investment products Rustulka proposed to sell to the Hs, and a handwritten notation had been inserted at the bottom of the page stating that, "[RH] has just inherited $550,000 from his mother".

[81] Two further Suitability Assessment Forms were in evidence relating to investments the Hs made in February and March 2015. The one dated February 2015 had all check boxes marked "Yes", and noted that the Hs both had "successful careers", "own[ed] their own home on an acreage", had net assets of over $1.8 million and liquid assets of over $1 million, and understood the high-risk nature of the exempt market, including the possibility they could lose all of their invested capital. The one dated March 2015 was virtually identical to the May 2013 version.

[82] Both TH and RH testified that there were a number of inaccuracies on the forms.

[83] While TH thought that the annual income figures shown on the KYC forms were approximately accurate, she disagreed with the suggestion on the Suitability Assessment Forms that RH could earn anything close to $150,000 per year at that time. Similarly, RH agreed that he was earning approximately $75,000 per year at around the dates shown, but noted that this amount varied considerably from year to year depending on what he was doing. He would only earn more than that amount and up to $150,000 if he worked full-time year-round, which he was not doing

at the time. In addition, he was unsure of the "other" sources of income shown, and where the figures had come from.

[84] The Hs also questioned the accuracy of some of the total net assets, net liquid assets, and net worth figures shown. However, their evidence as to what the correct numbers ought to have been was sometimes unclear or inconsistent.

[85] For example, notwithstanding the nonsensical math, TH said that she thought the numbers on the first KYC form were generally accurate. Despite this, she said that she thought their home was mortgage-free then and worth the $585,000 shown as the value of their total net assets. At the same time, she also said that she thought the home had a line of credit secured against it that had been used to purchase other real estate, and that they may also have owned a condominium as of that date.

[86] Similarly, and again despite the nonsensical math, RH said while he thought the numbers on the first KYC were generally accurate, he described their assets in May 2013 as including approximately $400,000 in RRSPs at Primerica, some cash, their home, a second property with approximately $40,000 in equity, and a condominium – although he could not recall the condominium's value or the size of any mortgage it may have had.

[87] TH testified that she did not understand the numbers shown on the second KYC form. However, her estimation of the correct numbers again appeared to involve some questionable math. Although she corrected the amount RH had received from his mother the previous year (a $400,000 gift rather than a $550,000 inheritance), she said that she thought the Hs' estimated net worth including that sum was only around $800,000 in May 2014. RH similarly disagreed with the numbers shown on the form, but thought their net worth at that time was approximately $1,200,000.

[88] While this evidence was therefore difficult to follow at times, we took it as evidence of the passage of time rather than as a lack of credibility.

[89] Moreover, the Hs' evidence with respect to other important points was very clear. TH was unequivocal in her disagreement with the statements on the KYC forms and Suitability Assessment Forms concerning the Hs' investment experience, risk tolerance and objectives. She testified that before investing through WealthTerra, the investments she and RH held were not in medium- or high-risk products, they were in low-risk products held at Primerica. She said she had little knowledge of exempt market investment products, and had never invested in one before meeting Rustulka.

[90] Further, TH stated that she was not comfortable with high levels of risk. She described her risk tolerance as "medium" at the time, and said that she told Rustulka it was "very important" she not lose her money. Contrary to the statements in the Suitability Assessment Forms, she disagreed that the Hs were interested in high-risk investments, especially given their respective ages.

[91] TH also denied that her investment time horizon was "15+ years", as she would have been nearly 80 years old by that time. She said she told Rustulka that because she was planning to retire

within the five years following May 2013, her time horizon for the investments she made through him was two to five years, and she was not comfortable with anything longer term. Her investment objective was not "[t]o move their investment dollars into the Exempt Markets" – it was to "make money for retirement".

[92] RH also addressed these issues clearly. He stated that his knowledge of the exempt market was "moderate to low" when he first met Rustulka, as he knew little about it and had never invested in it before. However, he considered his overall investing knowledge "[m]oderate to high" because of his time selling insurance for Primerica, his experience investing in RRSPs and some other types of investments, and the fact that he passed the mutual fund dealer's examination in 2011 or 2012 (even though he did not end up getting his mutual fund sales license).

[93] With respect to risk tolerance, RH described himself as willing to accept high risk – even "stupid high risk" – but he acknowledged that TH "is more conservative, very conservative". Therefore, it was his view that the assertion on the first Suitability Assessment Form that he and TH "do not mind the High Risks that come along with the [exempt] Market" did not accurately describe them both. He also said that when he and TH began investing through Rustulka, their investment objective was to earn "a rate of return that was fairly safe" so that they could retire earlier, and his objective for the money from his elderly mother was to have enough to look after her for the rest of her life. He therefore wanted a return that was better than what they would have achieved through a bank, but on investments that were "not very high risk", particularly in respect of the money he received from his mother. It was Rustulka's suggestion that they could do so by "mov[ing] their investment dollars into the Exempt Markets" as shown on the KYC forms.

[94] RH also disagreed that the Hs' investment time horizon was "15+ years". Given their respective ages, he felt it was approximately three to five years, or perhaps eight years at the most.

[95] In total, over the period from approximately May 2013 through March 2015, the Hs moved all of their savings to WealthTerra, and invested approximately $880,000 (plus another $36,000 USD) in exempt market products through Rustulka. This included approximately $300,000 of the funds RH received from his mother and his entire Primerica RRSP. Investments were made in BestGrow, Western Lion, Valhalla, and several others.

[96] Staff asked the Hs what Rustulka told them about some of these investment products. They testified that he gave very optimistic portrayals of the companies' successes and the returns that could be expected within relatively short time frames. He focused on those aspects while greatly downplaying the risks involved in the exempt market generally, and in these investments specifically. They said they understood from Rustulka that he and WealthTerra had done due diligence on the track records and financials of the companies, and that they were "stable", "solid", not "fly-by-night", and were unlikely to "go under". They further understood that these would be "fairly safe, secure investments" on which there was only a "[v]ery slim" chance they would lose money.

[97] According to RH, these representations played a "very big role" in his decision to make the investments he did.

[98] Despite this evidence, both TH and RH acknowledged that they had signed RAFs for each investment. However, both testified that Rustulka spent minimal time reviewing these documents with them, and portrayed the RAFs as nothing more than "a formality" necessary to make the investments. In other words, the Hs understood that the investments were "not necessarily high risk" despite what the language in the RAFs suggested, but the issuers were required by securities regulation to include such warnings and investors were required to sign and acknowledge them.

[99] Given the amount of money the Hs invested, Staff counsel asked them each whether Rustulka ever suggested that they were investing too heavily in exempt market products. Both stated that he did not. To the contrary, TH said that Rustulka "wanted [them] to invest everything" into WealthTerra's products, and both she and RH reported that Rustulka suggested they sell or remortgage their home in order to make further investments. They declined to do so.

[100] TH and RH reported mixed success with respect to the status of their investments. Some paid returns, some had paid returns for only a limited period of time, and some had paid no returns at all. They understood that some of the issuers were still going concerns at the time of the Hearing, or were in the process of trying to salvage the business. Others – such as Western Lion – had ceased to operate, and the Hs considered the principal they had invested "a write-off". Only one investment returned their principal, in the amount of $70,000.

[101] Finally, the Hs were asked about the impact of the financial losses they sustained on their WealthTerra investments. It has delayed their planned retirement, to the point that TH questioned whether they would ever be in a financial position to retire. RH stated that he used his entire RRSP to make the investments. He is still working, so he is unable to holiday or enjoy free time as he would like to in his later years.

[102] As for the future, TH said that she is no longer willing to make these kinds of investments in the Alberta capital market. RH pointed out that they no longer have the money to do so.

**4. BJ**

[103] BJ has a high school education, and worked for the Alberta provincial government until he retired from his position there in June 2019.

[104] BJ and his spouse, WJ (sometimes referred to collectively in these reasons as the **Js**), met Rustulka in the spring of 2015 after being referred to him by WJ's sister. Their first meeting with him was at their home, where he presented them with various investment opportunities. BJ stated that he and WJ had "[v]ery poor" knowledge with respect to the exempt market at the time they first met Rustulka, as they had never invested in it before.

[105] BJ noted that Rustulka told him and WJ that he had previously worked as a police officer and a pastor. This increased the level of trust they had in him.

[106] Individual KYC forms for BJ and WJ, both dated March 3, 2015, were in evidence. BJ indicated that he recognized both forms, and said that he and WJ signed them, but Rustulka filled them out. The forms contained the following information:

- BJ was 52 years old, and WJ was 53; they had no dependents;
- BJ was still working for the government of Alberta, at an annual salary of $72,000;
- WJ was working in administration for a public school board, at an annual salary of $94,000;
- excluding their primary residence, the Js had total net assets of $466,900, net liquid assets of $204,900, and a net worth of $466,900;
- the Js' purpose in investing with WealthTerra was to make long- and short-term investments;
- each of the Js had "Good" investment knowledge and a "High" risk tolerance, both as previously defined;
- the Js' investment objective was to prepare for retirement, with an investment time horizon of "15+ years"; and
- the Js' investments outside the exempt market were medium- and high-risk, and were valued at $120,000.

[107] Each KYC was accompanied by a WealthTerra Suitability Assessment Form, also dated March 3, 2015. All check boxes on both Suitability Assessment Forms were marked "Yes". The content was identical and repeated some of the information from the KYC forms, although the Suitability Assessment Forms stated that the Js' had "over $260,000" in liquid assets rather than the $204,900 shown on the KYC forms. The Suitability Assessment Forms also noted that in addition to their home, the Js owned an acreage with a house outside of Edmonton and had a "minimum debt load". The narrative went on to say that the Js were preparing for retirement within five to 10 years, and wanted to get into the exempt market to earn greater returns. Rustulka claimed he had informed the Js of the high risks of the exempt market, but they were "willing to take the higher risk for higher returns".

[108] In response to Staff counsel's questions about the accuracy of this information, BJ testified that while the income and estimated net worth figures (but *including* their primary residence) were accurate, the estimated net asset (*excluding* their primary residence) and net liquid asset figures were overstated. BJ explained that they owned what he described as a modest "weekend place" outside of Edmonton worth approximately $200,000, but otherwise their assets included only the equity in their primary residence (approximately $200,000), some vehicles, and the pensions they had with their respective employers. They had no other investments until they invested through WealthTerra.

[109] BJ also addressed the portions of the KYC forms that he considered correct: his general investment knowledge was "Good" as shown, his purpose in investing with WealthTerra was to make long- and short-term investments as shown, and his investment objective was to prepare for retirement as shown, although he said he told Rustulka that he hoped to retire at age 55 and not within five to 10 years. He did not disagree that his investment time horizon was "15+ years", but said that Rustulka told him and WJ that the actual "turnaround" for the investments Rustulka presented was three to five years, within which they would "double to triple [their] money".

[110] BJ acknowledged that he initialled the box on the KYC form that indicated that he was comfortable with a high-risk investment, could risk losing some or all of the original investment amount, and had no immediate liquidity needs. He also acknowledged Rustulka's notation on the

Suitability Assessment Forms that the Js had been warned about the high risk. However, he explained that Rustulka also told them that "it was a formality to inform us of the risk factor, but in [Rustulka's] opinion, there was no risk involved, just a formality that had to be signed and discussed." This was significant for the Js, as BJ described their risk tolerance at the time as "low". They did not have an ability to withstand significant financial losses.

[111] Collectively, the Js invested approximately $130,000 through WealthTerra on March 3, 2015, including investments in BestGrow, Western Lion, and two others. An identical copy of the March 3, 2015 Suitability Assessment Form was included with each subscription agreement.

[112] According to BJ, he and WJ leveraged their two properties in order to generate the cash needed to make these investments. Rustulka had "highly recommended" that they do so, and even arranged for a property evaluation to be conducted on their weekend home for that purpose. However, Rustulka did not explain the additional risks of using borrowed funds to invest.

[113] BJ testified that he understood from Rustulka that "the Government of Alberta [had] protected or had involvement" with the companies presented, "to make sure that they were on board and a decent company". When Staff asked for further details in this regard, BJ explained that "what [Rustulka] had described" was that "basically the Government of Alberta looked into these companies, and they were secured to some point, that they were just not run-of-the-mill or the fly-by-night companies". The Js relied on this information in deciding to make the investments they did, as they appeared to be more secure.

[114] BJ testified that Rustulka described BestGrow as a "solid, solid investment", and that he (Rustulka) knew the person who ran the company. BJ understood that it was a start-up business. He recalled receiving a "pamphlet" about the company from Rustulka, and thought he had looked at its OM. He said Rustulka did not describe BestGrow as a risky investment, but instead focused on "the gold pot at the end of the rainbow", advising, as mentioned, that they could expect to double or even triple their money within as little as three years. BJ did not think there was "any risk at all" that he would lose money on the investment. He reiterated that he and WJ trusted Rustulka – especially in light of his past as a police officer and pastor – and decided to proceed with the investment in reliance on Rustulka's representation that it was secure.

[115] BJ's evidence was similar with respect to what Rustulka told the Js regarding Western Lion and the others. He understood that Western Lion was "a great investment opportunity" that was "safe", with "minimal risk", and a "negligible" chance of losing all their money. Another was a "[s]olid company", "[v]ery safe", and also a "great investment" that would generate "enormous" returns with "minimal risk" and a "[n]egligible" to "[n]onexistent" chance of losing money. The other offered "[a]mazing" returns, essentially doubling an investor's money within three years and tripling it within five. It, too, carried "virtually no risk", and there was a "negligible" chance of losing money. BJ said he made his investment decisions in reliance on these representations, especially the assurances that there was no risk, or a "very minimal risk".

[116] RAFs with respect to each of the Js' investments were in evidence. BJ indicated that he could not recall the exact discussion they had with Rustulka at the time those forms were signed,

but testified that Rustulka spent very little time going over them and did not clearly explain the risks. According to BJ, "everything regarding any kind of risk that was explained to us, it was just a formality that he had to bring to our attention". Rustulka minimized that aspect, and told the Js "not to worry about any risk involved".

[117] BJ did not recall Rustulka discussing suitability, or warning the Js about investing too heavily in exempt market products.

[118] With respect to the current status of these investments, BJ reported that some have paid returns in fairly nominal amounts, but he and WJ have not recouped their principal from any of them. At the time of the Hearing, the Js still owed approximately $100,000 on the line of credit they took out to finance the investments.

[119] BJ testified that the financial losses he and WJ have sustained have put a "tremendous strain" on both of them. He described being "humiliated" into having to sell the Js' primary residence in the city and buy a mobile home to live in on rented land, and the disruption of their plans to build a home on their weekend property. He further testified that his view of investing in the Alberta capital market has "soured . . . to say the least", and he will never invest again because he and WJ cannot afford any additional financial losses. He also indicated that both he and WJ will have to defer their retirement plans, and that he was going to have to seek another job to supplement his pension. At the end of his testimony, he told us that he would be leaving the Hearing "humbly and shamefully and tail between [his] legs".

**5. BK**

[120] BK has a grade 12 education, and was employed as a salesperson at the time of the Hearing. He was referred to Rustulka by a co-worker in 2013.

[121] BK had never invested in anything before meeting Rustulka, other than to purchase a few thousand dollars' worth of silver. He had never heard of the exempt market, and described his investment knowledge at the time as "[v]ery poor" to "none". He therefore relied heavily on what Rustulka told him.

[122] BK also said he had a "high level of trust" in Rustulka, because he was aware that Rustulka was a former law enforcement officer and pastor, which he considered "probably two of the most honest professions in the world". He said this played a major role in his decision to invest through Rustulka.

[123] BK identified his WealthTerra KYC form dated May 18, 2013. He recalled spending no more than five to 10 minutes discussing it with Rustulka, who had filled it out and then simply directed him where to sign or initial. The form included the following information:

- BK was 53 years old at the time, married, but with no dependents;
- he was working as the operations manager for a carpet wholesaler, earning $75,000 per year;
- his spouse's income was $42,000 per year;

- including their primary residence, BK and his spouse had total net assets of $305,000, net liquid assets of $200,000, and a net worth of $305,000;
- his purpose in investing with WealthTerra was to make long- and short-term investments;
- his investment knowledge was "Good", and he had a "High" risk tolerance, both as previously defined;
- his investment objective was "[t]o start investing into the Exempt Markets";
- his investment time horizon was "15+ years"; and
- he had medium- and high-risk investments outside the exempt market, and investments outside of WealthTerra worth $213,000.

[124] A Suitability Assessment Form of the same date had all check boxes marked "Yes" for BK. The narrative stated that BK owned "a large quantity of silver coins", and understood the risks of the exempt market (including that he could lose all of his invested funds). However, he was willing to take the higher risk for a higher return. The form also indicated that BK had over $200,000 in pension funds that were going to be paid to him in cash.

[125] A second Suitability Assessment Form for BK dated September 21, 2014 contained similar information in a longer narrative. All check boxes were again marked "Yes". The narrative explained that BK had a company pension he was able to transfer into a locked-in retirement account, did not intend to retire "any time soon", and in fact expected to work beyond age 67. It also indicated that BK owned "a vast amount of silver coins worth a street value of $15,307" that would be worth much more "if melted down". Rustulka claimed that he had explained the high risks of the exempt market to BK and his spouse, but BK had "strategi[z]ed" how he would distribute his investment funds among three opportunities (including BestGrow and Valhalla) in order to cover any losses. Moreover, he had his silver collection "to drop back to".

[126] BK testified as to numerous points of dispute with the information shown on these forms, including the financial details. His annual income was closer to $60,000 than the $75,000 shown, and his spouse's annual income was closer to $36,000 than the $42,000 shown. He thought their net assets and net worth were less than the $305,000 shown, as they did not own a home at that time, and their only assets were the silver and their employment pensions. He disagreed with the notion that he could rely on his silver collection if he sustained investment losses, because it was not worth enough. According to BK, Rustulka knew the correct income and asset figures, but told BK that, "these are just figures that I put down. They don't mean anything". BK agreed to Rustulka doing so because Rustulka had said there was a certain financial threshold BK had to meet in order to make these kinds of investments.

[127] As for his investment objective at the time, BK testified that he wanted to build funds for retirement at age 63 to 65. Therefore, his time horizon was less than "15+ years". He was inexperienced and did not have "Good" investment knowledge, nor did he have a high risk tolerance. To the contrary, BK described his investment knowledge as "very limited" or "none at all", and said he had wanted only "very, very low risk" investments because he could not afford to lose any of his money. He reiterated that this was very important to him, as those were all the funds he had for retirement.

[128] According to BK, Rustulka said exempt market investments were "high-risk", but then described the risk on a five-point scale, where "one" was the "most volatile", and "five" was the safest. Based on his understanding of the scale, BK chose investments Rustulka said were a "four" or a "five", as Rustulka told him that those investments were "very safe", and had been "handpicked by himself and WealthTerra" such that there was "very little chance" BK would lose his money. He decided to invest on that basis, as "it seemed like a sure thing".

[129] BK acknowledged that Rustulka had him sign and initial documents – including RAFs – that mentioned high risk and the possibility of losing everything, but said that Rustulka spent little time reviewing these documents with him. Instead, Rustulka emphasized his one-to-five scale and the fact that the investments BK was making were "fours" or "fives", and were therefore '"a no-brainer"'. BK testified that whenever Rustulka brought him documents to sign, he signed or initialled quickly where Rustulka directed and did not read what he was signing, as Rustulka "was always in a hurry". As he understood it, the RAFs were simply a part of the "red tape" – a "formality" necessary to complete the investment transactions.

[130] In 2014, BK and his spouse invested a total of $187,398.20 in exempt market products through Rustulka, including almost $95,000 in BestGrow and over $60,000 in Valhalla. He used all of the employment pension funds he had built up over a long career in order to do so. Despite the fact that Rustulka knew he was investing all of his money, including his pension, he said that Rustulka did not suggest he was putting too much into the exempt market.

[131] When shown BestGrow's March 27, 2014 OM, BK thought he had seen at least part of it before he invested, but he did not read it in its entirety. Instead, he relied on Rustulka's description of BestGrow (which Wellwood had called a "one", or "probably one of the highest risk investments [they] had") as the "safest of all the investments that were selected by him and WealthTerra" – a "five" on the five-point scale and a "guaranteed winner". The assurance of safety was the deciding factor in BK's decision to invest in BestGrow. He understood that there was "zero" likelihood he would lose some or all of his money.

[132] BK briefly addressed an email in evidence that Rustulka appears to have sent to clients on May 15, 2013, and which BK said was forwarded to him by someone he knew (apparently the next day). This email referred to BestGrow as a "new product" on WealthTerra's shelf, and encouraged readers to invest in it as soon as possible because it was likely to sell out to "a large firm" very soon. Rustulka further described it as a '"White Collar"' investment that would normally only be available to the wealthy. He claimed that BestGrow's "[t]echnology partner" had never had a failed facility, and that the investment had been through "3 due diligence processes" including WealthTerra's.

[133] According to BK, Rustulka rated Valhalla (which Wellwood described as a "three") as a "four" on his one-to-five scale. He recalled that Rustulka told him it was not quite as safe as BestGrow, but was still "a very safe investment". Again, BK understood it was "[v]ery unlikely" he would lose his money, and made his decision to invest based on that understanding. He did not recall seeing Valhalla's April 2, 2014 OM, but thought he may have received other documents concerning Valhalla after he made his investment.

[134] BK indicated that as of the date of his testimony, he did not know the current status of any of his investments. He has not received any returns from any of them, nor any repayment of principal. As he does not know whether any of them will ever pay out, he and his spouse are afraid of what the future might hold for them, as they were not in a position to lose all of their money.

[135] BK further stated that he would not invest in the Alberta capital markets again, because his experience with Rustulka "has put a bad taste in [his] mouth". He did not know anything about "these types of investments", and realizes now that he should not have trusted one person with all of the money that he had.

**6. HLM**

[136] HLM has a post-graduate education, and worked in psychology and education before retiring in approximately July 2016.

[137] Unlike Staff's other investor witnesses, HLM said she first met Rustulka in early 2011, prior to his joining WealthTerra. She and her spouse were looking for investments they could make to grow her 85-year-old mother-in-law's assets to provide for her care and to provide her with something to leave to her six children after her death. On her behalf, they had invested in an exempt market product through Rustulka and it had done very well, returning over $55,000 on a $200,000 investment within a few years. HLM said that she and her spouse trusted Rustulka because of the success they had had with this investment, and because he was personable, seemed sincere, and "professed to be a Christian".

[138] Rustulka filled out a WealthTerra KYC form in HLM's name, which she signed and initialled. It was dated October 26, 2014, and contained the following information:

- HLM was 58 years old at the time, married, with no dependents;
- she was employed as a school principal, earning $80,520 per year;
- her spouse was earning $66,560 per year, plus $26,000 in "other" income;
- including their primary residence, HLM and her spouse had total net assets of $1,109,000, net liquid assets of $399,000, and a net worth of $1,109,000;
- HLM's purpose in investing with WealthTerra was to make long-term and short-term investments;
- she had "Good" investment knowledge and a "High" risk tolerance, both as previously defined;
- her investment objective was to get ready for retirement, with a time horizon of "15+ years"; and
- she had $380,000 in investments outside WealthTerra, in medium- and high-risk products.

[139] All check boxes were marked "Yes" on HLM's Suitability Assessment Form of the same date. The form also indicated that HLM and her spouse had about $90,000 in equity in their home, and were "not thinking about retiring any day soon". It stated that they had $280,000 in investments outside the exempt market, and had another $200,000 or more that they wanted "to use to support their mother". They were identified as accredited investors with net financial assets of over

$1 million who were familiar with the exempt market and knew that it was high-risk and they could lose all their money.

[140] Like the other investor witnesses, HLM pointed out numerous inaccuracies on these forms. She and her spouse actually wanted to retire in 10 years or less. While the income figures shown were generally correct, HLM denied that she and her spouse were accredited investors and that they had total net assets of $1,109,000. She testified that at the time, their assets included approximately $200,000 equity in their home, cash savings of approximately $10,000, her pension worth approximately $500,000, and exempt market investments worth approximately $200,000. They had paid for the latter by cashing in RRSPs and, on Rustulka's recommendation, remortgaging their home. HLM also noted that their only investment outside the exempt market was in diamonds worth approximately $94,000.

[141] Although the subscription agreement was in her and her spouse's names, HLM testified that as Rustulka knew, the $135,000 they invested in Western Lion on October 26, 2014 came from her mother-in-law's funds, which they held to pay for her ongoing care. They signed an RAF with respect to the high risk of the investment, but HLM said they spent "very little" time reviewing it with Rustulka and had little discussion about risk. She recalled seeing a short brochure with respect to Western Lion, but did not recognize the OM when it was shown to her at the Hearing and did not recall receiving it or reading it.

[142] However, HLM admitted that she and her spouse knew Western Lion was considered a high-risk investment, particularly because it involved the oil and gas industry. They were hesitant about proceeding with it at first, but Rustulka assured them that Western Lion had already found oil on its property and simply needed the funding to extract it – so it was "almost a done deal" and would provide monthly income of 16 to 20% "almost right away". In addition, he told them the company had two other properties that had a "very high potential" to produce oil. In reliance on these assurances and the fact that their previous exempt-market investment had done so well, they decided to take the risk.

[143] HLM and her spouse received a letter within a year of investing in Western Lion, advising them that its drilling rig had broken and its lease was about to expire. She therefore understood that the entire investment in Western Lion had been lost, apart from approximately $7600 initially paid in returns. She testified that she feels she and her spouse have let their family down, as they have not recouped the $300,000 they had from the sale of her mother-in-law's house.

[144] Overall, HLM described the impact of her investment experience with Rustulka as "significant in terms of loss of funds and what [they] can afford for retirement". She acknowledged that they had been too trusting, and said that if she and her spouse ever invest in the Alberta capital market again, it will be in "very, very low-risk" investments and not the exempt market.

### 7. BN

[145] BN testified that he has a high-school education, and had a long career in telecommunications before retiring in December 2018.

[146] BN first met Rustulka in 2014. At the time, he planned to retire within the subsequent few years, and was looking for financial stability going into retirement. He had made a few small investments in stocks previously, but had no knowledge of the exempt securities market.

[147] BN testified that the KYC form in evidence for him was completed by Rustulka, although he acknowledged having initialled it. The form was dated July 14, 2014, and disclosed the following:

- BN was 61 years old at the time, divorced, and had no dependents;
- although it stated BN was "Retired", it also stated that his annual income was $75,000, plus $16,200 in pension income;
- including his primary residence, he had total net assets of $488,500, net liquid assets of $328,500, and a net worth of $488,500;
- his purpose in investing with WealthTerra was to make long- and short-term investments;
- he had "Good" investment knowledge and a "High" risk tolerance, both as previously defined;
- his investment objective was "To Move More into the Exempt Markets for Income Revenue & Long Term Investments";
- his investment time horizon was "15+ years"; and
- outside of WealthTerra and the exempt market, he had $175,000 in medium- and high-risk investments.

[148] On the accompanying Suitability Assessment Form of the same date, all check boxes were marked "Yes". The narrative portion stated that BN owned his own home and was retired, but was looking for work to assist him with his monthly budget. It also stated that he understood the exempt markets were high-risk and he could lose his invested funds, but he was willing to take the risk to get "better results".

[149] While BN said that he thought the income figures on the KYC form looked accurate, he thought that the figures for his total net assets, net liquid assets, net worth and investments outside of WealthTerra were overstated. He estimated that at the time, his assets included, at most, approximately $250,000 equity in his home, $100,000 in investments and $30,000 in cash.

[150] As mentioned, BN had no knowledge of the exempt market when he met Rustulka – and said at the Hearing that he still does not understand it – so he testified that his investment knowledge could only have been considered "Good" with respect to the conventional stock market. Since he wanted to achieve "[s]ome sort of stability in going into retirement", he thought that the investment objective shown on his KYC form was generally correct, but disagreed that his investment time horizon was as long as "15+ years".

[151] With respect to risk, BN agreed that he was "willing to take more risk for better results", but did not agree that Rustulka had "informed [him] that the Exempt Markets are classified as a 'High Risk' market and he could lose some or all of his invested funds" as represented on his Suitability Assessment Form. As BN explained, he was willing to accept some risk, but not the

risk that he would lose everything he invested. He stated that Rustulka had not explained that possibility to him "at all".

[152] BN further explained that in discussions with Rustulka concerning risk, he was under the impression that risk meant the investments' value could fluctuate as it does in the stock market, not that it meant he could lose all of his money. He did not recall Rustulka saying that exempt market investments were safe or secure, but said he was certain that Rustulka never warned him he could lose his money entirely. BN also noted several times during his testimony that Rustulka had assured him the oil and gas, food-growth, and diamond businesses were not "going away" as a way to suggest that the risks were limited.

[153] On this basis, BN invested a total of $108,691.10 through Rustulka in 2014, in Western Lion, BestGrow, and Valhalla. He funded these investments by selling all of the other investments he had, including stock in the company he worked with for 37 years. Rustulka never suggested to him that he was investing too heavily in exempt market products.

[154] BN acknowledged that Rustulka gave him documents to review with respect to Western Lion, and recognized its OM. However, he said that he did not review them at any length or in any detail independently, as he did not have the ability to assess the company on his own. To the contrary, he considered that to be Rustulka's job. BN also said he thought the oil and gas industry was safe, and did not recall Rustulka mentioning any "downsides" to an investment with Western Lion. He did not recall Rustulka raising the issue of its suitability for him.

[155] BN understood that BestGrow's business was hydroponics, which he also thought was a safe industry given Rustulka's suggestion that it was one of the types of businesses that was not "going away". He did not recall Rustulka saying that it was a safe or suitable investment for him, but he also did not think Rustulka warned him about the risk of losing some or all of his money. He understood that the RAFs Rustulka had him sign were simply something he "had to sign" in order to "complete the transaction" or "finish the paperwork".

[156] BN's evidence was similar concerning his investment in Valhalla, since the diamond business was another that Rustulka said was not "going away". He did not think that Rustulka discussed the company with him in any detail. As with BN's other investments, Rustulka focused instead on the potential for a 15% return, which BN understood was "if not guaranteed, [then] very high". Again, while he did not think that Rustulka said it was a safe, secure investment, he did not think Rustulka specifically addressed its suitability for him, or the possibility that he could lose some or all of his money.

[157] With respect to his investments in all three companies, BN described signing RAFs quickly at his front door when Rustulka came over with them. They spent "[v]ery little" time going over them. He did not rely on what the forms said about risk. He relied on what Rustulka said instead, because he considered that "[Rustulka's] job" and the reason Rustulka "came to [his] house".

[158] BN received a monthly dividend from Western Lion for a few months, but understood that it "went under" within the first year to 14 months. He received no returns on his investments in

BestGrow or Valhalla, and has not received a repayment of his principal on any of his WealthTerra investments.

[159] BN invested all of the funds he had saved for retirement with Rustulka. As a result of the financial losses he has suffered, he can no longer enjoy his retirement as he had hoped; as he described it, he now "just more or less exist[s]". He could not afford to lose the money he did, and testified he would not have made these investments if he had understood that could be the result.

[160] BN stated that he will never invest in Alberta's capital markets again, and does not have the money to do so in any event.

## V. LAW AND ANALYSIS

### A. Overview – Registrant Obligations

[161] As explained in *Canadian Securities Regulation*, 5th ed. (D. Johnston, K. Rockwell and C. Ford, Markham: LexisNexis Canada Inc., 2014), Canadian securities regulation has two primary goals: investor protection and the promotion of efficient capital markets (at p. 18). One of the means for achieving these goals is the requirement that certain parties involved in the securities industry register in accordance with securities laws (*ibid.* at pp. 25, 473). To qualify for and maintain registration, these parties must meet certain standards of integrity and proficiency, and adhere to certain standards of conduct (*ibid.* at pp. 472-473).

[162] A "registrant" is defined in s. 1(aaa) of the Act as "a person or company registered or required to be registered under this Act or the regulations". Pursuant to s. 75.2(1) of the Act, registrants have an obligation to "deal fairly, honestly and in good faith with [their] clients".

[163] Along with the requirements set out in the Act, NI 31-103 has governed the registration regime and the obligations of registrants in Alberta since September 28, 2009. The Companion Policy to NI 31-103 (**31-103CP**) and periodic staff notices provide guidance as to how CSA members – including the ASC – will apply NI 31-103.

[164] CSA Notice 31-336, referenced earlier in these reasons, describes registrant obligations as follows (at pp. 3-4):

> Securities laws impose a general duty on registrants to deal fairly, honestly and in good faith with clients. Part 13 of [NI 31-103] sets out the principal KYC, KYP, and suitability obligations for registrants. These obligations work together. The KYC, KYP and suitability obligations are an extension of the duty to deal fairly. In turn, the suitability obligation requires a registrant to *know* the client, *know* the product that is the subject of the proposed recommendation or client order, and to form an opinion as to whether the product is suitable in light of the client's investment needs and objectives. [original emphasis]

[165] The notice indicates that these obligations "are among the most fundamental obligations owed by registrants to their clients and are cornerstones of our investor protection regime" (at p. 1). Accordingly, a registrant's failure to comply with them "is an extremely serious matter" (at p. 2).

[166] The obligations articulated in NI 31-103 apply to both EMD firms (such as WealthTerra) and Dealing Representatives (such as Rustulka). Section 11.1 of NI 31-103 requires firms to "establish, maintain and apply policies and procedures that establish a system of controls and

supervision sufficient to . . . provide reasonable assurance that the firm and each individual acting on its behalf complies with securities legislation". During the Relevant Period, 31-103CP explained, "[a] registered firm is responsible for the conduct of the individuals whose registration it sponsors" and "has an ongoing obligation to monitor and supervise its registered individuals in an effective manner" (at s. 1.3).

[167] The decision of the ASC in *Re Lamoureux* (2001 LNABASC 433, aff'd. 2002 ABCA 253) was issued prior to the advent of NI 31-103. However, it applied the Alberta predecessor to NI 31-103, ASC Policy 3.1 *Registrants Code of Conduct and Ethical Practices* (**Policy 3.1**). The obligations set out in Policy 3.1 were substantially the same as those now described in NI 31-103. *Lamoureux* is thus frequently cited in matters such as this, where it is alleged that a registrant has contravened securities laws by contravening NI 31-103.

[168] In *Lamoureux*, the respondent was a mutual fund salesperson who was found to have breached his obligations as a registrant, including by failing to "know his clients", recommending securities to his clients that were not suitable for them, and failing to make his clients aware of material negative factors with respect to the recommended securities (at pp. 2, 4, 18). In summarizing its conclusions, the panel stated as follows with respect to registrant obligations (at p. 2; see also pp. 5, 14-15, 18):

> A registrant, in recommending investments to clients[,] must adhere to a three stage process:
> - use due diligence to "know the product" and "know their clients"[,]
> - assess suitability by determining whether a particular securities product is an appropriate match for a particular client, and
> - if a securities product is suitable for a particular client the registrant can recommend the investment product but, in so doing, must make the client aware of material factors associated with the investment product.

[169] This "three stage process" has been adopted in other jurisdictions as well; see, for example, *Re Daubney*, 2008 LNONOSC 338 (at para. 17), *Re Sterling Grace & Co.*, 2014 LNONOSC 558 (at para. 220) and *Re Foresight Capital Corp.*, 2007 BCSECCOM 101 (at paras. 51-52). The panel in *Foresight* described the third stage as an obligation to "disclose the negative as well as the positive aspects of the proposed investment" (at para. 52).

[170] *Lamoureux* went on to note that determinations as to whether a registrant has met these regulatory obligations in relation to a particular client are dependent on the facts of the case (at p. 7; see also *Daubney* at para. 13). The determination "requires close analysis of the client's situation and the relationship between the registrant and the client", as "[b]oth the fiduciary and the regulatory obligations of a registrant may be more or less onerous depending upon the extent of the client's reliance upon the registrant" (*Lamoureux* at p. 7).

[171] While fiduciary duty is typically a matter of common law, we agree with the *Lamoureux* panel's statement that "there are important similarities between registrants' fiduciary duties at common law and their regulatory obligations" (at p. 7). In that regard, the panel cited the Supreme Court of Canada in *Hodgkinson v. Simms et al.* ((1995), 117 D.L.R. (4th) 161 at p. 183), which in turn cited *Varcoe v. Sterling* ((1992), 7 O.R. (3d) 204 at pp. 234-236). That passage included the following (*Lamoureux* at pp. 7-8):

> The relationship of broker and client is not *per se* a fiduciary relationship . . . Where the elements of trust and confidence and reliance on skill and knowledge and advice are present, the relationship is fiduciary and the obligations that attach are fiduciary. . . .
>
> The relationship of the broker and client is elevated to a fiduciary level when the client reposes trust and confidence in the broker and relies on the broker's advice in making business decisions. When the broker seeks or accepts the client's trust and confidence and undertakes to advise, the broker must do so fully, honestly and in good faith. . . It is the trust and reliance placed by the client which gives the broker the power and in some cases, discretion, to make a business decision for the client. Because the client has reposed that trust and confidence and has given over that power to the broker, the law imposes a duty on the broker to honour that trust and respond accordingly.

[172] After reviewing similar conclusions in other case authorities, the *Lamoureux* panel stated (at pp. 9-10):

> . . . the extent of the regulatory obligations imposed by Policy 3.1 will vary according to the degree to which clients reasonably place their reliance upon and trust in the registrant. In our view, the regulatory obligations imposed by Policy 3.1 are at least as extensive as the fiduciary duties imposed by the common law in these circumstances.

[173] We draw the same conclusion with respect to the regulatory obligations imposed on EMDs and Dealing Representatives by NI 31-103.

## B. Know Your Client (KYC) Obligation

### 1. The Law

[174] As outlined above, the "three stage process" set out in *Lamoureux* for registrants to follow in making an investment recommendation to a client begins with the use of due diligence to know the product and know the client. Given the allegations in the NOH, we confine our discussion and analysis here to Rustulka's KYC obligations, and whether he discharged those obligations appropriately in his dealings with the investors who testified at the Hearing.

[175] In *Lamoureux*, the panel described the KYC obligation as "the obligation to learn about the client, their personal financial situation, financial sophistication and investment experience, investment objectives and risk tolerance" (at p. 10). Although, as mentioned, *Lamoureux* pre-dates NI 31-103, this description accords with s. 13.2 of NI 31-103, which states in part:

> (2) A registrant must take reasonable steps to
>
> . . .
>
> (c) ensure that it has sufficient information regarding all of the following to enable it to meet its [suitability] obligations under section 13.3 . . .
>
> (i) the client's investment needs and objectives;
>
> (ii) the client's financial circumstances;
>
> (iii) the client's risk tolerance . . .

> (4) A registrant must take reasonable steps to keep the information required under this section current.

[176] During the Relevant Period, 31-103CP explained (at s. 13.2):

> KYC information forms the basis for determining whether trades in securities are suitable for investors. This helps protect the client, the registrant and the integrity of the capital markets. The KYC obligation requires registrants to take reasonable steps to obtain and periodically update information about their clients.

[177] While 31-103CP thus noted that the KYC requirement is in furtherance of the overarching securities legislation policy goals of protecting investors and the integrity of the capital markets, it provided no specific guidance beyond what is given in s. 13.2(2) of NI 31-103 as to what information must be collected and how. For assistance in this regard, we refer to case law and other sources that suggest additional client details that should be collected – typically, as at WealthTerra, in a KYC form – and considered. These details include the client's "financial sophistication and investment experience" as indicated in *Lamoureux* (at p. 10), as well as his or her age, investment knowledge, and investment time horizon (*Daubney* at paras. 18-19; see also *Re Sawh*, 2012 LNONOSC 547 at para. 165, aff'd. 2013 ONSC 4018 (Div. Ct.)).

[178] In addition, some sources expand upon the items in the list of required information given in s. 13.2(2)(c) of NI 31-103. *Daubney* explains that "investment objectives" include the client's retirement plans, and suggests specific aspects of the client's "financial circumstances" that should be ascertained: his or her assets (both liquid and illiquid), income, net worth, and employment status (at paras. 18-19). CSA Notice 31-336 explains that a client's "risk tolerance" includes not only his or her willingness to accept risk, but also his or her ability to withstand the risk of losing the funds invested (at p. 12). It further suggests that a registrant should review a completed KYC form with the client to ensure its accuracy (at p. 12).

**2. Staff's Position**

[179] The Staff Submissions emphasized the importance of the KYC obligation, citing the Alberta Court of Appeal's observation in *Cunningham v. Wiltzen* (2017 ABCA 185) that, "[t]he 'Know Your Client' rule has been described as the 'cardinal rule'" (at para. 24). Staff also relied on *Lamoureux* and CSA Notice 31-336. Among the passages cited was this statement from *Lamoureux* with respect to the role of a KYC form (at p. 13):

> Neither the "know your client" obligation nor the "suitability" obligation can be fulfilled merely by completing poorly-constructed forms or by following a procedure in a perfunctory fashion. Forms and procedures are merely tools that can assist in performing a task and that may provide reminders or evidence of efforts undertaken or not undertaken.

[180] Staff then gave a detailed summary of the evidence given by the investor witnesses at the Hearing with respect to the "false, inaccurate, and/or misleading information" on the KYC forms and Suitability Assessment Forms Rustulka completed for them, which Staff argued showed that Rustulka failed to comply with his KYC obligations. Some of the specifics Staff pointed to included the following:

- overstating SA's investment time horizon and inaccurately recording his net liquid assets, net worth, and investments outside of WealthTerra;

- overstating DC's investment time horizon and net worth; misstating her risk tolerance and investment knowledge, as well as the nature of her investments outside of the exempt market;

- overstating the Hs' investment time horizon, income, total net assets, and net worth; misstating TH's risk tolerance; overstating the amount of money RH received from his mother and describing it incorrectly as an inheritance when it was an *inter vivos* gift; understating the percentage of the Hs' total assets represented by one of their investments;

- overstating BJ's total net assets and investments outside of WealthTerra and misstating his risk tolerance;

- misstating BK's investment objective, investment knowledge, and risk tolerance; overstating his investment time horizon, annual income, total net assets, and net worth;

- misstating HLM's investment objective; overstating her investment time horizon, net financial assets, and total net assets; understating the percentage of her assets that were invested in the exempt market; and

- overstating BN's investment time horizon and net liquid assets.

[181] Staff also argued that Rustulka failed to know his clients by not inquiring about their past experience investing in the exempt market and not assessing whether they were investing too heavily in that market.

### 3. Discussion and Conclusion on KYC Obligation

[182] In accordance with Staff's summary of the evidence, it is clear that when compared with the testimony of the investors who testified at the Hearing, there were numerous inaccuracies in the KYC forms Rustulka completed for those individuals. The extent of the inaccuracies varied, but in almost all cases the investors indicated that their available financial resources (income, assets, or both) had been overstated, as had their investment knowledge – especially with respect to the exempt market – and investment time horizons. In addition, in almost all cases, the investors denied that they had the high risk tolerance shown on their KYC forms; they had wanted low-risk investments on which they would not lose money – money they could not afford to lose, given their personal and financial circumstances.

[183] In some instances, the investor witnesses did not appear to have a clear understanding or recollection of their net assets or net worth at the time they invested with Rustulka, particularly where they held pensions through their employers and seemed to have difficulty assessing their value. In such instances, one might be tempted to conclude that at least some of the misinformation on the KYC forms was the result of simple misunderstanding or miscommunication between

Rustulka and his clients. However, the consistency of the testimony as to the overstatement of the investors' financial resources undercuts that possibility, especially in combination with the other consistent misstatements as to investment knowledge, risk tolerance, and time horizons – matters with respect to which the witnesses' evidence was unequivocal and almost unanimous.

[184] Moreover (and as will be discussed further in the next section of these reasons), all of these items pertain directly to the suitability of investments in exempt market products for these individuals. We think it no coincidence that each KYC form in evidence indicated that the investor – regardless of his or her age and other circumstances – had "Good" investment knowledge, a "High" risk tolerance and, in all cases but one, an investment time horizon of "15+ years".

[185] Taken together, all of this evidence leads us to the conclusion that Rustulka prepared KYC forms with a view to maximizing his commissions rather than with a proper view to the investment objectives and best interests of his clients. Instead of recording accurate information, he recorded the information necessary to ensure that the transaction would be approved and considered suitable.

[186] We observed several instances where this conduct was blatant. BK testified that Rustulka knowingly and purposely misrepresented BK's financial information on the KYC form so that BK would fit within the requirements to make the investments. DC testified that she told Rustulka on several occasions that she and her common-law spouse kept their finances separate and that his financial information should not be included or considered with hers. Mathematically, the Hs' first KYC form was nonsensical, as was the KYC form for the Js.

[187] Thus, while Rustulka completed KYC forms for these investors, the forms did not accurately reflect due diligence or true knowledge of the investors' circumstances, or deliberately misrepresented those circumstances. We therefore conclude that Rustulka either did not know his clients, or knew his clients but falsified their KYC forms for the purpose of making sales.

[188] In either case, we find that Rustulka breached his obligations as a registrant under s. 13.2 of NI 31-103, as alleged in the NOH.

## C. Suitability Obligation

### 1. The Law

[189] The second of the "three stage process" set out in *Lamoureux* for registrants to follow in making an investment recommendation to a client requires the registrant to "assess suitability by determining whether a particular securities product is an appropriate match for a particular client" (at p. 2). An investment is suitable if "'it will achieve the investment objectives of the client while keeping [within] the level of risk determined by the client's comfort level and overall circumstances'" (*Lamoureux* at p. 16, citing the British Columbia Securities Commission in *Re Foerster*, 1997 LNBCSC 26).

[190] The OSC described the suitability requirement as "an essential component of the consumer protection scheme of the Act and a basic obligation of a registrant", and, like CSA Notice 31-336, observed that "a course of conduct by a registrant involving a failure to comply . . . is an extremely

serious matter" (*Re E.A. Manning Ltd. et al.* (1995), 18 OSCB 5317, as cited in *Daubney* at para. 213 and in *Sawh* at para. 164).

[191] Section 13.3 of NI 31-103 articulates the suitability obligation in part as follows:

> (1) A registrant must take reasonable steps to ensure that, before it makes a recommendation to or accepts an instruction from a client to buy or sell a security, or makes a purchase or sale of a security for a client's managed account, the purchase or sale is suitable for the client.

[192] During the Relevant Period, the applicable portion of 31-103CP explained (at s. 13.3):

> Subsection 13.3(1) requires registrants to take reasonable steps to ensure that a proposed trade is suitable for a client before making a recommendation or accepting instructions from the client. . . .
>
> . . . Having the registered firm's approval for representatives to sell a product does not mean that the product will be suitable for all clients. Individual registrants must still determine the suitability of each transaction for every client.

[193] According to the panel in *Lamoureux*, suitability is a fact-specific determination, and the determination can only be made after a registrant has "put himself in the position of knowing and understanding the investment, the particular risks associated with the investment and how those risks may affect individual clients" (at pp. 15, 26; see also *Daubney* at para. 13). The suitability obligation therefore flows from a registrant's KYP and KYC obligations, as a failure to know the product and the client is likely to lead to an inappropriate suitability determination. This was reiterated in CSA Staff Notice 33-315 *Suitability Obligation and Know Your Product* (**CSA Notice 33-315**) dated September 4, 2009, which says that registrants must understand the following to determine suitability:

> 1. the general investment needs and objectives of their client and any other factors necessary for them to be able to determine whether a proposed purchase or sale is suitable (know your client or KYC), and
>
> 2. the attributes and associated risks of the products they are recommending to clients (commonly referred to as know your product or KYP)[.]

[194] The extent of the KYC information a registrant will need to make a suitability determination may vary depending on the client's particular circumstances, the type of security involved, and the client's relationship to the registrant (see 31-103CP at s. 13.3). Relevant circumstances will generally include the client's income, net worth, risk tolerance, liquid assets, and investment objectives (*Lamoureux* at pp. 14-15). Comparing the risk of the investment with the risk tolerance of the investor is of particular importance – according to *Lamoureux*, this comparison is "probably the most critical element in the registrant's suitability obligation" (at p. 17; cited with approval by the OSC in *Daubney* at para. 202).

[195] Moreover, risk tolerance is not simply a matter of asking the client's preference. In *Re Jaynes* (2000 LNONOSC 126), the OSC held that (at p. 7 (QL)):

> …notwithstanding what a client may indicate as their risk tolerance level, speculative trades may be wholly unsuitable based on their personal circumstances; a registrant's responsibility is to properly identify when this is the case and even refuse to execute unsuitable trades on behalf of a client when necessary.

[196] In particular, a registrant should consider his or her client's age, investment time horizon, and financial situation, as a high-risk investment may be unsuitable for an older client of modest means who is near to retirement and therefore has a limited ability to withstand and recover from financial losses – even if that client says he or she is prepared to accept a high level of risk (see *Sawh* at para. 213; *Daubney* at para. 199). The client's investment knowledge and sophistication should also factor into the analysis for the reason pointed out in *Lamoureux*: some clients' "investment experience and sophistication may be insufficient to enable them to fully recognize or assess the risks inherent in an investment" (at p. 16). For such clients, the registrant's assessment of suitability is all the more important.

[197] Much of this guidance is also set out in CSA Notice 31-336. Several of the additional points made in CSA Notice 31-336 are of particular relevance to this matter, including the following:

- "[a]ssessing suitability is more than a mechanical fact-finding or 'tick the box' exercise. It requires meaningful dialogue with the client to obtain a solid understanding of the client's investment needs and objectives, and to explain how a proposed investment strategy is suitable for the client in light of the client's investment needs and objectives" (at p. 2; see also p. 19);

- a registrant should consider any proposed use of leveraging when assessing suitability, with particular reference to the client's investment knowledge, risk tolerance, and investment objectives (at pp. 14, 18);

- a suitability assessment should take into account the size of the investment the client is proposing to make and what proportion of his or her total holdings it represents (at p. 15);

- extra care in determining suitability should be taken where the client is a senior, on a fixed income, or is otherwise vulnerable (at p. 20); and

- diversification should be considered when assessing suitability, since lack of diversification could expose the client to additional risk; registrants are reminded to be cognizant of over-concentration in a single issuer, a group of related issuers, a single industry, or the exempt market itself, and are told that "[m]ost CSA staff will consider investments (either individually or taken together with prior investments) in securities of a single issuer or group of related issuers that represent more than 10% of the investor's net financial assets as potentially raising suitability concerns due to concentration" (at p. 22).

[198] As an adjunct to suitability, we note that a registrant also has a responsibility to explain the enhanced risks of leveraged investing to a client who is unfamiliar with them. This was explained in *Daubney* (at para. 25):

> Where a registrant recommends leveraging, i.e. borrowing money to invest in a recommended product, the registrant is obliged to assess whether the client's circumstances are such that they have the ability to meet debt obligations and tolerate losses under different market scenarios. Because leveraging can magnify losses, it is critical that the registrant ensures the client understands the risks of borrowing to invest, in particular the risks of using collateral, including investments made with monies borrowed, as security for loans.

[199] If a client cannot bear a loss and still service the debt, leveraging is an unsuitable strategy for that client.

**2. Staff's Position**

[200] After reviewing the applicable law, the Staff Submissions highlighted the following with respect to each of the investors, which Staff argued demonstrated their unsuitability for high-risk exempt market products:

- SA was not a sophisticated investor. He had limited investment knowledge in general and "very poor" knowledge of the exempt market in particular, having never invested in it before. He trusted and relied on Rustulka. In addition, Staff argued that Rustulka did not "know" his client, SA, as he had misstated SA's investment time horizon, net liquid assets, and net worth. Further, Rustulka did not accurately inform SA of the actual the risk level of the investments he recommended for the As – specifically, BestGrow and Valhalla.

- DC wanted to retire within the next six to seven years, had a minimal risk tolerance, did not wish to lose any of her money (as it was her retirement savings), had no prior knowledge of the exempt market, and had no prior experience investing in the exempt market.

- TH wanted to retire within the next five years. She had a "medium" risk tolerance but understood it was unlikely she would lose some or all of her money on the investments Rustulka recommended. As she invested the personally significant amount of $300,000, it was important to her that she not lose any of it. She had limited knowledge of the exempt market and had never invested in it before.

- RH invested a significant amount of money, $300,000 of which he invested on behalf of his mother. He wanted those funds to be put into less risky products, as they were intended to pay for his mother's ongoing care. He had no previous knowledge of the exempt market and had never invested in it before.

- BJ wanted to retire within the next five years, had a low risk tolerance, and had a limited ability to withstand investment losses. He borrowed the $130,000 he used to invest by leveraging real estate. He had "very poor" knowledge of the exempt market and had never invested in it before.

- BK wanted to make low-risk investments, as he was using all of his pension money and could not afford to lose any of it. He was looking to retire within the next eight

to 10 years and had no prior knowledge of the exempt market. He had never invested in either the exempt market or the stock market before, and had "very poor" investment knowledge.

- Although HLM and her spouse were aware that Western Lion was high-risk and had invested in the exempt market before, Staff argued that the investment addressed at the Hearing was unsuitable for HLM's mother-in-law, who was approximately 85 years old at the time and needed those funds for her ongoing care. In addition, Staff pointed out that HLM did not seem to have an accurate understanding of the exempt market and its differences from the stock market.

- BN did not understand the actual risks of the exempt market – including the possibility that he could lose all his money. He sold all of his prior investments in order to invest $100,000 in the exempt market in the hope that the investments would fund his retirement. He could not afford to lose any of this money. He had no prior knowledge of the exempt market.

[201] In addition, Staff argued that there was no evidence Rustulka ever turned a client away on the basis of suitability. They pointed to the commissions Rustulka earned on the sales he made to his clients, and submitted that he had prioritized his interests in making sales and earning commissions over meeting his obligation to ensure the investments his clients made were suitable for them.

### 3. Discussion and Conclusion on Suitability Obligation

[202] As outlined by the relevant authorities, the KYC information collected by a registrant about his or her client forms a key component of the foundation for a proper suitability analysis. Given our earlier findings with respect to the extent and nature of the misinformation contained in the witnesses' KYC forms in this matter, that key component was hopelessly flawed, leaving an impossibly weak foundation upon which suitability could be assessed.

[203] The Suitability Assessment Forms in evidence did nothing to ameliorate the situation. The series of "Yes/No" check boxes tied to the list of "Suitability Considerations" in the top half of each form were reflective of the "'tick the box' exercise" cautioned against in CSA Notice 31-336. Indeed, the fact that every box on every Suitability Assessment Form in evidence was checked "Yes" when the testimony of the investors made it clear that in most cases, most of the boxes should have been checked "No" is indicative of active misrepresentation of the suitability of these investments for these clients, which is significantly more troubling than the passivity or superficiality suggested by the phrase, "'tick the box' exercise".

[204] In addition, the narrative sections in the bottom half of the Suitability Assessment Forms were largely uninformative: each is no more than a paragraph long, simply repeating much of the information – or misinformation – from the KYC forms with little, if any, additional commentary or analysis. Where new details appeared, the witnesses frequently pointed out that those details, too, were incorrect. At times the information in a Suitability Assessment Form for a particular client contradicted the information in a KYC form apparently prepared by Rustulka for the same

client on the same date – for example, the conflicting figures shown for the Js' liquid assets, or for HLM's investments outside the exempt market.

[205] Accordingly, we conclude that like the KYC forms, the Suitability Assessment Forms served less as a reflection of the reality of each relevant investor's circumstances and more as a poor attempt to justify Rustulka's unsuitable investment advice. It should have been obvious to any reasonably well-trained person at WealthTerra charged with reviewing the trades for compliance purposes that the information presented in the forms was at best, not supportive of suitability, and at worst, in several instances, nonsensical and contradictory. If compliance review had been performed properly from the outset, it is likely that at least some of Rustulka's clients would not have sustained the financial damage that they did.

[206] On the basis of risk profile alone – which, as mentioned, was described by the panel in *Lamoureux* as "probably the most critical element" in assessing suitability – virtually any exempt market investment would have been inappropriate for at least DC, TH, BJ, and BK. DC, BJ, and BK were unequivocal in their evidence that they wanted only low-risk investments, and all four testified that they could not afford to or were unwilling to lose any of the money they were investing. DC and BK specifically noted that they had been relying on those funds for retirement. Despite this, Rustulka pushed these investors to purchase exempt market products, including significant investments in BestGrow – which, according to Wellwood, was one of the riskiest investments WealthTerra had available at the time.

[207] Moreover, even if we were to set aside the risk tolerance of these investors, their personal circumstances were such that speculative, high-risk, illiquid exempt market products were inappropriate for them. Although DC and BJ were only in their early fifties at the time they invested, both were looking to retire in the relatively near future and said that their investment objective was to prepare for retirement. Both had a relatively modest income and net worth. All of these factors suggest a limited amount of time and a limited ability to withstand and recover from financial losses.

[208] BK – also in his early fifties – did not indicate that his retirement was imminent at the time he invested. However, his financial circumstances were even more limited than those of DC and BJ. He and his spouse earned modest incomes and did not own their own home. Their primary assets were their employment pensions worth approximately $200,000, plus a few thousand dollars in silver. The pension funds were converted to cash, and, on Rustulka's advice, BK and his spouse invested nearly all of it – just less than $190,000 – in exempt market products, including $95,000 in BestGrow and over $60,000 in Valhalla. This strategy was obviously unsuitable for investors of such modest means. However, Rustulka not only failed to caution them against it, he deliberately misrepresented the financial information on BK's KYC form in order to facilitate it.

[209] Further, Rustulka ignored the guidance with respect to over-concentration and its potential to raise suitability concerns, as set out in documents such as OSC Notice 33-740, CSA Notice 31-336 and the June 10, 2013 memorandum WealthTerra sent to its Dealing Representatives. As mentioned earlier in these reasons, the latter stated that, "WealthTerra's policy is to ensure client allocation [i.e., in a single product or issuer, in a class such as the exempt market, or in a business sector such as real estate] does not exceed 20 to 30% of their overall portfolio". CSA Notice 31-336

cautioned against investing more than 10% of an investor's net financial assets in securities of a single issuer or group of related issuers. Despite the fact that BK's investments significantly exceeded both of these thresholds (and represented 95% of his portfolio and net liquid assets), Rustulka did not warn him that he was investing too heavily in certain issuers or in the exempt market itself.

[210] Over-concentration was also an issue for DC and BJ. The $80,000 DC invested represented 38% of her net liquid assets of $210,000, and the $130,000 the Js invested represented 63% of the $204,900 in net liquid assets shown on their KYC forms. DC rejected Rustulka's suggestion that she invest even more by cashing out her pension funds and remortgaging her home, but the Js were less fortunate. On Rustulka's recommendation, they borrowed against their real estate – including their home – to raise the cash for their investments. Rustulka did not explain the additional risk of this strategy or its suitability in their circumstances, and ultimately the risk manifested itself: unable to continue to service the debt, the Js were forced to sell their primary residence and move into a mobile home on rented land.

[211] As the panel in *Daubney* commented (at para. 204):

> We find that Daubney recommended excessive leveraging that was entirely unsuitable for these investors because: (i) they did not have sufficient income or unencumbered liquid assets to be able to respond to any market reverses; (ii) for many of the investors, their homes were their main assets; (iii) they were retired, about to be unemployed or close to retirement and had few earnings years left in which to make up any losses; and (iv) they told Daubney they wanted conservative investments that did not threaten their financial security.

[212] We draw the same conclusion here.

[213] As for the other investor witnesses, TH and RH were like DC in that they declined to follow Rustulka's recommendation to "invest everything" they had in WealthTerra products, including by remortgaging their home. However, over the course of less than two years, they used all of their savings – including RH's entire RRSP – and $300,000 of the funds RH received from his mother to invest over $900,000 in WealthTerra exempt market products.

[214] BN was like BK in that he did not borrow to make his investments, but did use his entire retirement savings.

[215] This level of concentration in the exempt market was entirely unsuitable for TH, RH, and BN, as was their concentration in the securities of at least certain individual issuers. Of the $138,000 TH invested, for example, $67,000 or 49% was in BestGrow. Even assuming the largest net liquid asset amount noted on the KYC forms for the Hs, their exempt market investments with Rustulka represented almost 90% of that total.

[216] Similarly, the approximately $109,000 BN invested through Rustulka represented roughly 84% of the figure he estimated as his net liquid assets at the time. Of that $109,000, over $55,000 or 50% was in BestGrow. Despite this, he, like the Hs, testified that Rustulka never raised the issue of over-concentration. To the contrary, the Suitability Assessment Forms Rustulka completed for the Hs claimed that the Hs were "diversifying" by investing in several different exempt market

products, ignoring the risk presented by the fact that they were investing so much of their net worth in the exempt market in the first place. Increasing the number of high-risk exempt market products in a portfolio that is made up entirely of other exempt market products is not diversification.

[217] These investments were also unsuitable for TH, RH, and BN on the basis of risk, even though each testified that he or she had been prepared to accept some level of risk, and RH went as far as to describe himself as a "stupid high risk" investor. RH acknowledged that that description did not apply to his spouse or to his mother's funds, and both TH and BN were clear that their acceptance of a certain amount of risk did not extend to the risk of losing their money entirely.

[218] In any event, regardless of what these witnesses may have said about their risk tolerance, Rustulka had an obligation to assess whether it was reasonable for them to assume that level of risk in light of their personal circumstances (*Jaynes* at p. 7 (QL); *Sawh* at para. 213; *Daubney* at para. 199). TH, RH, and BN were all around 60 years old at the time they first invested with Rustulka, and looking to retire within the next few years. RH's mother was elderly and in extended care that was to be funded by the income and returns from the investments RH made for that purpose. All three had moderate levels of income and a relatively modest net worth. As with DC, BJ, and BK, these factors suggest that BN and the Hs had a limited amount of time and a limited ability to withstand and recover from financial losses. Moreover, as they reached retirement, each would have needed some liquidity in the near future to cover their living expenses.

[219] Different considerations apply to SA and his spouse. They were situated differently than the rest of the investor witnesses, as they were only in their thirties when they invested with Rustulka and only invested the funds that they were specifically prepared to lose (having also declined Rustulka's suggestion that they use a line of credit or mortgage their home to raise additional funds for investment). The $26,344 the As invested in BestGrow and Valhalla represented a smaller proportion of their net liquid assets and net worth, and SA was earning a reasonable income. Accordingly, it was likely they could withstand and recover from even a total loss of their funds.

[220] However, other factors raise questions with respect to the suitability of the As' WealthTerra investments. SA testified that they had wanted only short-term investments at the time, with an exit of no more than five years. BestGrow and Valhalla – both illiquid investments with an indefinite time horizon – were not a match. In addition, SA had limited investment knowledge, especially with respect to the exempt market, in which he had never invested before. They therefore had insufficient investment experience and sophistication to recognize and assess the features and risks of the products Rustulka recommended to them. This made an accurate assessment of suitability on their behalf all the more important.

[221] The same may be said with respect to DC, BJ, BK, and BN, all of whom indicated they had limited investment knowledge and knew nothing about the exempt market. None of them had invested in it previously. Even the Hs – who had the benefit of some level of financial training with Primerica – knew little about the exempt market and had no experience investing in it.

[222] Only the last investor witness, HLM, had made exempt market investments prior to investing through WealthTerra. Her and her spouse's previous success with an exempt market

product recommended by Rustulka was one of the reasons they invested with him again and followed him to his new EMD.

[223] Despite this previous experience, however, HLM's evidence was clear that she and her spouse relied heavily on Rustulka's advice in making the $135,000 investment in Western Lion she spoke about at the Hearing. While they were aware Western Lion was considered high-risk and expressed to Rustulka that they were hesitant to pursue it for that reason and the general volatility of the oil and gas industry, Rustulka's confident assurances minimizing the risk and emphasizing his version of the company's positive outlook tipped the balance. Moreover, HLM said that she and her spouse told Rustulka those funds were part of the proceeds from the sale of her 85-year-old mother-in-law's house, and were intended to provide for the latter's ongoing care and give her a legacy she could leave to her six children after her death. Accordingly, the true risk of an investment in Western Lion did not match HLM's risk tolerance for that particular $135,000. A speculative, high-risk investment, carrying with it the possibility of a total loss of the investment, was not suitable in these circumstances.

[224] Overall, the evidence leads us to conclude that Rustulka made little – if any – proper effort to assess the suitability of the investments he recommended for the clients who testified at the Hearing. He recommended the same high-risk products and the same strategies to virtually all of them without regard for their actual circumstances, exposing them to losses from which they will struggle to recover, if they are able to recover at all. He focused on assurances of high rates of return paid in relatively short time frames instead of the factors that should have led him to question the suitability of those products for clients with a limited ability to recoup or withstand losses, or whose objective was financial security for their aging loved ones or for the retirement they expected to enjoy in the near future.

[225] We are particularly disturbed by the investor witnesses' near-unanimous evidence that Rustulka recommended they borrow, liquidate lower-risk investments (including pensions), or both, to make further investments in WealthTerra products. This occurred in each case despite the investors' disparate financial and personal circumstances, and despite the clear unsuitability of such a strategy for those who obviously could not shoulder the enhanced risk. As the OSC said with respect to the respondent in *Daubney*, "[h]e disregarded the central importance of risk tolerance in recommending suitable investments" and "focused on high rates of return" instead of "the potential for disaster in the combination of leveraged investing in high-risk investment products" (at paras. 202, 206). For some of Rustulka's clients, the "potential for disaster" was even further enhanced by their levels of concentration in the exempt market itself.

[226] Moreover, while the investment knowledge and experience of the investor witnesses varied somewhat, their testimony made it abundantly clear to us that none of them were sophisticated investors. Generally, those who had investment experience had only ever invested in conservative products in the past. This reinforces the conclusion that high-risk investment strategies were unsuitable for them (*Lamoureux* at p. 16). It also underlines the witnesses' vulnerability and heavy reliance on the recommendations Rustulka made and the information that he provided, even where that information directly contradicted what was contained in the documents they received and signed.

[227] We do not doubt that Rustulka was aware of his clients' reliance on him and exploited it in the interest of selling more securities – especially since he encouraged their trust by ensuring that almost all of them were aware of his past as a police officer and pastor, and specifically told them they could ignore what they read.

[228] In that regard, we reiterate that a registrant's suitability obligation is not discharged just because a client has said that he or she knew of or accepted the risk of an investment, or because he or she has signed documents to that effect. We agree with the panel in *Lamoureux* that, "no amount of disclosure to the investor, or acknowledgement by the investor, can convert an unsuitable investment into a suitable investment" (at p. 28) or displace a registrant's obligation to conduct a proper suitability assessment (at p. 16). We also agree with the comments of the panel in *Daubney* (at paras. 201, 210):

> While we recognize that clients have responsibilities to understand the potential risks and returns on their investments, this does not relieve [the registrant] of his duty . . . to make certain that they have this understanding and to make appropriate recommendations, especially in circumstances where he is dealing with investors who have relatively little investment experience.
>
> . . .
>
> While investors are well[-]advised to be cautious in choosing investments, the Act places the duty of care on the registrant, who is better placed to understand the risks and benefits of any particular investment product. That duty cannot be transferred to the client.

[229] Accordingly, we find that Rustulka breached his obligations as a registrant under s. 13.3 of NI 31-103, as alleged in the NOH.

## D. Misrepresentations

### 1. The Law

[230] At the third stage of the three-stage process for a registrant to follow in recommending an investment, "the registrant is obligated to make the client aware of the negative material factors involved in the transaction, as well as positive factors" (*Lamoureux* at p. 15). The *Lamoureux* panel explained further (at p. 15):

> The disclosure of material negative factors in the third stage of the process is intended to assist the client in making an informed investment decision. It should be emphasized that such disclosure cannot ameliorate deficiencies in either of the first two stages of the process. If a registrant recommends securities that are not suitable for a particular client, then disclosure by the registrant during the third stage is irrelevant to their suitability obligation in stage two. The registrant's failure may have been the result of not knowing the client, or not knowing the securities, or an error in the suitability determination but, once the improper recommendation has been made, it does not matter whether or how the registrant discloses the material negative factors, or whether the client claims to understand and accept the risks involved in the investment. The registrant has failed to fulfil their obligations.

[231] We have concluded that Rustulka failed to fulfill his obligations at the first two stages. The misrepresentation allegations in the NOH speak to his failures at the third stage.

[232] During the Relevant Period, s. 92(4.1) of the Act provided that:

> (4.1) No person or company shall make a statement that the person or company knows or reasonably ought to know
>
> (a) in any material respect and at the time and in the light of the circumstances in which it is made,
>
> (i) is misleading or untrue, or
>
> (ii) does not state a fact that is required to be stated or that is necessary to make the statement not misleading,
>
> and
>
> (b) would reasonably be expected to have a significant effect on the market price or value of a security . . .

[233] To prove that Rustulka contravened s. 92(4.1), Staff were therefore required to adduce sufficient evidence to show that:

(i) he made the statements alleged;

(ii) he knew or reasonably ought to have known that the statements were, in a material respect, untrue or omitted a fact required to be stated or necessary to make the statements not misleading; and

(iii) he knew or reasonably ought to have known that the statements would reasonably be expected to have a significant effect on the market price or value of the securities he was selling (see *Arbour* at para. 753).

[234] The last element addresses the materiality of a misstatement or omission. As explained in *Re Fauth* (2018 ABASC 175 at para. 258):

> The inquiry as to whether or not a statement or omission "would reasonably be expected to have a significant effect on the market price or value of a security" may be usefully restated as an inquiry into "whether there is a substantial likelihood that such facts would have been important or useful to a reasonable prospective investor in deciding whether to invest in the securities on offer at the price asked" (*Arbour* at para. 765, citing [*Re*] *Capital Alternatives* [*Inc*., 2007 ABASC 79] at para. 239 and *Sharbern Holding Inc. v. Vancouver Airport Centre Ltd.*, 2011 SCC 23 at para. 61). That said, misrepresentations made to both prospective investors and existing investors are "within the contemplation of" s. 92(4.1), as misleading information may "prompt existing investors to continue with or augment their investments" (*Re Mandyland Inc*., 2012 ABASC 436 at paras. 196, 203).

[235] With respect to how this element may be proved by Staff, the panel in *Re Aitkens* explained (2018 ABASC 27 at para. 137):

> . . . "[c]ommon-sense inferences . . . may suffice in certain cases" (*Arbour* at para. 764, citing *Sharbern* . . . at paras. 58 and 61). While investors' evidence with respect to the impact the information may have had on their investment decisions may be considered (see, for example, [*Re*] *Aurora*[, 2011 ABASC 501] at para. 146), neither that evidence nor expert evidence on market price or value is required to meet the legal test (*Arbour* at paras. 763-66; see also *R. v. Zelitt*, 2003 ABPC 2 at paras. 32-34, distinguishing, *inter alia*, *R. v. Coglon*, [1998] B.C.J. No. 2573 (British Columbia Supreme Court)). That is because an ASC panel is itself an expert tribunal with the specialized

knowledge and experience necessary to "draw inferences as to the objective view of a reasonable investor" (*Arbour* at para. 765).

### 2. Staff's Position

[236] At para. 11.1, the NOH alleged that Rustulka "breached section 92(4.1) of the Act when he made material misrepresentations to his clients regarding general and specific risks associated with exempt market securities".

[237] The Staff Submissions pointed to two previous ASC decisions in which the panels held that false statements made with respect to the risks of an investment were materially misleading, as such statements "would reasonably be expected to have a significant effect on the market price or value" of the subject securities: see *Re 2 Wongs Make It Right Enterprises Ltd.* (2014 ABASC 475 at paras. 33, 37) and *Re TransCap Corp.* (2013 ABASC 201 at paras. 107, 110).

[238] Accordingly, it was Staff's position that "the risk of a security is material for the purpose of assessing whether a statement is a misrepresentation". They then cited specific evidence given by the investor witnesses at the Hearing (largely the same as that set out in the following sections of these reasons), analyzed each of the particular misrepresentations alleged in the NOH based on the elements of the three-part test set out in *Arbour* (at para. 753), and argued that each allegation had been proved.

### 3. Discussion and Conclusion on Misrepresentations

#### (a) Statements Made

##### (i) Safety and Security of Exempt Market Securities

[239] Paragraph 4.1 of the NOH alleged that Rustulka told his clients "exempt market securities were inherently low risk, safe and secure, when in fact they were inherently high risk, unsafe and not secure". In support of this allegation, the Staff Submissions pointed to evidence given by SA, DC, TH, RH, BJ, and BK.

[240] As set out previously in these reasons, the investor witnesses were consistent in their testimony that Rustulka significantly downplayed the overall risks of the exempt market, and focused instead on the positive aspects of the investments he presented and the high rates of return they could expect. Even where the investors reported that Rustulka mentioned risk – including high risk – they also reported that he diluted whatever cautionary effect that might have had, as he simultaneously made contradictory claims that while he was required to address risk, the actual risk was negligible.

[241] SA, for example, acknowledged that Rustulka told him "the risk level was high" for exempt market products. However, he also testified that Rustulka emphasized "on more than one occasion" that he had never lost any of his clients' money, a claim Rustulka repeated in the August 29, 2014 email to SA mentioned earlier in these reasons.

[242] DC said that while Rustulka told her he had to mention risk, he "would downplay the severity of the risk", and led her to believe it was "minimal" and she had "nothing to worry about".

[243] TH gave similar evidence: even though Rustulka had the Hs sign RAFs, he also told them the exempt market "wasn't really high risk", and it was "[u]nlikely" they would lose any money.

[244] We are therefore satisfied that Rustulka made the representations alleged in para. 4.1 of the NOH.

**(ii) Safety and Security of Specific Investments**

[245] Paragraph 4.2 of the NOH alleged that Rustulka told his clients "securities in specific issuers were low risk, safe and secure, and in well-established companies, when in fact they were high risk, illiquid, and in start-up, speculative issuers with no proven records of revenue or operations". In support of this allegation, the Staff Submissions relied on the evidence of SA, DC, the Hs, BJ, BK, and BN.

[246] SA invested in both BestGrow and Valhalla. He testified that he looked at the material he had been given about the two, including BestGrow's OM, and saw the high-risk warnings. However, Rustulka told him BestGrow was "safe" and "would not be high risk", and emphasized that he had never lost any of his clients' money, so the risk of the As losing theirs was "minimal".

[247] DC invested in several WealthTerra products, including BestGrow and Western Lion. She testified that Rustulka greatly downplayed the risk involved, such that she understood BestGrow was "very safe" and Western Lion was either no risk or "very, very low risk". He also led her to believe that Western Lion was a "leading" and "well-known" oil and gas company.

[248] Of the investors who appeared at the Hearing, the Hs invested the most money through Rustulka, in BestGrow, Western Lion, Valhalla, and a number of others. They, too, described how Rustulka had downplayed the risk of all of the products he presented to them, and they understood as a result that those products were all "fairly safe [and] secure", and there was a "[v]ery slim" chance of losing their money. The Hs also said Rustulka told them thorough due diligence had been done on each of the opportunities presented, and all of them were "stable", "solid", and not "fly-by-night", and were therefore unlikely to "go under".

[249] BJ testified that Rustulka told him BestGrow was "solid", and focused his attention on the prospect of healthy returns on investment. BJ did not think there was "any risk at all" or that he would lose his money. Rustulka portrayed Western Lion and the other companies in which BJ invested in a similar fashion: they were "[v]ery safe", with "minimal risk" and a "negligible" chance of losing money.

[250] BK gave evidence with respect to Rustulka's description of a five-point risk scale, and said Rustulka told him BestGrow was a "five", the safest of all the investments that were selected by him and WealthTerra, and a "guaranteed winner". As a "five", BK understood there was "zero" chance he would lose money on it. BK also invested in Valhalla, which Rustulka portrayed as a "four" – not quite as safe as BestGrow, but still "very safe" such that it was "[v]ery unlikely" he would lose his investment.

[251] HLM and her spouse invested $135,000 of her mother-in-law's funds in Western Lion. While she knew it was considered a high-risk investment and had reservations about investing in oil and gas, Rustulka negated that by assuring her and her spouse that the company had already

found oil and simply needed to extract it. Therefore, they understood it was essentially a "done deal" and there was little actual risk.

[252] Finally, BN, who invested in BestGrow, Western Lion, and Valhalla, described how Rustulka emphasized that the agriculture, oil and gas, and diamond industries were not "going away" any time soon, thereby minimizing the risks of investment in these companies. Rustulka did not tell him that there was any risk he could lose all of his money.

[253] Based on our review of the totality of the evidence given by the investor witnesses, we are satisfied that Rustulka made the representations alleged in para. 4.2 of the NOH. While the details and the extent of such representations varied, overall, the investors were clear that as Rustulka presented them specific opportunities from the WealthTerra shelf of products, he not only minimized and ignored any real discussion of the risks involved, he also expressly contradicted the written risk warnings in the documentation provided to them. As a result, he left them with the erroneous understanding that they had little to no cause for concern or caution despite the fact that in reality, they were making high-risk, speculative investments.

**(iii) Securities Backed or Vetted by Authorities**

[254] At para. 4.3, the NOH alleged that Rustulka told his clients "securities in specific issuers were backed, protected by, vetted, and/or otherwise safeguarded by the Government of Alberta and/or the [ASC], when in fact they were not". Staff relied on the evidence of DC and BJ in this regard.

[255] DC agreed with questions posed to her by Staff counsel at the Hearing as to whether Rustulka indicated exempt market products were "approved or backed by the government" and "backed or approved by the [ASC]". She explained that she understood "several lawyers and several people" were somehow responsible for "looking after" the exempt market. In addition, she said Rustulka told her "the safety of [her] money was backed by WealthTerra" and "the government", and that "the lawyers had looked after all of this, the commissions".

[256] BJ described his understanding of the exempt market, which included an understanding that "the Government of Alberta . . . protected or had involvement with these companies, to make sure that they were on board and a decent company". He further understood from Rustulka that "the Government of Alberta looked into these companies [i.e., those Rustulka presented to him, including BestGrow and Western Lion], and they were secured to some point, that they were just not run-of-the-mill or fly-by-night companies". In response to a question from a member of this panel, BJ stated that he could not recall any specifics, other than that Rustulka alluded to the fact that "the Government was the overseer or a watchdog on these companies".

[257] The evidence with respect to this allegation in the NOH was not as common among the investor witnesses as it was with respect to the other misrepresentation allegations. Moreover, it was unclear from DC's and BJ's testimony exactly what Rustulka said to them with respect to governmental or regulatory involvement. It is true that the exempt market, EMDs, and Dealing Representatives are subject to regulatory oversight as delegated by the government. Accordingly, not everything Rustulka might have said in this regard was necessarily false.

[258] In the result, we are not satisfied that there is sufficient clear, convincing, and cogent evidence to prove this allegation on a balance of probabilities.

**(iv) Risk Warnings Were Formalities**

[259] Paragraph 4.4 of the NOH alleged that Rustulka told his clients that "the [RAF] that was required to be signed by investors was procedural and that the 'high risk nature' warning could be disregarded, when in fact the RAF was an integral part of client protection to guard against unsuitably high risk investments".

[260] Six of the eight investor witnesses who appeared at the Hearing gave evidence in this regard.

[261] DC testified that Rustulka "chuckle[d]" at the risk warnings on the RAFs she executed for her BestGrow and Western Lion investments, and spent little time reviewing them with her. She understood that signing them was simply a necessary part of the process to close the transactions and that the actual risk was limited.

[262] Likewise, the Hs indicated that Rustulka spent little time reviewing the RAFs they signed, and that he portrayed them as a "formality". Despite the warnings on the documents, Rustulka assured them the investments they made were "not necessarily high risk".

[263] Very similar evidence was given by BJ, BK, and BN: Rustulka spent very little time reviewing their RAFs with them, and did not thoroughly explain the risks inherent to the exempt market or to the specific investment products they purchased. BJ explained how Rustulka treated anything with respect to risk as "just a formality" that a Dealing Representative was required to mention. BK said he signed all of his investment documentation quickly and without reading it, and that Rustulka focused on his five-point risk scale rather than anything the documents said. He understood the RAFs were "red tape" – again, just a "formality". BN described signing documents at his front door without reading them when Rustulka brought them by for execution, as he relied on what Rustulka told him about risk rather than the written information. He considered the RAFs something he "had to sign" to "complete the transaction" and "finish the paperwork".

[264] The consistency of this evidence supports the allegation that Rustulka minimized the significance of the RAFs his clients signed, and thereby further minimized the potential risk they faced in making their investments. In doing so, he undercut the essential purpose of RAFs: to protect investors against assuming unsuitable levels of risk by warning of the potentially negative outcomes of investing in an exempt market product, including the associated illiquidity and the possibility that the entire investment could be lost.

[265] We are satisfied that Rustulka made the representations alleged in para. 4.4 of the NOH.

**(b) Awareness Statements Were Untrue**

[266] We are also satisfied that Rustulka knew or reasonably ought to have known that the representations alleged at paras. 4.1, 4.2, and 4.4 of the NOH were untrue. He had experience and training as a Dealing Representative, including the ongoing WealthTerra training and product training Wellwood described, and successfully wrote the exempt market products exam. The risks

of the exempt market would have featured prominently and repeatedly, and he knew of the requirement to address those risks by having his clients execute RAFs, and by indicating he had done so in each Suitability Assessment Form.

[267] Further, Rustulka was expected to be familiar with any OMs associated with the specific products on WealthTerra's shelf, and the OMs in evidence for BestGrow, Western Lion, and Valhalla expressly disclosed a range of risk factors, including their lack of an operating history. Wellwood confirmed that Rustulka would have been trained not to make the kinds of claims that he did with respect to any of WealthTerra's products, and that, in particular, BestGrow and Western Lion were considered to be among its riskiest offerings.

[268] Lastly, Rustulka would have known from his training that RAFs are essential to investor protection in exempt market investing. Even apart from Wellwood's evidence about WealthTerra's expectations and training with respect to its Dealing Representatives' obligation to review and thoroughly explain RAFs to their clients, we doubt Rustulka could have passed the exempt market products examination without understanding their importance and his role in ensuring his clients understood their importance.

**(c) Awareness Statements Would Affect Market Price or Value**

[269] Finally, we are satisfied that Rustulka knew or reasonably ought to have known that the misrepresentations alleged at paras. 4.1, 4.2, and 4.4 of the NOH would affect the market price or value of the securities his clients purchased, as he knew or reasonably ought to have known that such statements would affect their willingness to make the investments they did. Indeed, we have no doubt that that is precisely why he made them. All of these misrepresentations relate to risk, and Rustulka's minimization of risk. Not only is it self-evident that an investor would be motivated to pursue a low-risk, high-return investment opportunity, the investor witnesses specifically testified about the significant influence Rustulka's assurances had on their investment decisions.

[270] For example, RH described his "stupid high" risk tolerance and acknowledged that any company has a possibility of "going under". However, with respect to the investments he made through WealthTerra, he said he was swayed by Rustulka's representation that the companies he presented had been thoroughly vetted and were "financially stable", such that investments in them were "fairly safe" and "secure". We have no doubt that even a high-risk investor would prefer a lower-risk venture that ostensibly offers similarly high returns.

[271] Others – including DC, BJ, BK, and BN – made their investment decisions on the basis of Rustulka's assurances, given that they were unwilling to risk losing their money and said they would not have proceeded if they had known such loss was a possibility. In response to those who told him they had a low risk tolerance and were not interested in anything risky, Rustulka assured them any risk was slim to non-existent.

[272] As stated in *TransCap* (at paras. 107, 110), cited in the Staff Submissions:

> These were statements that went to the heart of what investors were seeking (as we heard from witnesses) and were promised: safe investments, with lucrative returns that would be generated by a business operated by sophisticated, knowledgeable and experienced principals. . . .

> . . .
>
> These misleading or untrue statements were material. As just discussed, they concerned matters that in our view would, self-evidently, affect significantly the market price or value that a reasonable investor would ascribe to [the subject] securities – indeed, the decision to invest any money at all.

[273] Rustulka's responsibility for these misrepresentations is not diminished where the investor witnesses acknowledged receiving and reviewing – whether in whole or in part – the OMs for the securities he recommended, or where they signed RAFs. As in *Lamoureux*, most of the investor witnesses who testified before us were "unsophisticated, inexperienced and conservative [. . .] investors of modest means" who had "at most limited capacity to assess the risk" (at p. 3). Most said they did not recall reading the documents they received, "or that, if they did, they did not appreciate the significance of what they had signed" because they relied on their registrant (at p. 27). We therefore consider the following comments of the *Lamoureux* panel equally applicable here (at p. 27):

> Receiving an offering memorandum or signing an acknowledgment does not necessarily show that a purchaser has been made aware of the risks associated with a particular investment. That determination requires an assessment of all the circumstances surrounding the transaction including the documents presented to the investor, the sophistication of the investor and the circumstances in which the offering memorandum was received and the acknowledgment signed.
>
> . . .
>
> An offering memorandum can be a valuable source of information in the hands of a sophisticated, confident investor. Less sophisticated investors may require considerable explanation from their registrant in order to become "aware" of the risks described in the offering memorandum. Where investors are reasonably relying on such explanation by a registrant, the quality and extent of that explanation will weigh more heavily than the flow of documents in a determination of whether the registrant made the investor aware of the risks involved in the transaction.

[274] Despite the "flow of documents" between the investors and Rustulka, the obligation to ensure his clients understood the risks of exempt market investing remained with him. He knew or ought to have known from the KYC process that his clients were generally unsophisticated investors with limited knowledge or experience, especially in the exempt market. They were dependent on his advice and recommendations, as they had limited ability to assess the risk on their own. Therefore, his responsibility as a registrant to explain the risks of the investments to his clients was "all the greater", because he encouraged inexperienced clients to rely on him, and did not "raise[. . .] the subject of risk in any meaningful way at all" (*Foresight* at para. 393).

[275] In any event, even if the investors had read the printed materials closely, Rustulka actively subverted their message. He directed his efforts toward ensuring his clients did not understand the risks they faced so they would be more likely to accept his recommendations and purchase the securities he presented.

[276] We therefore find that Rustulka breached s. 92(4.1) of the Act as alleged in the NOH, as he made misrepresentations to his clients with respect to: (i) the risk, safety, and security of exempt market investments; (ii) the risk, safety, and security of specific exempt market investments; and (iii) the RAFs his clients signed by telling them the documents were simply procedural and the risk warnings could be ignored.

## VI. CONCLUSION

[277] As in *Lamoureux*, the evidence led at the Hearing painted "a picture of a sales[-]driven registrant who recommended [exempt market] investments with little regard to his clients' financial circumstances or investment objectives" (p. 3). Rustulka either did not know his clients, or he misrepresented what he knew on their KYC forms and Suitability Assessment Forms, and recommended securities purchases and investment strategies that were patently unsuitable for them. He further exacerbated the situation by making misrepresentations with respect to risk while over-estimating and over-emphasizing the potential upside. He failed in his duty "to make a balanced presentation regarding prospective investments, and to warn the investor client of the risks" (*Cunningham* at para. 30).

[278] Since we have found that all of the allegations in the NOH were proved by Staff on a balance of probabilities (with the exception of the specific misrepresentation alleged at para. 4.3), this proceeding now moves into a second phase to determine what, if any, sanction or cost-recovery orders ought to be made against Rustulka.

[279] To that end, a hearing management session is scheduled to take place at 2:30 p.m. on June 25, 2020. The purpose of this session will be to set a timetable for the delivery and hearing of evidence (if any) and submissions on the issue of appropriate orders.

June 17, 2020

**For the Commission:**

"original signed by"
Kari Horn

"original signed by"
Kate Chisholm

"original signed by"
Raymond Crossley