September 10, 2003

IN THE MATTER OF: THE SECURITIES ACT

- and -

IN THE MATTER OF: DJORDJE "GEORGE" VLAOVIC

REASONS FOR DECISION
OF
THE MANITOBA SECURITIES COMMISSION

Panel:

Chair	Mr. D. G. Murray
Board Members:	Mr. R. L. Pollack, Q.C.
	Ms. K.E. Hughes

Appearances:

Ms K. G. R. Laycock	)	Counsel for the C
Mr. Djordje "George" Vlaovic	)	On his own behal

Background

This hearing took place over five days from May 26th through 29th, 2003 and again on June 23rd, 2003. Testimony was heard from 13 witnesses and 74 Exhibits were entered into evidence. Ms. Laycock, staff counsel, represented the Commission. The Respondent, Mr. George Vlaovic ("Vlaovic") was not represented by counsel.

At the time of the hearing Vlaovic was not registered in any capacity with the Commission. The Certified Statement of Director (Exhibit 5) notes that he was formerly registered as a mutual fund salesperson, commencing April, 1996. His registration was suspended on September 24, 2001, when his sponsorship was terminated by his employer at the time. He has not been registered since that date. The issue before the panel was whether Vlaovic should also be denied access to the exemptions under The Securities Act.

Staff counsel took the position that Vlaovic's course of conduct while registered and while his registration was either suspended or had lapsed, was such that the public interest demanded that he be prevented from operating in any capacity in the securities industry, including in the exempt market. The course of conduct was detailed by staff counsel in the Amended Statement of Allegations (Exhibit 4) and the testimony of 9 witnesses.

Course of Conduct

Vlaovic's activities were presented by staff counsel in several time frames, including three periods of employment as a registered salesperson with Summit Securities Ltd., TWC Financial Corporation and W.H. Stuart Mutuals Ltd., as well as during periods when he was not registered.

A. Employment with Summit

Vlaovic was employed with Summit (subsequently Summit Aurum Financial Group) from April 27th, 1998 until February 15th, 2000. Testimony was heard from Alan Dickson ("Dickson"), Vlaovic's branch manager and supervisor and James Shore ("Shore"), then president and CEO of Summit.

Vlaovic joined Summit in April, 1998. Dickson testified that he was aware that Vlaovic liked to put through a lot of mutual fund trades for his clients, anywhere from 200 to 400 per week. These were mostly "switches" from one fund to another within a fund family. Dickson had been advised that Vlaovic operated on the basis of many transactions where he felt he could move clients into different market sectors in anticipation of short-term gains. This method of attempting to time the market with mutual funds is very unusual and was considered as such by Dickson.

Dickson testified that at first he was impressed with Vlaovic's enthusiasm and work ethic and that his "numbers" were decent. In fact, in 1999, Vlaovic received a merit citation from Summit for the amount of new product sold.

Dickson testified that Vlaovic's real problems started in the summer of 1999. At that time Dickson apparently took notice of the huge number of trades or switches that Vlaovic was putting through the system. Dickson was concerned that with hundreds of switches being processed weekly, Vlaovic possibly was not obtaining proper instructions for each trade. This is a logical conclusion and the panel finds its surprising that it was not made until Vlaovic had been trading in this manner at Summit for over a year.

In fact, Vlaovic acknowledged to the panel on more than one occasion during the hearing that he had been practising discretionary trading. He indicated that he couldn't possibly have taken instructions for all the trades he was putting through and that his clients approved of his representing them in this manner. In fact, in order to allow him to operate as he was, Vlaovic had drawn up, for the signature of his clients, his own form of Power of Attorney that in essence gave him authority to do discretionary trading on their behalf. This is clearly outside the scope of authority for mutual fund dealers/representatives and the form was at odds with the Limited Power of Attorney that Summit provided its salespeople. Vlaovic's Power of Attorney (Exhibit 11) was quite distinctive, including large stylized "dollar signs" printed at the bottom.

At the hearing Dickson testified that he had no knowledge of the existence or use of these improper Powers of Attorney until one was actually brought to his attention. In cross-examination Vlaovic challenged him and suggested that Dickson had approved of his form. This was denied. It did seem odd to the panel that Dickson, who was responsible for reviewing Vlaovic's trades, would not earlier have become aware of the unorthodox Power of Attorney form or become concerned about the "Know Your Client" and discretionary trading implications

of the huge numbers of trades being put through by Vlaovic. Interestingly, in his testimony, Mr. Shore, the president and CEO stated that he became aware of the potential problems not through the firm's compliance process, but through operations. Vlaovic's voluminous trades were jamming the system.

This resulted in a September, 1999 meeting between Shore, Dickson and Vlaovic where a number of concerns were raised, including a client complaint which had been received. The issue of Vlaovic's method of trading for his clients was discussed. Shore testified that he told Vlaovic that he should not attempt to time the market by mutual fund switches and that strategic trading should be left to fund managers. Vlaovic was told that a "buy and hold" strategy was best for mutual funds. Shore stated that Vlaovic continued to maintain that his system worked best for his clients.

It had become clear that Vlaovic was not obtaining instructions from his clients for all or even most trades. However, as no client complaints about discretionary trading had been received, Dickson decided to "let sleeping dogs lie" and deal with the issue on a going forward basis. Vlaovic was instructed that this type of trading had to stop and that he must keep a record of all client instructions received for trades and have the instructions initialed. These records were to be reviewed by Dickson on a regular basis. He was also directed to use only the Power of Attorney forms issued by Summit, which contained the standard requirements and limitations as were the norm in the industry.

Dickson testified that he had also become concerned about the amount of leveraging that Vlaovic was engaging in with his clients. He estimated that 25% of all new business done by Vlaovic was in leveraged transactions and in his opinion this amount was excessive. Shore agreed with this assessment. At the September meeting Vlaovic was directed to cease all leveraging activity. Finally, since joining Summit, Vlaovic had not actually physically located himself at the branch office to which he was assigned. Vlaovic instead had worked out of his home, attending at the Summit office only to drop off his trades and pick up his client's statements. This situation does not lend itself to proper supervision and it is surprising that it went on as long as it did. At the September meeting Vlaovic was directed to work out of the branch office and to maintain all of his records there. Vlaovic was given a letter dated September 22, 1999 signed by Dickson (Exhibit 10) setting out the several directions given.

Another meeting took place between these three individuals in January, 2000. During the intervening months it appears that little changed in Vlaovic's activities. While there was no evidence at the hearing to show that he continued to use his own Power of Attorney forms, Dickson acknowledged that Vlaovic did not move into the Summit office nor did he either reduce his level of trading or provide records of receiving client's instructions for his trades. A review of his trading accounts had not been done. Dickson also testified that he believed Vlaovic continued to leverage clients. He said that he "isn't proud" of the fact that he allowed Vlaovic's unauthorized trading practices to continue between September, 1999 and January, 2000. At the January, 2000 meeting, Vlaovic was again prohibited from using leveraging and directed to reduce the number of trades he put through. Shortly thereafter Vlaovic tendered his resignation.

B. Employment with TWC Financial Corporation

Vlaovic was subsequently registered as a mutual fund salesperson for a period of about six months (February 22, 2000 to August 23, 2000) through TWC Financial Corporation. The TWC branch office to which Vlaovic was assigned operated under the name of Merit Wealth. Vlaovic's supervisor and branch manager was Ed Buraczewski. Buraczewski testified that Vlaovic, at the outset, raised the issue of using his own form of Power of Attorney. He advised Buraczewski that he had been allowed to use it at Summit (although this was untrue). Buraczewski referred the request to the compliance department of TWC and was told that Vlaovic could only use the authorized TWC form of Limited Power of Attorney or another similar form authorized by a mutual fund company. Buraczewski received this information by fax in early March, 2000 (Exhibit 15). Buraczewski reviewed the Limited Power of Attorney form with Vlaovic. He also testified that he pointed out to Vlaovic that any redemptions required a client's signature, all trades using the Limited Power of Attorney required prior verbal instructions and that they must be noted on a form called a "Representative Contact Log" provided by TWC. He also stated that he reviewed with Vlaovic the prohibition against discretionary trading set out in TWC's compliance manual. Exhibit 15, which is a package including the fax from TWC, the authorized Limited Power of Attorney form, Vlaovic's unauthorized Power of Attorney form and the appropriate excerpt from the TWC policy manual, was placed in Vlaovic's personnel file.

According to Buraczewski, Vlaovic made it clear to him when he was hired that he put through many trades each week. He told him that one of the reasons Vlaovic left Summit was the firm's inability to service his trading volume. Buraczewski felt TWC could accommodate this volume. Buraczewski testified that on average Vlaovic put through 140 to 150 trades per week. Vlaovic's trading practices, as described by Buraczewski were reminiscent of Vlaovic's mode of operating at Summit. Buraczewski testified that the trades were almost all switches within a fund family. Vlaovic, who again worked out of his home, would come to the office each Monday with about 150 trades and then would only come in again the following Wednesday or Thursday to pick up client statements. Buraczewski stated that while most of the other six salespeople he supervised would usually put through five to ten switches in a month and that ten is a high number for a week, Vlaovic's monthly volumes were in the range of 400 to 600 switches.

Vlaovic advised that he researched the next week's trades on the weekend and brought them in for processing the following Monday. The method and frequency of trades, in the panel's view, should have made it clear to Buraczewski that it was highly unlikely that Vlaovic was receiving specific client instructions on each one. In fact, the thought occurred to Buraczewski that Vlaovic may be engaging in discretionary trading and he testified that he asked Vlaovic on a couple of occasions if he received client authorizations for his trades. The answer he received was along the lines of, "my clients know what I'm doing". This apparently satisfied Buraczewski.

Buraczewski also testified that TWC received no discretionary trading complaints from Vlaovic's clients. Just to be on the safe side, Buraczewski wanted to review Vlaovic's Representative Contact Log where verbal instructions would be noted. As with Summit, Vlaovic maintained his business records at his home and he put Buraczewski off by saying that he would bring them in once he moved into the TWC branch office. As in the case of Summit, the move to the branch office and the review of records at TWC never came.

A meeting took place on June 28th, 2000 attended by Vlaovic, Buraczewski, Sheldon Stier ("Stier"), the President of Merit, Guy Nolin ("Nolin"), TWC Sales Manager and Margaret Clarke ("Clarke"), Operations Manager for Merit. Buraczewski testified that at this meeting Vlaovic acknowledged that he simply had no time to obtain instructions for all of the trades that he put through. Nolin and Clarke had similar recollections of Vlaovic's acknowledgement. Buraczewski stated that at this meeting it became clear to him for the first time that Vlaovic had been engaging in discretionary trading. Clarke, on the other hand, who kept minutes of the meeting, had a different recollection. She testified that she believed that everyone at the meeting, (with the possible exception of Nolin) "knew up front" that Vlaovic was trading without obtaining client authorizations. Where her evidence differs from Buraczewski's on this point, the panel accepts Clarke's version of the meeting.

The meeting of June 28th, 2000 was called by Nolin. It is noteworthy that, as had been the case at Summit, the meeting did not arise as a result of the vigilance of those responsible for compliance at TWC but because the number of Vlaovic's trades had become an operational issue. The system was being backlogged and TWC could see no benefit to the company from this type of trading. In fact, both Buraczewski and Clarke believed that the meeting had been called simply to seek operational solutions and were surprised when Nolin raised the issue of discretionary trading. This was clear in their testimony and in the minutes (Exhibit 18) prepared and subsequently typed by Clarke.

While Vlaovic was told that discretionary trading was improper, discussion at the meeting kept returning to whether it was possible to, as Clarke described it, "get around" the need for Vlaovic to obtain authorization for each trade. On the question of addressing the cost to TWC of the voluminous trading, the suggestion of Vlaovic charging a switch fee arose (in fact Vlaovic did thereafter start charging switch fees of 1.33% on the trades).

Another suggestion which was raised at the meeting was to have "disclosure statements" signed by clients suggesting any trades by Vlaovic on their account were pre-authorized. The possibility of a "bulk log" not requiring noting instructions for each individual trade was also raised. Surprisingly, Nolin agreed to take these suggestions back to TWC. Even more surprisingly, at the end of the meeting Vlaovic was not directed to immediately cease and desist his method of operating, pending a response from TWC. Evidence suggests that in fact Vlaovic continued with his established trading pattern until he was terminated by TWC about eight weeks later.

Nolin did not respond with TWC's position on the suggestions of getting around securities industry rules. Instead, on August 14, 2000 Vlaovic was terminated by a letter signed by Nolin (Exhibit 19). The termination date was set as of August 31, 2000. The reason given for termination was Vlaovic's failure to comply with company requirements. The letter also required that any further trades by Vlaovic pending August 31, 2000 must be accompanied by an original signature. When, a few days later, Vlaovic threatened to sue TWC if they refused to process trades he presented without a client's signature his termination date was immediately moved up to August 23, 2000.

C. Employment with W.H. Stuart Mutuals Ltd.

Vlaovic was registered a third time as a mutual fund salesperson from November 7, 2000 until September 24, 2001, this time with W.H. Stuart Mutuals Ltd. Testimony was heard from Mr. Derrick McMillan ("McMillan") who was W.H. Stuart's chief compliance officer for Canada during this time. Due to the past concerns surrounding Vlaovic's activities the Commission's Director of Registrations placed several conditions on his registration with W.H. Stuart of which McMillan was aware. The restrictions included that no trades were to be processed without a client's signature or other acceptable proof that authorization had been given. In fact, according to McMillan the policy of W.H. Stuart was not to allow verbal authorizations for trades. Vlaovic was made aware that all trades required a signature, a fax or an email from the client confirming the instructions. Vlaovic accepted these conditions, although he indicated it would be difficult with the volume of trades that he processed.

Vlaovic in fact did continue at W.H. Stuart to process many more trades than the average representative. This was accepted by his branch manager, Bruce Derraugh ("Derraugh") who was called as a witness by Vlaovic. Derraugh confirmed that he was made aware of Vlaovic's method of processing voluminous trades and felt W.H. Stuart could handle them as long as there were the required supporting documents. He testified that it did appear that Vlaovic was complying. Derraugh audited Vlaovic's files on a couple of occasions and he noted the required authorizations appeared to be in place. Unfortunately, not all was as it appeared.

An audit of Vlaovic's records by McMillan in September, 2001 revealed that trade authorizations were being recycled by Vlaovic. Signed authorizations were being used over and over again with new dates being substituted for old. Apparently this had not been discovered by Derraugh in his file review. It was obvious to McMillan that Vlaovic was putting through trades for which he had not received authorization. This, in fact, was acknowledged on the record by Vlaovic. He stated that he tried to comply with requirements but the volume of trades involved in his system simply made it impossible to obtain prior authorization for all trades.

As a result of McMillan's findings Vlaovic was terminated by W.H. Stuart on September 24, 2001. In the course of his review McMillan made certain other findings, which included the fact that Vlaovic had several clients who were residents of Ontario. Vlaovic was never registered to do business in Ontario and should not have been trading for these individuals. The panel questions why the branch manager would not have determined this through his own reviews. Vlaovic has not been registered in any capacity with the Commission since September 24, 2001 and he has not applied to be registered.

Staff counsel led evidence of additional alleged improper conduct of Vlaovic including:

> 1. Vlaovic sent to his former clients (while suspended) a form of his own creation, called Investment Funds Performance Deals, whereby he guaranteed a minimum 10% return on investments. In addition, the document suggested Vlaovic would personally compensate any client to the extent of one-half of any actual returns that were below 10%, while a client would pay to Vlaovic one-half of any returns achieved over 15%. This represents unregistered trading, guaranteeing risk free investing and entering into personal financial dealings with a client, all of which are either illegal (when unregistered) or improper (when registered) conduct.

Vlaovic denied ever acting on this offer with any investors, either while registered or unregistered. The evidence of one of his former clients, however, Hazel Jamieson Werner, contradicts this claim.

2. After being terminated by W.H. Stuart and as such, while unregistered, Vlaovic operated a web site wherein, among other things he held out the selling of mutual funds. This in fact was admitted for the record by Vlaovic.

3. Staff counsel elicited evidence on several instances of unprofessional conduct in communications both with employers and clients.

While evidence was received on the three areas above the panel does not find it necessary to deal with these matters in any detail.

Findings

The panel finds that at all three mutual fund dealers by which Vlaovic was employed, he engaged in discretionary trading. Not only did he do it knowing that it was outside his scope of authority, he did it in the face of instructions from employers that he refrain from such activity. In addition, both by his words and his actions he attempted to mislead his employers into believing that he was complying with requirements. While, in the opinion of the panel it was far too easy to mislead his employers, we find that his conduct in so doing was clearly intentional.

The panel also finds that Vlaovic traded without registration. There are numerous other findings that the panel could make that are set out in the Amended Statement of Allegations and for which evidence has been led, but, as stated above, we do not feel it necessary so to do. The findings we have made are sufficient for our purposes.

Disposition

The securities industry is one of the most highly regulated industries. While industry participants may not agree with all of the rules, they have to respect them. They are designed to protect the interests of investors and the capital markets. A mutual fund salesman, such as Vlaovic, cannot engage in discretionary trading; that is reserved for those who have obtained the requisite education and credentials.

The fact that he was not allowed to put through trades without the specific instructions of clients was made known to Vlaovic by his employers. He was advised on more than one occasion that his method of trading was not only against the rules of conduct for the industry but not in the best interests of his clients. Vlaovic refused to accept this and continued to engage in discretionary trading in defiance of industry requirements and specific instructions. He also attempted to hide what he was doing.

Vlaovic suggested to the panel on numerous occasions during the hearing that he was not an ordinary person. He said that he was an individual of high intelligence and considerable capability. This may be true. There are, however, any number of equally intelligent and capable

individuals operating in the securities industry who understand the necessity of abiding by its rules and precepts. In Vlaovic's case, he felt he knew better than his supervisors and clearly believed that rules which would not allow him to operate in his preferred fashion should not apply to him. A representative in Vlaovic's position is usually dealing not only with the funds of his clients but with their future plans. This responsibility requires an individual to honour the rules and limitations imposed upon him despite the fact that he may believe he can do better his own way.

On his own behalf, Vlaovic pointed out that his clients liked and trusted him, that there were no client complaints about his method of investing for them, that no one was hurt financially by his actions and that many of his clients received good returns. All of this may be true and the panel heard evidence that he was liked by, and his actions appreciated by, many of his clients. The panel can also accept his assertion, which is shared by two of his former supervisors, that he was motivated by the financial interests of his clients as opposed to his own interests. These are all testaments to Vlaovic but they do not change the fact that his conduct was improper and could have resulted in serious negative consequences for those relying on him.

Vlaovic is not registered with the Commission and the question before the panel is simply whether he should be denied access to the exemptions under the Act. This depends on whether the panel feels that it is in the public interest. We have no doubt that in the case of Vlaovic, who refuses to be governed, that the public interest requires that he not be an operative in the securities industry, and this includes the exempt market. As such, the panel orders that he be denied access to the exemptions under The Securities Act for an indefinite period.

One Final Point

At several times during the hearing Vlaovic asked the panel why, given the level of supervision that he received, he was the only individual facing Commission sanctions. It seems to the panel that the question is a valid one.

For the most part the supervision given to Vlaovic was poor. With both of his first two employers he maintained his business operation and his client records at his place of residence as opposed to the branch office despite the fact that in both instances he was directed to relocate his business and his records to the branch office. This never occurred and the issue was never forced.

At both Summit and TWC Vlaovic's files were never reviewed by his direct supervisors. At W.H. Stuart his direct supervisor apparently did reviews of his files but missed evident problems. The level and timing of the trading done by Vlaovic should have raised obvious concerns with supervisors, but at best he was simply taken at his word and at worst, supervisors appeared to turn a blind eye to the obvious. That it took an operational issue just to get his conduct on a management agenda before any compliance issue was identified is astounding.

Poor supervision does not excuse Vlaovic as the panel is confident that he knew what he was doing was improper and that he continued to do so with full knowledge and in the face of instructions to the contrary. Nonetheless, the supervision received was less than adequate. In the

opinion of the panel the question of conduct in the investigation and hearing of this matter could well have gone beyond Vlaovic himself.

Costs

An award of costs is in the discretion of the panel. Staff counsel has submitted a Statement of Costs, based on the Regulation, in the amount of $32,000.00. Although the investigation was extensive and the hearing took 5 days, not including argument, the panel considers the amount requested to be excessive, in the circumstances.

There is no doubt that an order of costs is warranted. Vlaovic put staff counsel to the proof of all allegations, many of which were acknowledged after evidence was put in. In addition, a good deal of time each day was spent while Vlaovic asked for copies of and reviewed documents which had been provided to him well before the hearing. The fact that the hearing took 5 days to complete is largely Vlaovic's responsibility.

At the same time, Vlaovic suggested that one of the reasons he was contesting the matter was to point out that he should not necessarily have been alone in answering the allegations surrounding his conduct. This theme made up a part of the cross-examinations he conducted. As noted above, the panel can understand his point. Although Vlaovic cannot excuse his conduct, we were not convinced that the entire root of the problem was dealt with at the hearing. We are not prepared to make Vlaovic responsible for all of the costs claimed.

The panel has decided upon a global order of costs in the amount of $5,000.00.

September 10, 2003

"*D.G. Murray*"
D. G. Murray
Chair

"*R. L. Pollack ,Q.C.*"
R. Pollack
Member

"*K.E Hughes*"
K.E. Hughes
Member