

BRITISH COLUMBIA SECURITIES COMMISSION  
*Securities Act*, RSBC 1996, c. 418

Citation: Re Zhong, 2015 BCSECCOM 165

Date: 20150505

**Hong Liang Zhong**

<b>Panel</b>	Audrey T. Ho	Commissioner
	George C. Glover, Jr.	Commissioner
	Gordon L. Holloway	Commissioner

**Hearing Dates** June 16, 17, 18 and July 28, 2014

**Submissions Completed** February 3, 2015

**Date of Findings** May 5, 2015

**Appearing**

Anthony Abato For the Executive Director

Hong Liang Zhong For himself

**Findings**

**I. Introduction**

- [1] This is the liability portion of a hearing under sections 161(1) and 162 of the *Securities Act*, RSBC 1996, c. 418.
- [2] In a notice of hearing issued August 6, 2013 (3024 BCSCEECOM 303), the executive director alleged that the respondent Hong Liang Zhong:
- a) engaged in the business of trading in foreign exchange (forex) contracts without being registered, contrary to section 34 of the Act;
  - b) guaranteed the return of investors' principal investment, thereby making a prohibited representation contrary to section 50(1)(a)(ii) of the Act;
  - c) perpetrated a fraud contrary to section 57(b) of the Act; and
  - d) engaged in conduct that is contrary to the public interest.
- [3] The executive director called four witnesses at the hearing: the primary investigator on this matter and three investors.

[4] The respondent attended a voluntary interview with Commission staff in 2011, before the issuance of the Notice of Hearing. The respondent also attended the hearing but did not testify. He cross-examined the executive director's witnesses and entered documentary evidence. He also made written and oral submissions on liability.

## **II. Background**

[5] Zhong is a resident of British Columbia. He has never been registered in any capacity under the Act.

[6] Zhong moved to Vancouver from New York in 2004. While in New York, he was self-employed and traded in stocks and forex. He began trading in forex in 2001. He had an account with MG Financial Group (MGF), an electronic spot foreign exchange trading platform, since 2001.

[7] Zhong moved to Vancouver in 2004. That year, he kept an office in Richmond for two months and had some forex clients.

[8] In January 2005, Zhong became a referring broker for MGF. As such, MGF would pay him a commission based on the volume of trading in a referred client's account.

[9] MGF records indicate that Zhong:

- a) had referred 30 clients to MGF by July 19, 2009; and
- b) was associated with 67 separate online trading accounts at MGF dating back to 2005, including approximately ten accounts belonging to Zhong or his wife.

[10] At first, the investors referred by Zhong to MGF opened "individual" (self-traded) accounts. They did not designate a money manager/trading agent. Between 2005 and 2008, Zhong earned US\$23,374 in commissions from MGF.

[11] In 2009, Zhong began to recruit investors who would let him trade forex for them. He solicited investors by posting ads on "westca.ca", a Chinese-language classifieds website. He also hosted parties at his home, and recruited investors through word-of-mouth. He described himself to investors as a successful forex trader and told some investors that he had "never lost" money trading forex.

[12] In 2009, Zhong began to refer to MGF a number of investors who opened "managed" accounts, with Zhong as the referring broker and his wife as the "money manager"/"trading agent".

[13] MGF closed its retail operations around September 2010. Zhong began trading on Forex Capital Markets, Ltd. (FXCM), another electronic forex trading platform.

[14] The Notice of Hearing that is the subject of this hearing relates to 14 forex investors recruited by Zhong who opened trading accounts at MGF and/or FXCM during 2009-2011.

*The MGF investors*

[15] The evidence demonstrates a similar pattern among the MGF investors. By opening an account with MGF, an investor authorized MGF to buy and sell forex with counterparty banks in accordance with instructions from the investor's designated trading agent. The accounts involved trading using leverage. The investor was required to immediately meet shortfalls in any margin requirements, or risk the automatic liquidation of any open positions with a resultant loss. Although the transactions involved foreign currencies, the investor never accepted or made delivery of the actual currencies.

[16] Zhong referred 12 investors to MGF who opened trading accounts between April 2009 and July 2010. Of the 12 investors:

- a) Zhong was the designated referring broker for 11;
- b) ten appointed Zhong's wife as their trading agent, giving her complete trading authority over their accounts. For that work, they agreed to pay her between 30 and 50 percent of the trading profit; and
- c) of the remaining two MGF investors, one told staff that Zhong traded his MGF account and would receive 50% of the trading profit, and Zhong was the designated trading broker for the other and would receive 40% of the trading profit.

[17] Despite their appointment of Zhong's wife as trading agent, the investors had no or minimal interactions with Zhong's wife.

[18] Commission staff conducted a voluntary interview of Zhong's wife at her home in 2013. She told Commission staff that she had never traded forex. She never met or spoke with several investors named by Commission staff even though she was their designated trading agent. She said that forex trading was her husband's business. To help him, she had allowed him to use her name on documents and signed documents when asked by him.

[19] Two of the MGF investors testified at the hearing. One investor (HJ) met Zhong after seeing his online posting. The other investor (LJ), a co-worker of Zhong's wife, was introduced to Zhong by his wife.

[20] Investor HJ testified that Zhong (calling himself Wall Street Guy) posted ads on a Chinese-language classifieds website called “westca.ca”, inviting people to his home for lobsters for a small fee. HJ saw a posting to recruit 10-15 people to invest \$3,000 each in forex trading (to create a free dinner club), and another to recruit 10-15 people to invest \$20,000 each in forex trading (to create a free tour group). The sales pitch was that if people gave Zhong money to invest, he would generate enough money for them to pay for dinners and travel. Zhong also said investors would get their principal back regardless of whether the investments made a profit or lost money.

[21] The testimony of the two investors was consistent:

- a) Zhong invited each investor to his home for a private meeting. Zhong showed them on his computer examples of online forex accounts and how he made a lot of money for other people. Zhong told HJ that he was a very successful forex trader and “had never lost” money.
- b) When the investors were ready to invest, Zhong obtained personal information from them and filled out on their behalf an online application to open a trading account at MGF. They did not know what was on the account opening forms; they did not read them and Zhong did not explain them. Zhong entered their electronic signatures into the account application.
- c) Zhong also gave them a limited power of attorney to sign. They understood that the purpose of the power of attorney was to appoint Zhong to trade forex on their behalves. JH saw Zhong sign his wife’s name on that document but understood it would be Zhong who would do the trading.
- d) HJ testified that he could go online to see account activities but he was unable to trade his account (the trading agent had complete authority over trading).
- e) They understood Zhong would trade for them, and be compensated by sharing in the profits generated. Since it was a profit-sharing arrangement, Zhong would be paid only if his trading were profitable.
- f) Zhong promised there would be no risk to their principal. LJ said Zhong’s guarantee was a condition to her decision to invest.
- g) Zhong did not tell them that he would receive a commission based on the volume traded. Although the application documents contained a disclosure relating to referring broker commissions, they did not see it and Zhong did not explain it to them.

h) Both contacted Zhong when they saw online the trading losses in their accounts. HJ tried to withdraw from the arrangement but Zhong said he could not do so until the year was up. Zhong told LJ the trading losses did not matter because he had a year to recoup her losses.

[22] These investors' testimony was confirmed in part by what Zhong told Commission staff at his voluntary interview:

- a) Zhong said he had hosted parties at his house and posted invitations online. He said his initial goal was to form a diners' or travelers' group where members would pool money together and Zhong would trade forex with that money. Any profits from trading would be used to pay for the meals and trips for the group.
- b) Zhong admitted that he traded forex for these two investors. He admitted to telling HJ that he would take 50% of the trading profit as compensation and he would compensate HJ for any trading loss at the end of their one-year agreement. He also said he was going to return JL's money but decided not to do so when she wrote negative comments about him in the newspapers.

[23] Commission staff spoke with eight other MGF investors (they were unable to contact the remaining two MGF investors), and entered into evidence staff's notes of these conversations. These investors' descriptions of their interactions with Zhong are corroborated by the *viva voce* testimony of HJ and JL, and we find them reliable in the circumstances.

[24] Of these eight investors:

- a) four said Zhong did not tell them that he would receive referral commissions from MGF, and one said Zhong told him that MGF was paying Zhong a commission. The executive director had submitted that Zhong also concealed his referral commissions from two other investors (XDX and GJP), but we do not find the investigator notes of his conversations with these investors sufficiently clear to make that finding.
- b) seven said Zhong guaranteed the return of their principal. The executive director had submitted that Zhong also gave a guarantee to the remaining investor (SKN), but we do not find the investigator's notes of his call with that investor sufficiently clear to make that finding.

[25] The investors relied on Zhong to trade and make money for them. The investors were passive; their role was to authorize the opening of the forex trading accounts and to fund them.

***The FXCM investors***

- [26] Zhong referred to FXCM three investors who opened accounts in 2010 and 2011. One of these investors was also one of the 12 MGF investors.
- [27] Zhong's wife was the designated referring broker for two investors. There is no evidence on whether she was the designated referring broker for the third investor (DS).
- [28] Zhong was the designated trading agent for one investor (DS). At his voluntary interview, Zhong admitted to trading for DS.
- [29] There is no documentary evidence on whether Zhong was the designated trading agent for the other two investors. However, both investors told Commission staff that Zhong traded their accounts for which he would receive a share of the trading profit (40% in one case, 50% in the other), and both investors had indicated on their account opening forms that their accounts would be traded by someone else.
- [30] Unlike the MGF arrangement, the referring commission was payable by the investors and not by FXCM.
- [31] One FXCM investor (DS) testified at the hearing. Zhong told DS that he was a financial star; that he invented a special system to trade forex that was very successful and he would never lose the principal. Zhong told DS to sign the forex account opening application and Zhong would arrange everything for him. Zhong guaranteed his principal investment if there were losses. With respect to referral commissions, Zhong only said he would be compensated by sharing in 50% of the trading profit.
- [32] Commission staff spoke with the other two FXCM investors. Both said Zhong guaranteed their principal, but did not tell them that there would be a referral commission.

***Concealed commissions***

- [33] We find that Zhong was the designated referring broker for 11 MGF investors, and Zhong's wife was the designated referring broker for two FXCM investors.
- [34] Although there was no documentary evidence showing the identity of the designated referring broker for the third FXCM investor, we inferred that either Zhong or his wife was the designated referring broker for that investor. That is an inescapable conclusion since Zhong would only make money based on trading volume if he or his wife was designated the referring broker, and he had consistently designated either himself or his wife as referring broker for the other investors' accounts.

[35] The MGF referring broker agreement prohibits the referring broker from also acting as the manager or trader of the referred customer's account. It requires the referring broker to inform the referred customer that MGF will compensate the broker for the referral by way of a commission based on the volume of trading activity.

[36] According to the investors, Zhong told them that Zhong would make money by sharing in the trading profits. We find that Zhong did not tell at least nine investors that either he or his wife would be paid a commission based on trading volume.

***Guarantee of principal***

[37] Zhong entered into written Transaction Agency Agreements with four MGF investors, whereby Zhong guaranteed the return of the full principal amount to these investors after one year.

[38] According to the investors interviewed by Commission staff, Zhong verbally made a similar guarantee to at least three other MGF investors, two FXCM investors, and the MGF investor who also traded at FXCM. We do not find the investigator's notes of his conversation with one investor (SKN) to be sufficiently clear to prove that Zhong also guaranteed SKN's trading losses.

[39] We therefore find that Zhong guaranteed the return of principal to at least 10 investors.

***Investors' trading losses***

[40] In general, once an investor funded his or her account, dozens of trades were executed on an almost daily basis. The forex company made margin calls, which resulted in the automatic liquidation of any open positions. This created significant trading losses for the investors.

[41] As an example, investor HJ lost \$23,500 of his \$30,000 principal in less than a week.

[42] The 14 investors deposited more than \$500,000 with the forex firms and lost about \$400,000 in forex trading in a matter of months. The sole investor who made money at MGF subsequently lost it in trading at FXCM. One investor (DS) recovered approximately \$80,000 from FXCM, but that was to compensate him for a technical computer glitch caused by FXCM.

***Zhong's compensation***

- [43] Although Zhong did not generate a profit for any investor (save for the one who ultimately lost it in trading conducted by Zhong at FXCM), between December 31, 2008 and September 30, 2010, Zhong earned US\$108,405 in commissions from MGF based on the volume of trading in all of his referred clients' accounts. The executive director did not receive from MGF a break-down to determine the amount of referral commissions that only pertained to trading in the 14 investors' accounts. Zhong also earned approximately \$12,000 in trading fees, primarily from the investor who made a profit in his MGF account.
- [44] There is no evidence on the amount of referral commissions that he or his wife earned from the FXCM accounts.

***Zhong's position***

- [45] Save for his specific admissions to Commission staff at the voluntary interview, Zhong's general position was that: he did not and there was no documentary evidence to prove that he traded or opened trading accounts for all 14 investors, the witnesses lied, Zhong spent a lot of time with the investor witnesses explaining and reviewing the account opening information and they understood everything, and the Commission investigator made unwarranted conclusions based on unsupported statements from investors.

**III. Analysis and Findings**

**A. Credibility**

- [46] We find the witnesses to be credible. Their testimony was internally consistent and supported by extensive documentary evidence obtained from MGF that included signed copies of Zhong's referred broker agreement, Zhong's commission account statements, investors' account opening and power of attorney forms, and brokerage and account statements.
- [47] Although there was much less documentary evidence obtained from FXCM, DS' testimony was consistent with what was available, and with the evidence and pattern of conduct relating to the MGF arrangements.
- [48] We also gave weight to the investigator's notes of his conversations with the investors who did not testify. Their recounting of their dealings and arrangements with Zhong were consistent with the testimony of the investors who did testify, corroborated in part by documentary evidence, and consistent with the pattern of Zhong's conduct established by testimony and documentary evidence.

**B. Trading in securities without registration**

- [49] Section 34(a) of the Act states that: "a person must not trade in a security ... unless the person is registered in accordance with the regulations and in the category prescribed for the purpose of the activity."



- [50] To establish this contravention, the executive director must prove that:
- a) the arrangement with Zhong outlined above is a “security” as defined under the Act;
  - b) Zhong “traded” in securities as defined under the Act; and
  - c) Zhong did not have an exemption from the registration requirement.

***Was the arrangement with Zhong a “security” under the Act?***

- [51] “Security” is very broadly defined under section 1(1) of the Act and includes an investment contract.
- [52] In *Canada Pacific Consulting Inc. and Michael Robert Shantz*, 2012 BCSECCOM 86, this Commission held that “an investment contract is an investment of money in a common enterprise with profits to come from the efforts of others.” The panel in that case found that the arrangement under which the investors deposited their funds (for forex trading) was an investment contract because: the arrangement required an investment of money; the investors’ profits were to come from the efforts of other persons other than themselves; and a commonality existed between Canada Pacific and the investors.
- [53] Similarly, in this case, the arrangement between Zhong and the investors clearly required the investment of money from the investors. It is also clear that, once the investment funds were provided, the investors’ role was a passive one. Any profit was to come from the expertise of Zhong. As one witness testified, Zhong had total control over the investment funds and would not permit the investor to withdraw his investment even when losses began to accumulate.
- [54] In *Yuen Chow International Group, et al* [1995] 22 BCSC Weekly Summary 26, this Commission heard allegations against one of the corporate respondents, Hang Lung, relating to forex contracts “purporting to represent the purchase and sale on margin of certain foreign currencies.” The panel analyzed the forex contracts at issue using the broad approach for an investment contract taken in *Pacific Coin Exchange v. Ontario Securities Commission* [1978] 2 S.C.R. 112, and said (at paragraph 3.1):

The forex contracts offered to the public by Hang Lung involved the investment of money for the purpose of speculating in foreign currencies. The intention of any client opening a contract would be to earn a profit, not to take delivery of the currency.

- [55] In *Pacific Coin Exchange*, the court explained the commonality that must be present in order to establish that an arrangement falls within the definition of “investment contract” (at page 129):

A common enterprise existed when the enterprise is undertaken for the benefit of the supplier of capital (the investor) and of those who solicited the capital (the promoter). In that relationship, the investor's role is limited to the advancement of money, the managerial control over the success of the enterprise being that of the promoter; therein lies the community.

[56] Similarly, the arrangements between Zhong and the investors in this case involved the investment of money for the purpose of speculating in foreign currencies. The intention of the investors was to earn a profit and not to take delivery of the underlying foreign currencies. Their role was limited to the advancement of money into the forex accounts, and they were wholly reliant on the efforts of Zhong to generate profit on those investments. A commonality existed between Zhong and each investor in the way described in the cited cases.

[57] We find that the investment scheme between Zhong and the investors is an investment contract, and is a "security" under the Act.

***Did Zhong "trade" in securities***

[58] Section 1(1) of the Act defines a "trade" to include "a disposition of a security for valuable consideration" and "any act, advertisement, solicitation, conduct or negotiation directly or indirectly in furtherance of" a disposition of a security for valuable consideration.

[59] Zhong traded in securities when he entered into arrangements with the investors to buy and sell forex on their behalf, and with an understanding that he would share in the profits of the arrangements with the investors. This constitutes a trade in securities for valuable consideration as defined in the Act.

[60] Further, Zhong's advertisement and solicitation activities (online postings, hosting parties and meeting with investors at his home to explain the arrangements), his negotiations and other conduct (entering into guarantees with investors, opening trading accounts for investors) fall squarely within the definition of "trade". They were all done in furtherance of entering into investment contracts with the investors for the purchase and sale of forex by Zhong on behalf of the investors, for which Zhong or his wife would receive valuable consideration in the form of referral commissions and profit sharing.

[61] Accordingly, we find that Zhong traded in securities.

***Was a registration exemption available to Zhong under the Act***

[62] The executive director identified two potentially relevant exemptions from registration for the period covered by the Notice of Hearing.

*(i) The accredited investor exemption*

- [63] Until its repeal on March 27, 2010, National Instrument 45-106 section 3.3(1) provided an exemption from registration for a trade in security if the purchaser purchased the security as principal and was an accredited investor.
- [64] We find that this exemption was not available to Zhong. The evidence is that all except two investors were not accredited investors. There is no evidence either way for the two remaining investors.
- [65] It is the responsibility of a person trading securities to ensure that the trade complies with the Act, and that person bears the onus of proving that any exemption that he relies on is available to him. (See *Solara Technologies Inc. and William Dorn Beattie* 2010 BCSECCOM 163, paragraphs 32-33.) Zhong has not satisfied the onus on him to prove that the two remaining investors were accredited investors.

*(ii) The “not in the business of trading” exemption*

- [66] Commencing September 28, 2009, National Instrument 31-103 section 8.4(1) provided an exemption from the dealer registration requirement for a person if that person “is not engaged in the business of trading in securities ... as a principal or agent”, and “does not hold himself ... out as engaging in the business of trading in securities ... as a principal or agent”.
- [67] The Companion Policy to NI 31-103 (at section 1.3) gives guidance for determining whether a person is “engaged in the business of trading in securities” under NI 31-103 section 8.4(1):

*Factors in determining business purpose*

This section describes factors that we consider relevant in determining whether an individual or firm is trading or advising in securities for a business purpose and, therefore, subject to the dealer or adviser registration requirement.

This is not a complete list. We do not automatically assume that any one of these factors on its own will determine whether an individual or firm is in the business of trading or advising in securities.

*(a) Engaging in activities similar to a registrant*

We usually consider an individual or firm engaging in activities similar to those of a registrant to be trading or advising for a business purpose. Examples include promoting securities or stating in any way that the individual or firm will buy or sell securities. If an individual or firm sets up a business to carry out any of these activities, we may consider them to be trading or advising for a business purpose.

*(b) Intermediating trades or acting as a market maker*

In general, we consider intermediating a trade between a seller and a buyer of securities to be trading for a business purpose. This typically takes the form of the business commonly referred to as a broker. Making a market in securities is also generally considered to be trading for a business purpose.

*(c) Directly or indirectly carrying on the activity with repetition, regularity or continuity*

Frequent or regular transactions are a common indicator that an individual or firm may be engaged in trading or advising for a business purpose. The activity does not have to be their sole or even primary endeavor for them to be in the business.

We consider regularly trading or advising in any way that produces, or is intended to produce, profits to be for a business purpose. We also consider any other sources of income and how much time an individual or firm spends on all activities associated with the trading or advising.

*(d) Being, or expecting to be, remunerated or compensated*

Receiving, or expecting to receive, any form of compensation for carrying on the activity, including whether the compensation is transaction or value based, indicates a business purpose. It does not matter if the individual or firm actually receives compensation or in what form. Having the capacity or the ability to carry on the activity to produce profit is also a relevant factor.

*(e) Directly or indirectly soliciting*

Contacting anyone to solicit securities transactions or to offer advice may reflect a business purpose. Solicitation includes contacting someone by any means, including advertising that proposes buying or selling securities or participating in a securities transaction, or that offers services or advice for these purposes.

[68] The Commission applied this guidance in *Gibraltar Global Securities Inc.*, 2012 BCSECCOM 194, and cited the following factors in determining that Gibraltar was engaged in the business of trading in securities:

- a) it advertised investment management services on its website;
- b) it provided trading services with repetition, regularity and continuity;
- c) it made multiple trades for at least eight BC residents; and
- d) it was compensated in the form of trading commissions.

- [69] In applying the guidance set out in the Companion Policy, we find that the “not in the business” exemption in NI31-103 was not available to Zhong, based on the following:
- a) he solicited investors to engage him to trade for them;
  - b) he held himself out as an expert forex trader;
  - c) he engaged in frequent and regular forex trading transactions, for himself and other people, since at least 2005; and
  - d) he engaged in these activities for pay - he expected to receive, and did receive, significant compensation from these transactions.
- [70] Accordingly, we find that Zhong traded in securities without being registered and contravened section 34(1) of the Act.

### **C. Prohibited representation**

- [71] Section 50(1)(a)(ii) of the Act states that:

A person, ... with the intention of effecting a trade in a security, must not ... represent that the person or another person will ... refund all or any of the purchase price of the security.

- [72] Zhong gave guarantees to at least ten investors that he would repay their principal after one year. These guarantees were tantamount to promises to refund the investors’ purchase prices.
- [73] Zhong gave these guarantees as part of his sales pitch to solicit investors who would authorize him to trade for them. Accordingly, they were given with the intention of effecting trades in a security.
- [74] We therefore find that Zhong provided prohibited representations and contravened section 50(1)(a)(ii) of the Act.

### **D. Fraud**

- [75] Section 57(b) of the Act states that:

A person must not, directly or indirectly, engage in or participate in conduct relating to securities or exchange contracts if the person knows, or reasonably should know, that the conduct ... perpetrates a fraud on any person.

- [76] The executive director says Zhong perpetrated fraud in three ways:
- a) when he concealed commissions from his investors and failed to disclose a conflict of interest,

- b) when he made a false guarantee to his customers, and
- c) when he deceived the forex firms by designating his wife as the referring broker/trading agent.

[77] In *Anderson v. British Columbia (Securities Commission)*, 2004 BCCA 7, the British Columbia Court of Appeal set out the elements that must be established to prove fraud under the Act, citing from *R. v. Theroux*, [1993] 2 SCR 5 (at p. 20):

“...the actus reus of the offence of fraud will be established by proof of:

1. the prohibited act, be it an act of deceit, a falsehood or some other fraudulent means; and
2. deprivation caused by the prohibited act, which may consist in actual loss or the placing of the victim’s pecuniary interests at risk.

Correspondingly, the mens rea of fraud is established by proof of:

1. subjective knowledge of the prohibited act; and
2. subjective knowledge that the prohibited act could have as a consequence the deprivation of another (which deprivation may consist in knowledge that the victim’s pecuniary interest are put at risk).”

[78] In *R. v. Cuerrier*, [1998] 2 S.C.R. 371, the court dealt with whether non-disclosure can constitute fraud. The court stated (at page 116), “the essential elements of fraud are dishonesty, which can include non-disclosure of important facts, and deprivation or risk of deprivation.”

[79] This was elaborated in *Re Lathigee* 2014 BCSECCOM 264, where the Commission said (at paragraphs 24-25):

... That non-disclosure can constitute dishonesty is fundamental to the public interest purposes of the Act. It is consistent with the disclosure obligations imposed by credible securities regulation regimes everywhere. The requirement for complete and accurate disclosure so that investors can make well-informed investment decisions is fundamental to the fostering of confidence in our capital markets

It follows that, in the context of fraud under the Act, an “important fact” would include one that would affect a reasonable investor’s investment decision.

***Fraud on the investors***

- [80] There is an obvious conflict of interest between how Zhong would make money from the trading and how the investors would make money from the trading, given that Zhong would make money based on the volume of trading regardless of performance, while the investors would only make money if the transactions generated profits.
- [81] Zhong used his wife's name to bypass the forex firms' safeguards and conceal from the forex firms his breach of their requirements.
- [82] The inherent risks in forex trading were so significant that the forex firms included prominent disclosure in their account opening forms.
- [83] The MGF online application form states as follows:

22. NO GUARANTEES. Customer acknowledges that Customer has no separate agreement with Customer's broker or any MG employee or agent regarding the trading in Customer's Currency Forex account, including any agreement to guarantee profits or limit losses in Customer's account. Customer understands that Customer is under an obligation to notify MG's Compliance Officer immediately in writing as to any agreement of this type. ...

The online application includes a customer acknowledgement on the following:

4. [Referring Broker] has not guaranteed any returns or made any false claims concerning any level of expected returns for spot foreign currency trading.
5. [Referring Broker] has advised me that spot foreign currency trading is highly speculative and carries serious financial risk.
- [84] Both the FXCM limited power of attorney and commission acknowledgement forms contain similar cautions:

Because the risk factor is high in the foreign exchange market trading, only genuine "risk" funds should be used in such trading. If Trader does not have the extra capital the Trader can afford to lose, Trader should not trade in the foreign exchange market. No "safe" trading system has ever been devised, and no one can guarantee profits or freedom from loss. In fact no one can even guarantee to limit the extent of losses...

- [85] Yet, Zhong portrayed the arrangement to investors as a risk-free proposition for them: he was a successful trader, he had a special system and would not lose the investors' principal, he would make money only if the investors made money (by sharing in a percentage of the profit), and he would guarantee the return of their principal. Zhong hid from them the fact that he or his wife would also make money based on trading volume regardless of performance. Zhong did not explain to investors the forex firms' warnings regarding risks and guarantees. On the contrary, he offered guarantees to make forex trading with him seem far less risky than it actually was and to entice investors to trade through him.
- [86] In the absence of full disclosure on how Zhong would be compensated, an investor could not fully assess if the compensation amount were appropriate, if the compensation structure would incent Zhong to act in the investor's best interest or if it would do the opposite and add risk to their investments. In our view, the referral commission is an important fact that a reasonable investor needs to know in order to make an informed decision about whether to invest in forex through Zhong.
- [87] In the absence of full disclosure about the risks in forex trading and the questionable value of Zhong's guarantee, an investor could not fully assess the risks associated with his or her investments. In our view, those are also important facts that a reasonable investor needs to know in order to make an informed decision about whether to invest in forex through Zhong.
- [88] In hiding these important facts from the investors, Zhong was deceitful and committed a prohibited act.
- [89] Not only did Zhong have subjective knowledge of the prohibited act, he schemed to carry it out. The fact that he used his wife's name to bypass the forex firms' safeguards supports this conclusion. Only one investor among those interviewed said Zhong disclosed the referral commission. The investor witnesses all testified that Zhong completed the account opening forms for them and did not explain them. We conclude that Zhong deliberately concealed from investors the referral commissions and the true risks of their investments.
- [90] Zhong was an experienced forex broker and trader. He would have known, from his dealings with the forex firms and their requirements, that transaction-based commissions create a conflict of interest and that guarantees were not permitted by the forex firms because of their questionable value. He would have known that in hiding these facts from the investors, he deprived them of the ability to make proper risk assessments, thereby putting their pecuniary interests at risk. The risk of deprivation is even greater for the FXCM investors, since they (and not FXCM) were responsible for paying the referral commissions.
- [91] In this case, the prohibited acts caused actual loss to the investors.



[92] We find that Zhong perpetrated a fraud on the investors, contrary to section 57(b) of the Act.

***Fraud with respect to the forex firms***

[93] The executive director also asked us to find that Zhong had perpetrated a fraud with respect to the two forex firms.

[94] The basis of this submission with respect to MGF is that Zhong deceived MGF about his wife being the trading agent and as a result defrauded MGF as to the commissions paid on those accounts.

[95] Clearly, there was a breach of contract between MGF and Zhong and MGF is free to pursue its legal remedies. From a public interest perspective, we view this deceit, first and foremost, as a fraud on the investors. Having addressed that, we do not find it necessary to make a further finding that Zhong perpetrated a fraud on MGF.

[96] With respect to FXCM, we do not find any deprivation or risk of deprivation to FXCM since the commissions were payable by the investors and not FXCM. The basis of the executive director's submission is that the prohibited act was the deceit on FXCM in falsely naming Zhong's wife as the referring broker and the deprivation was in putting the FXCM investors' money at risk. This element of fraud is better addressed as a fraud on FXCM investors, which we have done.

[97] Accordingly, we decline to make separate findings of fraud with respect to the two forex firms.

***Contrary to the public interest***

[98] We have made findings that Zhong's conduct contravened sections 34, 50(1)(a)(ii) and 57(b) of the Act. We do not have evidence of conduct contrary to the public interest that is not part of the conduct supporting our findings of contraventions of those sections. Accordingly, we do not find it necessary to consider if Zhong's conduct were contrary to the public interest in addition to being contraventions of specific sections of the Act.

**IV. Summary of the Findings**

[99] In summary, we find that Zhong:

- a) engaged in the business of trading in securities, without being registered, with respect to 14 investors, contrary to section 34 of the Act;
- b) guaranteed the return of the principal of their investments to at least 10 investors, thereby making prohibited representations contrary to section 50(1)(a)(ii) of the Act; and

c) perpetrated fraud on investors, contrary to section 57(b) of the Act.

**V. Submissions on Sanctions**

[100] We direct the parties to make their submissions on sanctions as follows:

By May 27, 2015      The executive director delivers submissions to the respondent and to the secretary to the Commission

By June 10, 2015      The respondent delivers response submissions to the executive director and to the secretary to the Commission. Either party seeking an oral hearing on the issue of sanctions so advises the secretary to the Commission. The secretary to the Commission will contact the parties to schedule a hearing as soon as practicable after the executive director delivers reply submissions (if any).

By June 17, 2015      The executive director delivers reply submissions (if any) to the respondent and to the secretary to the Commission.

[101] May 5, 2015

**For the Commission**

Audrey T. Ho  
Commissioner

George C. Glover, Jr.  
Commissioner

Gordon L. Holloway  
Commissioner