

**BRITISH COLUMBIA SECURITIES COMMISSION**

*Securities Act*, RSBC 1996, c. 418

Citation: Re Zhong, 2015 BCSECCOM 383

Date: 20151208

**Hong Liang Zhong**

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

**Hearing Date** September 22, 2015

**Date of Decision** December 8, 2015

**Appearing**

Shaneel Sharma For the Executive Director

Hong Liang Zhong For himself

**Decision**

**I. Introduction**

- [1] This is the sanctions portion of a hearing under sections 161(1) and 162 of the *Securities Act*, RSBC 1996, c. 418. The Findings of this panel on liability dated May 5, 2015 (2015 BCSECCOM 165) are part of this decision.
- [2] The panel found that Hong Liang Zhong:
1. engaged in the business of trading in securities, without being registered, with respect to 14 investors, contrary to section 34 of the Act,
  2. 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
  3. perpetrated fraud on investors, contrary to section 57(b) of the Act.

## **II. Position of the Parties**

[3] The executive director seeks the following orders under sections 161(1) and 162 against Zhong:

1. Zhong be permanently prohibited from:

- a) trading in or purchasing securities and exchange contracts,
- b) becoming or acting as a director or officer of any issuer or registrant, and be required to resign from any such position that he holds,
- c) becoming or acting as a registrant or promoter,
- d) acting in a management or consultative capacity in connection with activities in the securities market, and
- e) engaging in investor relations activities;

2. Zhong pay to the Commission the following amounts:

- a) Canadian \$250,376.88 and US\$142,987.20, representing the amounts of the 14 investors' money that he traded and lost in contravention of sections 34 and 57 of the Act, and
- b) Canadian \$11,834.54 and US\$108,405, representing the amounts of trading agent fees and referring broker commissions, respectively, that Zhong obtained as a result of his misconduct; and

3. Zhong pay an administrative penalty of \$250,000.

[4] Zhong attended the hearing and made oral submissions, but on matters that were relevant to liability which we had already determined in our Findings. Zhong did not make any oral or written submissions that were relevant to sanctions.

## **III. Analysis and Findings**

### **A. Factors**

[5] Orders under sections 161(1) and 162 are protective and preventative, intended to be imposed to prevent future harm. See *Committee for Equal Treatment of Asbestos Minority Shareholders v. Ontario (Securities Commission)*, 2001 SCC 37.

[6] In *Re Eron Mortgage Corporation* [2000], 7 BCSC Weekly Summary 22, the Commission identified a non-exhaustive list of factors that are usually relevant to orders under sections 161 and 162 of the Act:

- the seriousness of respondent's conduct,
- the harm suffered by investors as a result of the respondent's conduct,
- the damage done to the integrity of the capital markets in British Columbia by the respondent's conduct,
- the extent to which the respondent was enriched,
- factors that mitigate the respondent's conduct,
- the respondent's past conduct,

- the risk to investors and the capital markets posed by the respondent's continued participation in the capital markets of British Columbia,
- the respondent's fitness to be a registrant or to bear the responsibilities associated with being a director, officer or adviser to issuers,
- the need to demonstrate the consequences of inappropriate conduct to those who enjoy the benefits of access to the capital markets,
- the need to deter those who participate in the capital markets from engaging in inappropriate conduct, and
- orders made by the Commission in similar circumstances in the past.

## **B. Application of the factors**

### ***Seriousness of conduct***

- [7] The Commission has consistently held that fraud is the most serious misconduct prohibited by the Act. In *Manna Trading Corp. Ltd.*, 2009 BCSECCOM 595, the Commission, at paragraph 18, said: "Nothing strikes more viciously at the integrity of the capital markets than fraud."
- [8] A promise to return the principal of an investment is also very serious misconduct. As demonstrated in this case, such a promise disguises the real risks associated with an investment and prevents investors from fully understanding and making informed investment decisions.
- [9] The Commission has also consistently held that any contravention of section 34 is inherently serious as the required registration of persons who advise investors and trade on their behalf is one of the foundational investor protections of the Act.
- [10] Zhong's misconduct was egregious. Through deceit and prohibited representations, Zhong deliberately misled investors into thinking that forex trading through him was a safe way to conduct forex trading, and concealed from investors the additional risks arising from the conflict of interest between how he would make money versus how the investors would make money from the trading. Zhong did not stop trading even when several investors learned of their losses and asked him to stop trading in their accounts.

### ***Harm to investors; damage to integrity of the capital markets***

- [11] Zhong's misconduct resulted in significant harm to his 14 investors. In total, they invested Canadian \$362,980 and US \$148,030, and lost Canadian \$250,376.88 and US\$142,987.20.
- [12] To date, they have not recovered any of their losses from Zhong. There is no evidence they will be able to recover any of that money. Two investors obtained judgements against Zhong in civil court. They had not been able to collect payment on those judgments.

- [13] The fact that one investor recovered about \$80,000 from one of the forex firms for a technical error committed by that firm does not lessen the harm caused by Zhong.
- [14] One investor testified that this experience had a very adverse effect on her emotional health. The money she lost was personal savings from many years of hard work at a low wage. In an investor impact statement, another investor stated that she invested and lost the \$20,000 that she had saved to help establish her family after they immigrate to Vancouver.
- [15] It is trite to say that Zhong's misconduct has done significant harm to the reputation and integrity of our capital markets. Investors become hesitant to invest in the market if they cannot trust those who trade and advise on securities to be ethical and to carry on these activities in compliance with applicable securities laws.

***Enrichment***

- [16] Zhong or his wife earned \$11,834.54 in trading agent fees, and additional amounts in referring broker commissions, from trading in the accounts of the 14 investors.
- [17] Zhong and his wife form a family unit; Zhong's wife allowed her name to be used in this scheme as Zhong requested. We consider Zhong to have been personally enriched by the fees and commissions earned in the name of his wife, in addition to those that were earned by Zhong in his own name. We find that Zhong was personally enriched as a result of his misconduct.

***Aggravating and mitigating factors***

- [18] There are no mitigating factors.
- [19] The executive director submits that the following are aggravating factors:
1. Zhong deceived the two forex firms when he forged his wife's signature on trading agent and referring broker forms. He also forged his clients' e-signatures on forex account applications.
  2. Zhong created a fake Chinese passport for one investor, which he used to open a forex account for that investor.
  3. Zhong told one forex firm that an investor was a New Zealand resident at the time the investor's account was opened, when that was not true.
- [20] These factors largely pertain to dealings between Zhong and the forex firms. It is not obvious how they aggravate the misconduct that gave rise to our findings of liability. In the liability phase, we declined to make any finding of misconduct by Zhong with respect to the forex firms. Similarly, we do not find these are aggravating factors with respect to the misconduct for which Zhong has been found liable.

***Respondent's past conduct***

[21] Zhong does not have a securities regulatory history.

***Risk to investors and the capital markets; fitness as director and officer***

[22] Zhong carried out a deliberate scheme to make money at his investors' expense. He showed callous disregard for the investors and the safeguards the forex firms put in place to protect investors. At the sanctions hearing, Zhong continued to deny any wrongdoing and maintained that the investor witnesses lied to the Commission.

[23] We see no basis for believing that Zhong will abide by securities laws in the future and conclude that his presence in our markets in any capacity represents a risk to investors.

***Specific and general deterrence***

[24] The sanctions we impose must be sufficient to ensure that Zhong and others will be deterred from engaging in similar misconduct.

***Previous orders***

[25] With respect to market prohibitions, the executive director cited *Re Samji*, 2015 BCSECCOM 29, and noted that the Commission has consistently imposed permanent bans in fraud cases for the protection of investors and our capital markets.

[26] With respect to section 161(1)(g) orders, the executive director referred to *Re Samji*; *Re Streamline Properties Inc.*, 2015 BCSECCOM 66; and *Re Michaels*, 2014 BCSECCOM 457.

[27] The executive director cited three Commission decisions in support of his submissions on administrative penalty: *Great White Capital Corp.*; 2011 BCSECCOM 303, *Canadian Pacific Consulting Inc.*, 2012 BCSECCOM 195; and *Re Cho*, 2013 BCSECCOM 454.

[28] In *Great White Capital Corp.*, the Commission found that the respondent Adam Keller defrauded four investors of \$523,100. Keller told investors he would use the money to execute foreign exchange trades or otherwise invest it on their behalf. He did not invest any of the money and used all of it for personal purposes. The panel ordered Keller to pay \$523,100 under section 161(1)(g) and an administrative penalty of \$1.6 million.

[29] In *Canadian Pacific Consulting Inc.*, the Commission found that Canadian Pacific and Michael Robert Shantz defrauded 11 investors of \$1.5 million and Shantz took \$210,000 of that money for his own use. The Commission found a blatant fraud. Canadian Pacific told investors their money would be used to invest in gold futures or foreign exchange contracts, but none of it was used for that purpose. There was no evidence that Canadian Pacific was engaged in any legitimate business - it lied to investors, stole their money and took elaborate steps to make the whole scam appear legitimate. The panel found that Shantz knew he was deceiving investors and ordered him to pay to the Commission the \$1.5 million and an administrative penalty of \$630,000.

- [30] In *Re Cho*, the Commission found that Won Sang Shen Cho perpetrated a fraud and made misrepresentations when he raised \$101,846 from five investors. There was no finding that Cho was enriched by his misconduct. The panel ordered Cho to pay to the Commission the amount he obtained from the investors (after deducting the amount he had since repaid to them), and an administrative penalty of \$200,000.

### **C. Appropriate sanctions**

#### ***Market prohibitions***

- [31] The Commission has consistently issued permanent market bans against those who have been found to have committed fraud.
- [32] Given the serious nature of Zhong's misconduct and his continuing denial of wrongdoing, we agree with the executive director that protection of the public requires that a complete ban be imposed so that Zhong cannot participate in our capital markets.

#### ***Section 161(1)(g) order***

- [33] Under section 161(1)(g), if a person has not complied with a provision of the Act, the Commission may order that the person pay to the Commission "any amount obtained... directly or indirectly, as a result of the failure to comply or the contravention." A section 161(1)(g) order is sometimes referred to as a "disgorgement order".
- [34] The executive director asks that we order Zhong to pay under this section the amount of the trading losses suffered by the 14 investors, plus the referring broker commissions and trading agent fees. He acknowledges there has not been any prior Commission decision where the Commission has ordered payment of all these amounts, but submits that we have the authority to do so.
- [35] In *Michaels and Streamline Properties Inc.*, the Commission confirmed that, in determining the appropriate order under section 161(1)(g), the question is not whether a respondent "profited" from the illegal activity but whether the respondent "obtained amounts" as a result of that activity. All money illegally obtained from investors can be ordered to be paid to the Commission, not just the "profit" made as a result of that activity.
- [36] The majority of the panel in *Streamline* (in paragraphs 49-50), quoting the Alberta Securities Commission in *Arbour Energy Inc.*, 2012 ABASC 416, indicated that the "amount obtained" in section 161(1)(g) does not mean "the amount retained, the profit, or any other amount calculated by considering expenses or other possible deductions". They further stated (in paragraphs 54-55) that the purpose of a section 161(1)(g) payment is to remove from a respondent any amounts obtained through a violation of the Act and, given the critical importance of investor protection, the fact that proceeds raised were used for the stated purpose of an investment should not automatically reduce the amount of the section 161(1)(g) order. The "amount obtained" can be the full amount raised in contravention of the Act and is not limited to a respondent's personal gain from the misconduct.

- [37] We agree with the above interpretations of section 161(1)(g).
- [38] Here, the amounts that the 14 investors invested in forex trading were obtained as a result of Zhong's misconduct. Zhong engaged in the business of trading for these investors without being registered under the Act. He gave the investors prohibited guarantees of their principal. He told them their investments were safe and he would make money only if they made money from the trading. One investor specifically testified that Zhong's guarantee of her principal was a condition to her decision to invest.
- [39] Accordingly, we find that the Commission has the authority under section 161(1)(g) to order payment of the full amounts invested by the 14 investors.
- [40] The next step is to consider if we should make that order in the circumstances of this case.
- [41] In *Re Michaels*, the Commission ordered the respondent to pay the commissions and marketing fees he earned, but declined to order payment of the amounts invested by Michaels' clients arising from his misconduct. The panel said (in paragraph 46(c)):

All but \$5.8 million of the amounts obtained as a result of Michaels' contraventions of the Act were retained by third parties in accordance with the intentions of the investors; to make an order for an amount in excess of the \$5.8 million would be punitive and inappropriate in the circumstances.

- [42] The circumstances here are very different from those in *Michaels*. Superficially, the investors' money was remitted to arms-length third parties (the forex firms) for forex trading as the investors intended, and Zhong did not use that money for personal purposes. However, Zhong had complete and sole control over that money and the trading. He alone determined how and when to trade and he did all the trading, and he used the investors' money to generate personal gain (commissions) at the investors' expense. Furthermore, unlike *Michaels*, the investments here were so different in risk profile than Zhong had represented to the investors that it is difficult to say that, in substance, the investments were what the investors had intended.
- [43] Given these circumstances, we find it is appropriate to order a section 161(1)(g) payment with respect to the amounts invested. We then consider if the order should be for the full amounts invested or some lesser amounts.
- [44] The Commission in *Michaels* said (in paragraph 46(b)):

The losses of the investors ... are to be considered only for the purpose of determining whether it is in the public interest to make a section 161(1)(g) order and do not correlate to the amount of the order, as this sanction is not focused on compensation or restitution.

- [45] The Commission also said, in the majority decision in *Streamline*, that it would be punitive and inequitable if the amount payable pursuant to a section 161(1)(g) order together with the amount payable pursuant to a court order obtained by investors in civil court exceed the total amount obtained by a respondent from investors through contraventions of the Act.
- [46] Although we agree with the *Michaels* principle reproduced in paragraph 44 above, it would be punitive to order Zhong to pay the full amounts invested by the 14 investors without deducting the amounts that the investors withdrew from these accounts and therefore were not lost to them.
- [47] However, we also find it is not appropriate to reduce the amount to be paid by Zhong under section 161(1)(g) by the \$80,000 that was returned by one forex firm to one of the 14 investors. As stated in *Michaels*, the purpose of section 161(1)(g) is not to compensate the investor for his loss caused by Zhong's misconduct. It is to remove from Zhong the amount that was obtained through his misconduct. Although the \$80,000 payment ultimately reduced the loss to that investor, it was made by a third party for a reason unrelated to Zhong's misconduct and does not lessen the amount that was in fact obtained through that misconduct.
- [48] Accordingly, we find that it is appropriate and in the public interest to order Zhong to pay under section 161(1)(g) the amounts deposited by the 14 investors into their forex accounts, minus the investors' withdrawals from, and incidental fees charged to, those accounts. The net of those amounts (i.e. the net deposits) are Canadian \$250,376.88 plus US\$142,987.20.
- [49] For the purpose of the order, we converted US\$142,987.20 into Canadian \$139,672.02. In doing the conversion, we used the Bank of Canada noon exchange rate on the date of the consolidated losses on the account statements in evidence, and on the account opening date for the one forex account without account statements. We have summarized our calculations in Schedule A to this decision.
- [50] Clearly, the trading agent fees and commissions were personal gains obtained as a result of Zhong's misconduct and the Commission has the authority to order him to pay those amounts. It would have been appropriate to require Zhong to pay to the Commission both amounts.
- [51] However, we find that the executive director has not proven the appropriate amount of commissions to be paid under section 161(1)(g). In our view, under section 161(1)(g), the executive director must prove, on a balance of probabilities, a reasonable approximation of the amount obtained by a respondent as a result of misconduct. The respondent may then attempt to prove that that amount is unreasonable. Any ambiguity is resolved in favour of the executive director, since a respondent should not benefit from any ambiguity when his or her wrong-doing gave rise to the uncertainty.



- [52] As the Ontario Securities Commission stated in *Re Limelight Entertainment*, (2008) 31 OSCB 12030 (paragraph 53), which was quoted with approval in *Re Ground Wealth Inc.*, (2015) 38 OSCB 9835 (paragraph 28):

Staff has the onus to prove on a balance of probabilities the amount obtained by a respondent as a result of his or her non-compliance with the Act. Subject to that onus, we agree that any risk of uncertainty in calculating disgorgement should fall on the wrongdoer whose non-compliance with the Act gave rise to the uncertainty.

- [53] In this case, we only have evidence on the amount of commissions and trading agent fees received by Zhong from trading at one forex firm. With respect to the commission amounts, between December 31, 2008 and September 30, 2010, Zhong earned a total of US\$108,405 in referring broker commissions from MG Financial Group based on the volume of trading in all of his referred clients' accounts. The executive director advised that, despite his efforts, he was unable to obtain a break-down of the commissions to ascertain the portion that pertained to trading in the 14 investors' accounts. We are satisfied from the evidence that this amount included referring broker commissions with respect to the 14 investors. However, the evidence also indicates that other referred clients of Zhong maintained open accounts at MG Financial in that same time period. We were not provided with any evidence to indicate what portion of the commissions related to the contraventions of the Act. Therefore, we do not know to what extent the US\$108,405 included commissions generated from trading for these other referred clients of Zhong where misconduct has not been alleged.
- [54] The executive director submits that this uncertainty should not benefit Zhong, because he received the commissions during a pattern of fraud and unregistered trading. As noted above, the executive director must first prove, at least, a reasonably approximate amount obtained through misconduct. Had the executive director made submissions on the portion of the total commissions that represented an amount obtained in contravention of the Act, we would then consider if that amount was reasonable. However, we were directed to a global amount that included but may not be limited to the amount obtained in contravention of the Act. We appreciate that the executive director did try but was unable to obtain the necessary information to provide us with that evidence. Nevertheless, for this reason, the executive director has not met the burden of proof as it relates to the payment of commissions under section 161(1)(g). Although we are not ordering any payment of commission amounts, we are satisfied that the totality of the sanctions, even without the disgorgement of commissions, is adequate for purposes of specific and general deterrence.
- [55] We therefore order, under section 161(1)(g), that Zhong pay to the Commission the sum of \$390,048.90 (\$250,376.88 for the investors' Canadian accounts, and \$139,672.02 for the US accounts), together with \$11,834.54 in trading agent fees earned on these investors' accounts.

***Administrative penalty***

- [56] The executive director asked for an administrative penalty of \$250,000 on the basis that Zhong's misconduct was less egregious than that of Keller in *Great White Capital Corp.* and Shantz in *Canadian Pacific Consulting Inc.*, but more egregious than that of Cho in *Re Cho*.
- [57] We agree that Zhong's misconduct was less egregious than that of Keller and Shantz, in the sense that Zhong at least used his investors' money to trade in forex. We also agree that his misconduct was more egregious than that of Cho.
- [58] We agree with the executive director that an administrative penalty of \$250,000 is appropriate and consistent with the previous orders cited by the executive director. It significantly exceeds the amount of Zhong's personal enrichment and reflects the seriousness of Zhong's misconduct and other factors relevant to sanction, making it appropriate for Zhong personally. Further, it serves as a meaningful and substantial general deterrent to others from engaging in similar misconduct.

**IV. Orders**

- [59] Considering it to be in the public interest, and pursuant to sections 161 and 162 of the Act, we order that:
1. under section 161(1)(b)(ii), Zhong is permanently prohibited from trading in or purchasing any securities or exchange contracts;
  2. under section 161(1)(c), on a permanent basis, no exemption set out in the Act, in the regulations or a decision as defined in the Act, will apply to Zhong;
  3. under section 161(1)(d)(i), Zhong resign any position he holds as a director or officer of any issuer or registrant;
  4. under section 161(1)(d)(ii), Zhong is permanently prohibited from becoming or acting as a director or officer of any issuer or registrant;
  5. under section 161(1)(d)(iii), Zhong is permanently prohibited from becoming or acting as a registrant or promoter;
  6. under section 161(1)(d)(iv), Zhong is permanently prohibited from acting in a management or consultative capacity in connection with activities in the securities market;
  7. under section 161(1)(d)(v), Zhong is permanently prohibited from engaging in investor relations activities;
  8. under section 161(1)(g), Zhong pay to the Commission Canadian \$401,883.44; and

9. under section 162, Zhong pay to the Commission an administrative penalty of Canadian \$250,000.

[59] December 8, 2015

**For the Commission**

Audrey T. Ho  
Commissioner

George C. Glover, Jr.  
Commissioner

Gordon L. Holloway  
Commissioner

### Schedule A

<b>Date</b>	<b>Net Deposit (US\$)</b>	<b>Bank of Canada (noon) Exchange Rate</b>	<b>Net Deposit (CAN\$)</b>
<b>MG Financial</b>			
February 27, 2012	\$47,216.34	0.9983	\$47,136.07
<b>Forex Capital Markets, Ltd.</b>			
June 9, 2011	\$50,000.00	0.9732	\$48,660.00
July 7, 2011	\$45,770.86	0.9586	\$43,875.95
<b>Total</b>	\$142,987.20		\$139,672.02