

Re Murdoch

IN THE MATTER OF:

**The Dealer Member Rules of the Investment Industry Regulatory
Organization of Canada (IIROC)**

and

The By-Laws of the Investment Dealers Association of Canada (IDA)

and

David Wilson Murdoch

2012 IIROC 23

Investment Industry Regulatory Organization of Canada
Hearing Panel (Pacific District Council)

Heard: March 20, 2012, in Vancouver, BC
Decision: April 30, 2012

Hearing Panel:

Linda J. Murray (Chair), Brian Field, Chris Lay

Appearances:

Diana Iannetta, Senior Enforcement Counsel, for IIROC

David Wilson Murdoch and Robert Brush, for the Respondent

Hearing Panel Reasons for Decision (Settlement Hearing)

Introduction

¶ 1 David Wilson Murdoch (the Respondent) and the Investment Industry Regulatory Organization of Canada (IIROC) entered into a Settlement Agreement signed by the Respondent on February 28, 2012, and IIROC on March 1, 2012, pursuant to IIROC Dealer Member Rules 20.35 to 20.40 inclusive, and Rule 15 of the Dealer Member Rules of Practice and Procedure.

¶ 2 In the Settlement Agreement, the Respondent admitted that, from August 2005 to February 2008, the Respondent, as Branch Manager, failed to adequately supervise an RR, David Kenneth Smith, and the accounts of LS, contrary to then IDA Regulation 1300.2 and Policy No.2.

¶ 3 Pursuant to Dealer Member Rule 20.36, a Settlement Hearing was held on March 20, 2012, to consider the Settlement Agreement. A Settlement Hearing Book was provided in advance of the hearing by IIROC to the Respondent, his counsel, and to the Hearing Panel. The Hearing Panel was also provided with a copy of the Decision, dated February 7, 2012, of a previous Hearing Panel convened to consider this matter. The Hearing Panel is not bound by the Decision of the previous Hearing Panel but the Decision was taken into account by counsel in arriving at the Settlement Agreement which is the subject of this settlement hearing.

¶ 4 The Hearing Panel heard from counsel for the parties regarding the circumstances of the conduct, the relevant authorities, and submissions regarding the appropriateness of the proposed settlement agreement. IIROC and the Respondent jointly recommended that the Hearing Panel accept the Settlement Agreement.

¶ 5 The Hearing Panel adjourned the hearing to consider whether it was appropriate to accept the Settlement Agreement. The Hearing Panel determined unanimously to accept the Settlement Agreement and re-convened the hearing to advise the parties of its decision. The Hearing Panel signed the Settlement Agreement, which included one revision to paragraph 13, agreed upon by all parties, to remove from line 1 of that paragraph the words “(and still is)”.

¶ 6 The Hearing Panel issued the following Order in accordance with paragraphs 8 and 9 of the Settlement Agreement:

- a. a suspension of registration approval for 12 months as Branch Manager or from acting in any supervisory capacity;
- b. a fine in the sum of \$50,000; and
- c. costs payable by the Respondent to IIROC in the sum of \$3,500.

¶ 7 The Hearing Panel advised the parties that these written reasons would follow.

Statement of Facts, Contraventions and Terms of Settlement

¶ 8 The Settlement Agreement sets out the background and facts of this case, the contraventions admitted by the Respondent, and the agreed terms of settlement. With the consent of all parties, one correction was made at the hearing to paragraph 13 to remove from line 1 of that paragraph the words “(and still is)”. A copy of the amended Settlement Agreement is attached as Schedule A. The Settlement Agreement complies with Rule 14 of the IIROC Rules of Practice and Procedure.

Submissions of Counsel

¶ 9 IIROC counsel advised the Hearing Panel that considerable time was spent negotiating the terms of the settlement and there are public interest benefits of the settlement process. The Respondent was represented by experienced counsel. The parties had the benefit of comments from an IIROC Hearing Panel in December 2011.

¶ 10 IIROC counsel referenced the decision in *Re Milewski* [1999] I.D.A.C.D. No. 17, regarding the role of the Hearing Panel in a settlement hearing:

“... a District Council considering a settlement agreement will tend not to alter a penalty that it considers to be within a reasonable range, taking into account the settlement process and the fact that the parties have agreed. It will not reject a settlement unless it views the penalty as clearly falling outside a reasonable range of appropriateness. Put another way, the District Council will reflect the public interest benefits of the settlement process in its consideration of specific settlements.” (page 11)

¶ 11 In her submissions, IIROC counsel referenced the following potential mitigating factors:

- a. There was not a complete failure of supervision on the part of the Respondent. The Respondent made some inquiries of the RR, whom he trusted and shared a lengthy working relationship. The Respondent relied upon assurances of the RR, who was a close relative of the client, and upon a letter the client provided to the previous firm confirming that the client was satisfied with the trading activities in the account.
- b. The Respondent voluntarily resigned as Branch Manager in contemplation of a settlement hearing held in December 2011, and has not acted as a Branch Manager or in a supervisory capacity since that time.
- c. The Respondent continues to be employed by the firm.
- d. The Respondent has no disciplinary history.
- e. The conduct occurred four years ago and there have been no issues with the Respondent’s conduct since that time.

- f. The Respondent was cooperative, forthright and forthcoming throughout.
- g. The Respondent derived no personal benefit from the conduct in question and there was no evidence of dishonesty or deceit by the Respondent.

¶ 12 IIROC counsel referenced the following potential aggravating factors:

- a. The conduct occurred over about a three year period.
- b. There were obvious red flags, including the volume of transactions, the significant amount of commissions, decline in value of the account assets, and changes to the risk tolerance levels of the account on at least three occasions within a relatively short period of time.
- c. The client was 75 years of age and vulnerable.
- d. The client experienced a significant loss in the value of the account but has since been reimbursed, to some extent, by the firm.
- e. Despite the red flags, the Respondent did not contact the client to confirm that the client understood and agreed with the trading activities in the account.
- f. The Respondent failed to maintain evidence of his inquiries of the RR and his monitoring of the client accounts.

¶ 13 With respect to the issues of specific and general deterrence, IIROC counsel made the following submissions:

Specific deterrence. This is the second settlement hearing for the Respondent resulting in public notices on two occasions. Four years have elapsed since the conduct with no new issues regarding the Respondent's conduct. The Respondent voluntarily resigned as Branch Manager in December 2011. He will be denied a supervisory position, a promotional opportunity, for effectively 15 months, given his voluntary resignation. A fine of \$50,000 is a considerable amount. IIROC staff is confident that the recommended penalties and participation in the regulatory process are likely to deter the Respondent from similar conduct in the future.

General deterrence. The target groups for general deterrence include current and prospective Branch Managers and supervisors. The recommended penalties are likely to cause other branch managers and supervisors to take this type of situation seriously and enforce the message that supervisors cannot simply rely upon even the most trusted RR. In order to meet their supervisory responsibilities, supervisors must take additional steps, including contacting the client where appropriate.

¶ 14 Mr. Brush agreed with the submissions by IIROC counsel and emphasized the following factors on behalf of the Respondent:

- d. He distinguished between the Respondent's conduct from that of the RR, who benefited directly from the activities and failed to cooperate with IIROC's investigation.
- e. Mr. Brush emphasized the Respondent's good character and lack of previous disciplinary history. The Respondent cooperated fully with IIROC's investigation and readily accepted responsibility for his errors and omissions regarding his failure to effectively supervise the client's accounts in this case. Mr. Brush advised that the Respondent is unlikely to engage in similar conduct in the future.
- f. He agreed that the Respondent's actions, including his reliance upon head office inquiries regarding the accounts, were not sufficient and that the Respondent ought to have taken additional steps, including contacting the client, to discharge the Respondent's supervisory responsibilities in this case.
- g. Mr. Brush agreed that the recommended penalties will likely serve as a general deterrent.

¶ 15 IIROC counsel referred the Hearing Panel to the Dealer Member Disciplinary Sanction Guidelines, including Key Considerations When Determining Sanctions (section 3) and the specific guidelines regarding Failure to Supervise (section 4.3).

¶ 16 IIROC counsel referred the Hearing Panel to the following cases regarding factors and range of penalties:

Re Young [2010] IIROC No. 34

Re Donnelly [2010] IIROC No. 32

Re Bergh [2011] IIROC No. 41

Re Bacsalmasi [2004] I.D.A.C.D. No. 11

Re Fung [2004] I.D.A.C.D. No 25

Re Youden [2005] I.D.A.C.D. No. 52

Re David Kenneth Smith [2009] IIROC No. 48

¶ 17 The penalties in the cases ranged from no suspension to more than a one year, and fines from \$22,000 to \$70,000. Counsel pointed out that the recommended suspension of 12 months (effectively 15 months given the Respondent's voluntary resignation) is among the highest and the recommended fine of \$50,000 is at the high end of the range. IIROC and Respondent's counsel submitted that, given the facts of the cases, the proposed penalties were within the range of reasonableness and met the Guidelines and the principles of specific and general deterrence. Counsel both recommended that the Hearing Panel accept the Settlement Agreement.

Panel Reasons and Decision

¶ 18 The Hearing Panel acknowledged its role in considering the Settlement Agreement under Rule 20.36 and the principles set out in *Re Milewski*.

¶ 19 The Respondent admitted that, as Branch Manager, he erred in ignoring red flags and failed to adequately supervise the RR (David Kenneth Smith) regarding the accounts of LS, as particularized in paragraph 36 of the Settlement Agreement. The Respondent admitted that his conduct breached IDA Regulation 1300.2 and Policy 2. The Hearing Panel accepted the Respondent's admissions and concluded that the Respondent's conduct amounted to a contravention of those requirements.

¶ 20 The Hearing Panel considered a number of factors in determining whether to accept the Settlement Agreement including whether the terms of the settlement:

- a. were reasonable, given the conduct of the Respondent;
- b. addressed both specific and general deterrence;
- c. will prevent the type of conduct described from occurring in the future;
- d. will protect investors as a result of the proposed penalty; and
- e. will foster confidence in the integrity of the capital markets, IIROC, and the regulatory process.

¶ 21 The Hearing Panel considered the IIROC Dealer Member Disciplinary Sanction Guidelines. The Guidelines, while not mandatory, provide an indication to members of expectations and suggest ranges of penalties that might be appropriate to particular types of cases. In cases involving Failure to Supervise, the Guidelines list other potential factors to consider (including the extent of employee misconduct, the amount of losses, the presence of red flags, etc.) and recommend sanctions including: (1) a minimum fine of \$25,000; (2) a period of suspension or permanent bar from supervisory responsibilities; (3) re-write of PDO; and (4) permanent bar from approval in all capacities in egregious cases. Counsel made helpful submissions regarding the application of the Guidelines in this case.

¶ 22 The securities industry is a business of trust and confidence. Registrants must meet significant responsibilities and supervisors play an important role in protecting investors and maintaining the integrity of the capital markets. It is important for registrants and firms to appreciate that there will be significant penalties, including suspension and significant fines as a result of disciplinary action for failure to adequately supervise the activities regarding client accounts.

¶ 23 The Respondent had sufficient knowledge and experience and ought to have recognized the red flags regarding this client's account. The Respondent ought to have made more diligent enquiries, including contacting the client, and followed up even though others in the firm also had supervisory responsibilities.

¶ 24 The Hearing Panel accepted the submissions of counsel, summarized in paragraphs 9 through 17 above. The Hearing Panel acknowledged the assistance of both counsel.

¶ 25 The Respondent accepted responsibility for his conduct, cooperated with IIROC, and is unlikely to engage in similar conduct in the future. The penalties, which are at the higher end of the range, will send a message to others that more is required and serious consequences will result from failure to exercise individual responsibilities for the supervision of others and to take independent steps where red flags occur. The Hearing Panel believes that the proposed penalties will deter future misconduct by the Respondent and by others from engaging in similar conduct, which will improve compliance by industry participants and foster confidence in the industry and the regulatory process.

¶ 26 The Hearing Panel, after careful consideration, concluded that the Settlement Agreement terms are:

- a. reasonable and within the appropriate range for sanctions, given the facts and circumstances set out in the Settlement Agreement, the submissions of counsel, and the authorities cited; and
- b. meet the Guidelines and the principles of specific and general deterrence.

¶ 27 For the reasons set out above, the Panel unanimously accepted the Settlement Agreement. In accordance with the terms of the Settlement Agreement, the Hearing Panel imposed the following penalties, effective on the date of the Settlement Hearing, being March 20, 2012:

- a. a suspension of registration approval for 12 months as Branch Manager or from acting in any supervisory capacity;
- b. a fine in the sum of \$50,000; and
- c. costs payable by the Respondent to IIROC in the sum of \$3,500.

Dated April 30th, 2012

Linda J. Murray, Chair

Brian Field, Member

Chris Lay, Member

SETTLEMENT AGREEMENT

I. INTRODUCTION

1. IIROC Enforcement Staff and the Respondent, David Wilson Murdoch, consent and agree to the settlement of this matter by way of this settlement agreement ("the Settlement Agreement").
2. The Enforcement Department of IIROC has conducted an investigation ("the Investigation") into the conduct of Mr. Murdoch.
3. On June 1, 2008, IIROC consolidated the regulatory and enforcement functions of the Investment Dealers Association of Canada and Market Regulation Services Inc. Pursuant to the Administrative and Regulatory Services Agreement between IDA and IIROC, effective June 1, 2008, the IDA has retained IIROC to provide services for IDA to carry out its regulatory functions.
4. The Respondent consents to be subject to the jurisdiction of IIROC.
5. The Investigation discloses matters for which the Respondent may be disciplined by a hearing panel

appointed pursuant to IIROC Transitional Rule No.1, Schedule C.1, Part C (“the Hearing Panel”).

II. JOINT SETTLEMENT RECOMMENDATION

6. Staff and the Respondent jointly recommend that the Hearing Panel accept this Settlement Agreement.

7. The Respondent admits to the following contravention of IIROC Rules, Guidelines, IDA By-Laws, Regulations or Policies:

From August 2005 to February 2008, the Respondent, as Branch Manager, failed to adequately supervise an RR, David Kenneth Smith, and the accounts of LS, contrary to IDA Regulation 1300.2 and Policy No. 2.

8. Staff and the Respondent agrees to the following terms of settlement:

- a) A suspension of registration approval for 12 months as Branch Manager or from acting in any supervisory capacity; and
- b) A fine in the sum of \$50,000.

9. The Respondent agrees to pay costs to IIROC in the sum of \$3,500.

III. STATEMENT OF FACTS

(i) Acknowledgment

10. Staff and the Respondent agree with the facts set out in this Section III and acknowledge that the terms of the settlement contained in this Settlement Agreement are based upon those specific facts.

(ii) Overview

11. The Respondent, as Branch Manager, failed to take reasonable and adequate steps to supervise a Registered Respondent (RR) and his handling of certain client accounts. The Branch Manager failed to adequately question the RR with respect to:

- a) Changes to the investment objectives for the accounts and the reasons for those changes;
- b) High amounts of commissions earned on the accounts;
- c) Excessive trading in the accounts; and
- d) Discretionary trading in the accounts.

12. Furthermore, the Branch Manager ought to have confirmed with the client that she was in agreement with and understood the activities undertaken in her account.

(iii) Factual Background

13. During the material time, the Respondent was ~~(and still is)~~ the Branch Manager for the Vancouver office of Northern Securities Inc. (NSI). As Branch Manager, he is also responsible for supervising the firm’s sub-branches in British Columbia, including Kelowna.

14. As such, the Respondent was responsible for the supervision of David Kenneth Smith, a Registered Representative in the Kelowna branch.

15. In August 2005, Smith joined NSI. Shortly thereafter, LS, who had been a client of Smith at his previous firm, opened two accounts at NSI.

16. At the time of the account opening, LS was 75 years old and retired. LS is also Smith’s mother-in-law.

17. LS opened a Canadian margin account and a RRIF account. Her New Client Account Form indicated the following Investment Objectives and Risk Tolerance for both accounts:

60% - moderate to higher-risk income producing securities;

15% - moderate risk, growth-oriented securities;

25% - higher-risk, speculative securities and trading strategies

18. LS' approximate annual income was listed at \$90,000 and her Net Liquid Assets at \$1.9 million. The total equity balance in LS' accounts at NSI at the time of the account opening represented over 90% of her Net Liquid Assets.

Changes to Investment Objectives

19. Beginning in January 2006, the investment objectives of LS' accounts were changed a number of times. The first change took place only 5 months after the account was opened, and increased the risk tolerance to the following:

50% - moderate to higher-risk income producing securities;

10% - moderate risk, growth-oriented securities;

40% - higher-risk, speculative securities and trading strategies

20. The Respondent spoke to Smith about the changes in or around January 2006, and Smith advised him that the client wanted to do more speculative trading. The Respondent was satisfied with this response, despite the age and financial circumstances of the client and the fact that the objectives were changing only 5 months after the account was opened.

21. The investment objectives were again changed in November 2006, this time following an inquiry from NSI Head Office Compliance, advising Smith that the client holdings did not match the stated investment objectives. In response, Smith submitted an updated NCAF and increased the risk tolerance to the following:

50% - moderate to higher-risk income producing securities;

50% - higher-risk, speculative securities and trading strategies

22. Again, in March 2007, NSI Head Office Compliance queried the holdings in the account, and Smith responded with the following changes to Investment Objectives:

51% - moderate to higher-risk income producing securities;

49% - higher-risk, speculative securities and trading strategies

23. Although he was aware of this "update" to the NCAF, the Respondent did not raise any concerns with Smith.

24. In October 2007, Head Office Compliance again queried the account, raising concerns about the investments in high-risk securities. Despite this query, the Respondent did not raise any concerns himself with Smith, and did not contact the client.

25. In response to the queries from Compliance, Smith advised that the client had changed her investment objectives for the account and that updated account documents would be provided in the next few weeks. The investment objectives were not changed until February 2008, to the following:

25% - moderate to higher-risk income producing securities;

75% - higher-risk, speculative securities and trading strategies

26. By this time, the equity value of LS' accounts had declined significantly.

27. Despite the fact that this was the third time that the account objectives changed only after queries from Compliance, and the major decline in the value of the accounts, the Respondent did not have any issues with the increase in the risk tolerance levels in the accounts and did not speak to Smith or the client about this increase.

High Commissions and Excessive Trading

28. During the relevant period, the LS accounts on average generated approximately \$15,000 in commission

per month. In September 2005 the commissions reached \$49,000 and in 5 different months the commission was over 90% of Smith's total commission for each of those months.

29. The Respondent did not express any concern or make any inquiries of the Respondent or LS relating to the high level of commission.

Discretionary Trading

30. The LS accounts were averaging more than 66 trades a month. This would have necessitated a considerable amount of contact between Smith and LS in order to obtain authorization for those trades. The Respondent believed Smith was directing the activity in the account, despite the fact that the account was not set up as a discretionary account.
31. The Respondent relied on a letter written by Smith's previous firm to LS. The letter confirmed that the firm had spoken with LS and was satisfied that she was fully aware of all of the trades in her account. However, the Respondent failed to consider that the letter was three years old, and that in the same letter the previous firm advised that it would continue to closely monitor the trading in the account, despite LS' assurances.

Head Office Compliance Queries

32. As described above, Smith was contacted on several occasions by Head Office Compliance regarding the activity in the LS accounts. The Respondent was aware of many of these queries, although on one occasion he was not copied on correspondence between Head Office Compliance and Smith.
33. The Respondent was of the view that since Compliance was dealing with an issue, he was no longer responsible for that particular issue. This view is contrary to the obligations imposed upon him by Regulation 1300.2 and Policy No. 2.

Queries Raised by the Respondent

34. On three or four occasions the Respondent did query Smith with respect to the level of trading activity in the account shortly after the account was opened. He was satisfied with Smith's assertion that LS wanted to do such trading.
35. Although the Respondent spoke to Smith on these occasions, he maintained no record of these discussions or queries.
36. The Respondent failed to:
- a) make direct inquiries of the RR regarding:
 - i. why the trading was increasing in volume and risk;
 - ii. why the investment objectives in the accounts were changing only after queries from Compliance and so soon after the accounts were opened;
 - iii. why the client was willing to continue to incur major losses in the account;
 - iv. why the accounts were generating such large commissions; and
 - v. whether the client was authorizing each and every trade in the account and whether such authorizations were being documented.
 - b) make direct inquiries of the client regarding her awareness of and comfort with the activities of the RR and the activity in her account;
 - c) closely monitor the trading in the account on a daily and monthly basis; and
 - d) maintain evidence of those inquiries and his monitoring.

LS Client Complaint

37. By letter dated February 28, 2008, a lawyer for LS advised NSI that Smith had made numerous

unauthorized and unsuitable trades in LS' accounts, and that LS had suffered a considerable loss as a result. The letter was dated two weeks after LS signed the last NCAF updating her objectives.

38. NSI has settled with LS with respect to her complaint and reimbursed her for her losses.

IV. TERMS OF SETTLEMENT

39. This settlement is agreed upon in accordance with IIROC Dealer Member Rules 20.35 to 20.40, inclusive and Rule 15 of the Dealer Member Rules of Practice and Procedure.

40. The Settlement Agreement is subject to acceptance by the Hearing Panel.

41. The Settlement Agreement shall become effective and binding upon the Respondent and Staff as of the date of its acceptance by the Hearing Panel.

42. The Settlement Agreement will be presented to the Hearing Panel at a hearing ("the Settlement Hearing") for approval. Following the conclusion of the Settlement Hearing, the Hearing Panel may either accept or reject the Settlement Agreement.

43. If the Hearing Panel accepts the Settlement Agreement, the Respondent waives his/her/its right under IIROC rules and any applicable legislation to a disciplinary hearing, review or appeal.

44. If the Hearing Panel rejects the Settlement Agreement, Staff and the Respondent may enter into another settlement agreement; or Staff may proceed to a disciplinary hearing in relation to the matters disclosed in the Investigation.

45. The Settlement Agreement will become available to the public upon its acceptance by the Hearing Panel.

46. Staff and the Respondent agree that if the Hearing Panel accepts the Settlement Agreement, they, or anyone on their behalf, will not make any public statements inconsistent with the Settlement Agreement.

47. Unless otherwise stated, any monetary penalties and costs imposed upon the Respondent are payable immediately upon the effective date of the Settlement Agreement.

48. Unless otherwise stated, any suspensions, bars, expulsions, restrictions or other terms of the Settlement Agreement shall commence on the effective date of the Settlement Agreement.

AGREED TO by the Respondent at the City of Vancouver in the Province of BC, this 28th day of February, 2012.

“Witness **David Murdoch**

Witness **Respondent**

AGREED TO by Staff at the City of Toronto in the Province of Ontario, this 1st day of March, 2012.

Witness **Diana Iannetta**

Witness **Diana Iannetta**

Senior Enforcement Counsel on behalf of Staff of the
Investment Industry Regulatory Organization of Canada

ACCEPTED at the City of Vancouver in the Province of BC, this 20th day of March, 2012, by the following Hearing Panel:

Per: Ms. Linda Murray
Panel Chair

Per: Mr. Chris Lay

Panel Member

Per: Mr. Brian Field

Panel Member