

# Re Phillips

IN THE MATTER OF:

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

**and**

**Donald Earl Phillips**

2015 IIROC 20

Investment Industry Regulatory Organization of Canada  
Hearing Panel (Manitoba District)

Heard: February 5, 2015

Decision: February 5, 2015

Written Decision: February 10, 2015

## **Hearing Panel:**

Mr. Robert Hucal, Chair, Mr. William J. Welton and Mr. Alan McLaughlin

## **Appearances:**

Mr. Tayen Godfrey, Enforcement Counsel, IIROC

Donald Earl Phillips did not appear and was not represented

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## **DECISION**

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¶ 1 This Decision concerns a Settlement Agreement signed by the parties and submitted pursuant to Rule 15 of the Dealer Member Rules of Practice and Procedure.

¶ 2 The Agreement was signed on January 30, 2015 and is attached to form part of this Decision as though herein cited.

¶ 3 The Respondent advised IIROC Counsel he would neither be attending, nor be represented at the hearing. The Panel acknowledged the advice and agreed to proceed on the basis of the signed Settlement Agreement.

¶ 4 The Respondent had worked in the financial services industry for 18 years, under IIROC authority for the past 14 years as a Registered Representative for Wellington West Capital Inc. and its successor, National Bank Financial. He is not presently employed in the industry.

¶ 5 The complaint concerns 11 clients reflecting events commencing in 2012 and continuing through 2013 and relating to Flow Thru LP Units recommended by the Respondent.

¶ 6 The Respondent took part in a trading strategy marketed to a group of railway workers and created by a Mutual Fund Registrant employed by Wellington West Financial who, being unable to sell Flow Thru Units as an MFDA registrant, referred the clients to the Respondent to enable the Flow Thru Unit transactions.

¶ 7 The clients were sold Flow Thru Units on the premise that a portion of their pension proceeds should be invested in Flow Thru Units in order to reduce taxes by rolling the eligible portion of their pension fund into a tax-free life Income Fund Account. The portion invested in Flow Thru Units would reduce the tax burden by a

potential 100% tax deduction for the invested amount.

¶ 8 Pursuant to the referral arrangement, the Respondent received \$6,450 in commission.

¶ 9 Many of the Flow Thru Units declined in value and 8 of the clients suffered losses ranging from \$13,145 to \$45,371 of the principal invested.

¶ 10 The Respondent admitted that he failed to use due diligence to obtain sufficient knowledge of the features inherent in the Flow Thru Units and failed as well to ensure his recommendation to buy the Units was suitable for the clients.

¶ 11 The Respondent also admitted that he failed to take the necessary steps to know his clients in that he had little or no communication with his clients over a period of almost two years during which the marketing scheme took place; that the new account forms inaccurately indicated that the client's risk tolerance was high when that was not true; that the Respondent did not recognize that the clients did not understand the risks associated with the purchase of the Units; and that the clients may not have made the investments if they had understood their risky and speculative nature.

¶ 12 The clients' investment knowledge was generally overstated on the NCAF in that the clients were not aware that the investments were speculative, high risk investments, and that they were relatively illiquid and were more suitable for sophisticated investors with high marginal tax rates.

¶ 13 The Panel was presented with a series of decisions relating to similar risk tolerance and suitability issues, with dispositions, including large fines, *Moldovan* and *Jones*; and lengthy suspensions, *Jones* (ibid) and *Groome*. In all cases costs were awarded and re-write of the Conduct and Practices Handbook Course and close supervision were required.

¶ 14 The Hearing Panel is satisfied that the terms of the Settlement Agreement are reasonable, the financial penalty, including costs, the period of suspension and requisite supervision, all falling within the sanction guidelines, both historically and as currently promulgated. Consequently the Hearing Panel accepts the terms of the Settlement Agreement.

¶ 15 Notwithstanding the acceptance, the Panel Members are of the unanimous opinion that the Respondent's actions were a sufficiently serious attack on the integrity of the market that a lengthy suspension could also fall within the parameters of reasonableness and would have agreed to at least a five-year or permanent suspension if asked to confirm same.

Dated this 10<sup>th</sup> day of February, 2015.

Robert Hucal

William Welton

Alan McLaughlin

## SETTLEMENT AGREEMENT

### I. INTRODUCTION

1. IIROC Enforcement Staff ("Staff") and the Respondent, Donald Earl Phillips, consent and agree to the settlement of this matter by way of this agreement (the "Settlement Agreement").
2. The Enforcement Department of IIROC has conducted an investigation ("the Investigation") in the conduct of Donald Earl Phillips.
3. 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**

4. Staff and the Respondent jointly recommend that the Hearing Panel accept this Settlement Agreement.
5. The Respondent admits to the following contraventions of IIROC Dealer Member Rules, Guidelines, Regulations or Policies:
  - a. Between April 2006 and August 2008, the Respondent failed to use due diligence to learn and remain informed of the essential facts relative to eleven of his clients, contrary to Dealer Member Rule 1300.1(a) (Investment Dealer Association by-law 1300.1(a) prior to June 1, 2008); and
  - b. Between May 2006 and November 2008, the Respondent made unsuitable recommendations for the accounts of eleven clients, contrary to Dealer Member Rule 1300.1(q) (Investment Dealer Association by-law 1300.1(q) prior to June 1, 2008).
6. Staff and the Respondent agree to the following terms of settlement:
  - a. A fine in the sum of \$100,000;
  - b. A suspension of registration from IIROC for 18 months;
  - c. Successfully Rewrite the Conduct and Practices Handbook exam; and
  - d. A period of 6 months of close supervision upon any return to the industry.
7. The Respondent agrees to costs to IIROC in the sum of \$10,000.00.

## **III. STATEMENT OF FACTS**

### **(i) Acknowledgment**

8. 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) Factual Background**

9. This matter stems from the Respondent recommending the purchase of Flow-Through Limited Partnership Units to eleven of his clients. The Respondent failed to know these clients, and failed to recognize that such an investment was unsuitable for them.

### **Registration History**

10. The Respondent is no longer a registrant with IIROC. Previously, he held the following positions:
  - a. October 2011 to July 2013, worked at National Bank Financial as a Registered Representative;
  - b. March 2000 to October 2011, worked at Wellington West Capital Inc. (“WWC”) as a Registered Representative;
  - c. October 1998 to February 2000, worked at Wellington West Financial Inc. as Mutual Fund Financial Planner; and
  - d. January 1996 to October 1998, worked at Standard Life as Mutual Fund Salesman.

### **Background**

11. The Respondent took part in a trading strategy that was targeted at, and marketed to, railway workers and their pensions. The strategy was promoted by KM, who was a Mutual Fund Dealer Association (“MFDA”) registrant with Wellington West Financial Inc.
12. KM had been advising railway workers about the possibility of a tax free rollover of their pension funds. Part of KM’s plan was to give presentations to railway workers on the benefits of opting out of their defined benefit pension plans. On three occasions the Respondent participated by presenting a

slideshow (the “Slideshow”) explaining Flow-through Limited Partnership Units (“Flow-Through Units”) to the workers.

13. Railway workers could roll the eligible portion of their pension funds into a tax free Locked-in Retirement Account, or Life Income Fund Account, at any time before they turned 55 years old (after which time they would be locked into their pensions). Any remaining pension money above the eligible amount was paid to the clients and then subject to taxation.
14. KM and the Respondent suggested that these clients invest a portion of their pension proceeds in Flow-Through Units in order to reduce this tax burden, as the clients could potentially receive a 100% tax deduction for the amount invested in Flow-Through Units.
15. KM was unable to sell Flow-Through Units as a MFDA registrant. Instead, he referred the railway workers (pursuant to a fee sharing referral agreement) to the Respondent, who was employed at WWC in Winnipeg. The Respondent would then open new accounts and purchase various Flow-Through Units for the railway workers.
16. Pursuant to the referral agreement, the Respondent earned approximately \$6,450.00 commissions from the accounts of the eleven clients. This represents 30% of the related commissions compared to KM who received 70%.
17. Many of the Flow-Through Units declined in value. As a result, eight of the eleven clients suffered losses in their accounts.
18. In the course of recommending the Flow-Through Units to the Clients, the Respondent failed to inform them that they were high risk, speculative securities. Similarly, the Respondent’s Slideshow failed to provide a balanced portrayal of the risks associated with Flow-Through Units, and did not emphasize that they are considered high risk, speculative investments.

### **The Complainants**

19. IIROC began receiving complaints relating to the Flow-Through Unit investments in 2012, and received further complaints throughout 2013. The allegations herein relate to the handling of the accounts of the following 11 complainants (together the “Clients”): DC, CC, GD, DH, DK, DM, LP, KR, RS, FV and WW.

### **Failure to Know Client**

20. Upon receipt of a referral from KM, the Respondent would open a new account for the Client. However, the Respondent failed to take steps to know the essential facts related to these Clients. In all eleven cases:
  - a. The Clients had little or no communication with the Respondent. He either never met with the client, or spent little time with the client;
  - b. The Clients were retired at the time that they were referred to the Respondent;
  - c. The Clients’ New Client Account Forms (“NCAFs”) identified investment objectives and risk tolerances of 100% higher risk, speculative securities and trading strategies. This did not accurately reflect the true investment objectives and risk tolerances of the Clients;
  - d. The Respondent failed to recognize the Clients did not understand the risks associated with purchases of Flow-Through Units; and
  - e. The Clients would not have invested in the Flow-Through Units if they had understood that they were high-risk, speculative investments.
21. In most cases, the Clients’ level of investment knowledge was limited or poor. However, in all but two cases, the Clients’ investment knowledge was overstated on the NCAF. All but one NCAF identified the Client’s investment knowledge level as “good”.

## **Suitability**

22. In all cases, the purchases of Flow-Through Units were unsuitable for the Clients. All of which:
  - a. Were 55 or 56 years old;
  - b. Had just retired, or were about to retire; and
  - c. Did not wish to invest in high risk securities.
23. The various Flow-Through Units recommended by the Respondent were speculative, high risk investments, and in particular:
  - a. They were illiquid in that there was no secondary market through which the Flow-Through Units could be sold;
  - b. There were no assurances of a positive, or any, return on an investment in the Flow-Through Units;
  - c. Flow-Through Units are more suitable for investors with high marginal tax rates who can afford a loss on their investment; and
  - d. Flow-Through Units are more suitable for sophisticated investors who are aware of the inherent risks associated with resource exploration and development.

## **Losses**

24. Eight of the eleven clients suffered losses resulting from their purchase of Flow-Through Units. These eight clients would have been in a better financial position had they simply paid the taxes on the pension monies that they invested in the Flow-Through Units. Even after the tax benefit is accounted for, the approximate losses ranged from \$13,145.00 to \$45,371.00, representing a decrease of 24% to 35% of the principal invested in the Flow-Through Units.

## **IV. TERMS OF SETTLEMENT**

25. 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.
26. The Settlement Agreement is subject to acceptance by the Hearing Panel.
27. The Settlement Agreement shall become effective and binding upon the Respondent and Staff as of the date of its acceptance by the Hearing Panel.
28. 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.
29. 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.
30. 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.
31. The Settlement Agreement will become available to the public upon its acceptance by the Hearing Panel.
32. 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.
33. Unless otherwise stated, any monetary penalties and costs imposed upon the Respondent are payable immediately upon the effective date of the Settlement Agreement.

34. 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 Winnipeg in the Province of Manitoba, this 30 day of January, 2015.

“Witness”

Witness

“Donald Earl Phillips”

Donald Phillips

AGREED TO by IIROC Staff at the City of Calgary in the Province of Alberta, this 30 day of January, 2015.

“Witness”

Witness

“Tayen Godfrey”

Tayen Godfrey

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

ACCEPTED at the City of Winnipeg in the Province of Manitoba, this 5<sup>th</sup> day of February, 2015, by the following Hearing Panel:

Per: “Robert Hucal”

Panel Chair

Per: “Al McLaughlin”

Panel Member

Per: “William Welton”

Panel Member

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