Re OptionsXpress Canada Corp.

IN THE MATTER OF:

The By-Laws of The Investment Dealers Association of Canada

And

The Dealer Member Rules of the Investment Industry Regulatory Organization of Canada
and

OptionsXpress Canada Corp.

2012 IIROC 72

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

Hearing: December 19, 2012
Decision: January 9, 2013

Hearing Panel:
Patrick T. Galligan, Q.C. (Chair), Guenther W.K. Kleberg, Colleen Wright
Appearances:
Rob DelFrate - Enforcement Counsel
Terence Doherty - Counsel for the Respondent

REASONS FOR DECISION

¶ 1 The Staff of Investment Industry Regulatory Organization of Canada ("IIROC") and the Respondent entered into a Settlement Agreement, which they had negotiated pursuant to By-law 20.35. They submitted the Settlement Agreement to this Hearing Panel, pursuant to By-law 20.36 and Rule 15 of the Rules of Practice and Procedure, for approval or rejection. After considering the material filed and the submissions made by counsel, we issued an order accepting the Settlement Agreement. These are our reasons for making that order.

THE CONTRAVENTIONS

¶ 2 The Respondent has admitted to the following contraventions of IIROC Rules, Guidelines, IDA By-Laws, Regulations or Policies:

> Between April 2008 and January 2012, the Respondent failed to correct deficiencies identified during a Business Conduct Compliance Examination despite representing that it would do so and in doing so:
>
> i. Failed to maintain a proper supervisory system, contrary to IIROC Dealer Member Rules 29.27 and 38.1; and
>
> ii. Failed to observe high standards of ethics and conduct in the transaction of its business and engaging in any business conduct or practice which is unbecoming or detrimental to the public interest, contrary to IIROC Dealer Member Rule 29.1 (IDA By-law 29.1 or to June 1, 2008).

TERMS OF SETTLEMENT

¶ 3 Staff and the Respondent have agreed to the following terms of settlement:

- The Respondent to pay a fine of $65,000;
- The Respondent to pay costs to IIROC in the sum of $2,500.

THE CIRCUMSTANCES

¶ 4 The circumstances are set out, in detail, in paragraphs 10-35 of the Settlement Agreement. It is attached as Appendix "A" to these reasons for decision. The following is a brief summary of them.

¶ 5 In 2007 IIROC's Business Conduct Compliance ("BCC") staff conducted a review of the Respondent's system of internal controls to reasonably ensure the Respondent complied with regulatory requirements. That examination found that two significant deficiencies existed in these controls in relation to the Respondent's supervision of account activity and in respect of Canadian orders accepted by United States registrants. The Respondent represented to the BCC staff that it would put in place processes which would correct these deficiencies. The BCC accepted the Respondent's representations and closed its 2007 review.

¶ 6 In late 2011 and 2012 BCC staff conducted a subsequent review. During the course of this review BCC staff discovered that the deficiencies which the Respondent had represented were corrected, had not been corrected. The Respondent had not complied with the representations which it made to BCC staff with respect to the deficiencies uncovered during its 2007 review.

SERIOUSNESS OF THE CONTRAVENTIONS

¶ 7 The responsibility of Dealer Members to comply with their obligations to supervise their activities and their employees is a very important one. Supervision is necessary to ensure ethical conduct, fair trading and the integrity of the investment industry. The contraventions in this case must, therefore, be treated as serious ones. The contraventions are more serious because the Respondent failed to comply with the representation, which it had given to BCC. A regulator is entitled to assume that a Member will comply with its representations.

CIRCUMSTANCES OF MITIGATION

¶ 8 In the determination of an appropriate penalty, it is always necessary to consider circumstances of mitigation. The circumstances of mitigation which we take into account in this case are:

(1) The Respondent has no disciplinary history;

(2) The Respondent cooperated fully with IIROC Enforcement Staff during its investigation which demonstrates that the Respondent has acknowledged its contraventions, accepted its responsibilities and has shown remorse;

(3) There were no complaints from clients from which we infer that no losses were suffered.

DUTY OF A HEARING PANEL UPON A SETTLEMENT HEARING

¶ 9 It is clear from jurisprudence emanating from the courts and from Hearing Panels of IIROC, Investment Dealers Association and the Mutual Fund Dealers Association, that our task is not to decide whether, in this case, we would have arrived at the same decision as that reached by the parties. Rather, our duty is to determine whether the penalty is a reasonable one and that it meets the objectives of the disciplinary process which are to maintain the integrity of the investment industry. We cite from the recent decision of the Hearing Panel in *Re CIBC World Markets Inc.*, [2011] IIROC No. 38:

> 13 Finally, hearing panels will not lightly interfere with a negotiated settlement. As was said in *Re Milewski*, [1999] IDACD No. 17,
>
> > … 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.

14 Or, as put by Winkler J. (albeit in another context) in *Gilbert v. CIBC*, [2004] O.J. 4260:

> There is a presumption of fairness when a proposed class settlement negotiated at arms length … is presented to the court for approval. A court will only reject a proposed settlement when it finds that the settlement does not fall within a range of reasonableness.
>
> The test to be applied is whether the settlement is fair and reasonable … This allows for a range of possible results and there is no perfect settlement. Settlement is a product of compromise, which by definition, necessitates give and take.

15 In our view, the settlement, negotiated as it was by the parties assisted by capable counsel, does not clearly fall "outside a range of appropriateness" and it should therefore be, and was, accepted by the panel.

¶ 10 We share the opinion expressed by the hearing panel in *Re Vorstadt*, [2012] IIROC that the settlement process is an important one which should be "encouraged and supported".

GUIDELINES AND OTHER DECISIONS

¶ 11 In determining whether a settlement is a reasonable one, a hearing panel is entitled to look at regulatory guidelines and other decisions. Guidelines are not binding upon a hearing panel and cannot derogate from its responsibility to decide what may be an appropriate penalty in a given case. However, they are useful in that they show what penalties members of the industry think are generally appropriate. The Guideline appropriate to this case suggests a minimum fine of $50,000.00.

¶ 12 Decisions in other cases can often be of assistance by helping to indicate what might be a reasonable range of monetary penalties. Counsel referred us to a number of cases which involve the failure of a Member to have adequate supervisory processes in place and the failure to correct deficiencies identified in a compliance review. Those cases are *Re Wellington West Capital Inc.* [2000] I.D.A.C.D. No. 54; *Re Research Capital Corp.* [2005] I.D.A.C.D. No. 36; *Re Acadian Securities Inc.* 2009 LNIIROC 8; and *Re Jory Capital Inc.* 2010 LNIIROC 52. We have decided that it is not necessary to review those decisions because each has its own peculiar set of facts, which are not the identical as the facts in this case. These cases are helpful, however, because they show that this case fits within a reasonable range of penalties as shown in them.

IMPACT OF THE PENALTY

¶ 13 Monetary penalties are necessary to act as specific and general deterrence. The Respondent is not a large organization. The penalty, composed of a fine of $65,000 and costs of $2,500, is a significant penalty to it. The penalty is sufficient to act as a specific deterrent to this Respondent and should be sufficient to alert all Members that failure of supervision and failure to comply with representations made to a regulator will attract significant consequences.

DECISION

¶ 14 After the hearing, we considered the circumstances of this case and reached the conclusion that the settlement was a reasonable one. Therefore, we accepted it.

DATED this 9th day of January 2013

The Hon. P. T. Galligan, Q.C. - Chair

Guenther W.K. Kleberg

Colleen Wright

SETTLEMENT AGREEMENT

I. INTRODUCTION

1. IIROC Enforcement Staff and optionsXpress Canada Corp. (the "**Respondent**"), 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 the Respondent.

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 contraventions of IIROC Rules, Guidelines, IDA By-Laws, Regulations or Policies:

   Between April 2008 and January 2012, the Respondent failed to correct deficiencies identified during a Business Conduct Compliance Examination despite representing that it would do so and in so doing:

   i. Failed to maintain a proper supervisory system, contrary to IIROC Dealer Member Rules 29.27 and 38.1; and

   ii. Failed to observe high standards of ethics and conduct in the transaction of its business and engaging in any business conduct or practice which is unbecoming or detrimental to the public interest, contrary to IIROC Dealer Member Rule 29.1 (IDA By-Law 29.1 or to June 1, 2008).

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

   1) A fine in the amount of $65,000.

9. The Respondent agrees to pay costs to IIROC in the sum of $2,500.

III. STATEMEMT 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) Factual Background

Overview

11. IIROC Rules require that all Dealer Members establish and maintain a system of internal controls that is reasonably designed to ensure compliance with regulatory requirements. IIROC's Business Conduct Compliance ("**BCC**", formerly known as "**Sales Conduct Compliance**") department is tasked with regularly examining and testing these systems to identify any problems or concerns related to a Dealer Member's business conduct compliance systems or the implementation or operation of those systems. When deficiencies are noted, Dealer Members are required to address these concerns and to propose a course of action to correct the deficiencies.

12. Following a BCC examination in 2007, both the Respondent's Ultimate Designated Person and Chief Compliance Officer represented, on behalf of the Respondent, that it would take corrective measures to address certain deficiencies noted during such exam. Despite these representations, when a subsequent examination was conducted in late 2011 and 2012, it was discovered that many of the procedures proposed following the 2007 examination had not been properly implemented. As a result, several deficiencies continued to exist and others

increased in significance.

Registration History

13. The Respondent has been registered as an Investment Dealer since December 1, 2005. The Respondent offers online stock, options and futures brokerage service, on a self-directed basis to Canadian investors.

14 Between December 1, 2005 and January 11, 2012, Thomas Stern ("**Stern**") was the Respondent's President and Ultimate Designated Person. On December 22, 2008, he also became the Respondent's Chief Compliance Officer.

15 On January 11, 2012, Stern was terminated by the Respondent due, in part, to the conduct outlined below.

The 2007 Review

16 In 2007, BCC Staff conducted a Sales Compliance Review of the Respondent (the "**2007 Review**"). The 2007 Review identified several deficiencies, including two items that were noted by BCC Staff as "significant", relating to:

1) **Supervision of account activity** – there was no evidence of whether a supervisory review took place or that the reviewers made inquiries, received responses or took action to address concerns noted on the supervisory reviews; and

2) **Canadian Orders Accepted by U.S. Registrants** - registrants of the Respondent's US affiliate would accept verbal orders from Canadian clients. Although the Respondent had represented that these trades would be subsequently approved by a Canadian registrant, there was no evidence of the Canadian-registered CCO's or ADP's approval of these trades.

17 In response to the 2007 Review, both the Respondent's Ultimate Designated Person and Chief Compliance Officer, on behalf of the Respondent, undertook to address the deficiencies identified by BCC and outlined the steps to correct these issues.

18 Specifically, in response to the first deficiency, the Respondent advised that, for all reports containing accounts of the Respondent, it would implement a process to maintain supervisory review logs for exception reports containing the name of the report and the date reviewed.

19 In response to the second deficiency, the Respondent advised that it would:

1) Establish a change in the system processes to assure that telephone orders from Canadian clients would be routed to Canadian licensed representatives;

2) Implement new procedures for U.S. licensed representatives that come in contact with Canadian clients. The U.S. licensed representatives would guide and offer assistance to Canadian clients for placing trades on their own, but if any such client insisted on such representative placing trades on such client's behalf, then that client would be routed to a Canadian licensed representative.

20 Satisfied with the response, BCC closed the 2007 Review.

The 2012 Examination

21 In late 2011, BCC Staff began preparations for another Business Conduct Examination of the Respondent (the "**2012 Examination**").

22 On November 16, 2011, BCC Staff held an entrance meeting (the "**Entrance Meeting**") with Stern as well as Katherine Gory ("**Gory**"), at the time an Investment Representative and the Alternate Designated Person of the Respondent.

23 During the Entrance Meeting, BCC Staff inquired as to the steps taken by the Respondent to address the items identified during the 2007 Review. Specifically, BCC Staff asked Stern about the Canadian-resident orders which were processed by non-Canadian registered employees of the Respondent. Stern advised that he approved all orders that were accepted verbally by registrants of the Respondent's U.S. affiliate from Canadian resident clients. When asked how he maintained such evidence, he advised that it was evidenced electronically.

24 Stern did not advise whether the Respondent had corrected the deficiency related to the supervision of account activity as identified during the 2007 Review.

25 BCC Staff continued the 2012 Examination and identified several deficiencies, including items that were noted by

BCC Staff as “significant repeat” deficiencies. The items identified were:

1) **Daily, Weekly and Monthly Account Supervision** - there was no evidence of supervisory review for daily, weekly, and monthly account supervisory reports;
2) **Material Changes to Know-Your-Client ("KYC") Information** - there was no evidence of supervisory review and approval for changes to KYC updates;
3) **Supervision of Non-Client Accounts** - no evidence of a timely review of employee accounts held outside the firm;
4) **Delegation of Duties** - no evidence of written delegation of duties to multiple employees of an affiliated U.S. registrant;
5) **Documentation Deficiencies** - lack of supervisory approval of New Client Application Forms; and inadequate personal identity verification;
6) **Canadian Orders Accepted by U.S. Registrants** - verbal trade orders from Canadian residents were accepted by registrants of the U.S. affiliate. The Respondent was not able to provide evidence that it had taken any of the steps outlined in its response to the 2007 Examination with respect to Canadian orders.

26 In addition to these items, the 2012 Examination also identified a new item, the Chief Compliance Officer's (Stern) annual report to the Respondent's Board of Directors failed to accurately reflect the status of compliance at the firm.

27 Despite undertaking to address the deficiencies identified in the 2007 Report and despite Stern's representations that he approved all Canadian-resident orders which were processed by non-Canadian registered personnel, BCC Staff determined that these deficiencies had not in fact been properly addressed.

Stern

28 During the Entrance Meeting, the Respondent became aware that Stern's representations regarding the Canadian resident orders were not accurate. Following the meeting, senior personnel at the Respondent were made aware of Stern's misrepresentations.

29 The Respondent retained outside counsel to conduct an internal investigation into the allegations and determined that Stern had provided false and misleading information to BCC Staff. Stern was terminated by Respondent.

30 Stern has been recently disciplined by the Chicago Board Options Exchange Inc. ("**CBOE**"). During a review in October 2011 of OX Trading LLC, a related company of the Respondent, the CBOE found that Stern violated several CBOE Rules, including:

1) Stern failed to create and maintain a record to evidence the calculation of margin;
2) Stern failed to adequately supervise OX's Anti Money Laundering Program;
3) Stern made false statements or misrepresentations to the CBOE.

31 In August 2012, Stern submitted a letter of consent and was permanently barred from acting as a Trading Permit Holder or from association with a Trading Permit Holder or TPH organization.

32 Stern is not currently registered in any capacity with an IIROC regulated firm.

33 Pursuant to Dealer Member Rule 29.1, the Respondent acknowledges that it is responsible for the acts and omissions of Stern, the UDP, President, and later CCO of the firm during the relevant time.

Actions Taken by the Respondent

34 Since Stern's termination, the Respondent has undertaken steps to remedy the deficiencies outlined in the 2012 Examination.

35 In September 2012, the Respondent advised IIROC Staff of its intention withdraw its business operations in Canada.

IV. TERMS OF SETTLEMENT

36. 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.

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

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

39. 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.

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

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

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

43. 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.

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

45. 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 Toronto, in the Province of Ontario

this 19th day of December, 2012.

WITNESS RESPONDENT

AGREED TO by the Staff at the City of Toronto in the Province of Ontario, this 19th day of December, 2012.

WITNESS "Rob DelFrate"

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

ACCEPTED at the City of Toronto, in the Province of Ontario, this 19th _ day of December , 2012.

Per: "Patrick Galligan"

Panel Chair

Per: "Guenther Kleberg"

Panel Member

Per: "Colleen Wright"

Panel Member