Re Carinci

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

Steve Frank Carinci

2013 IIROC 49

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

Heard: August 7, 2013
Decision: August 28, 2013

Hearing Panel:
Patrick T. Galligan, Q.C., Chair; Richard Austin, Member; Nick Savona, Member
Appearances:
Diana Iannetta, Enforcement Counsel
Ellen Bessner, Counsel for the Respondent

REASONS FOR DECISION

¶ 1 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 CONTRAVENTION

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

> From June 2008 to August 2010, the Respondent failed to use due diligence to ensure that recommendations made with respect to certain securities were suitable for his clients, contrary to IIROC Dealer Member Rule 1300.1(q).

TERMS OF SETTLEMENT

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

(a) A suspension from approval in any registered capacity with IIROC for a period of one month beginning August 12, 2013;

(b) Fine of $40,000, which includes disgorgement of commissions for the trades at issue; and

(c) Successful re-write of the Conduct and Practises Handbook Course within 6 months of the acceptance of this Settlement Agreement.

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

THE CIRCUMSTANCES

¶ 4 The circumstances are set out, in detail, in paragraphs 8 - 44 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 2008 the Respondent learned of certain Leveraged Exchange Traded Funds ("LETFs"). He neglected to read the prospectus for them. Had he read the prospectus he would have learned that they were speculative and "can involve a high degree of risk and may only be suitable for persons who are able to assume the risk of losing their entire investment".

¶ 6 Nevertheless he recommended and executed orders for the purchase of those investments for two couples, neither of whom, in their New Account Application Forms ("NAAFs"), had indicated that they had that level of risk tolerance. Both couples lost money on their investments. He also invested for several other clients who, according to their NAAFs, did not have that tolerance for high risk.

SERIOUSNESS OF THE CONTRAVENTION

¶ 7 The importance of a registered representative's obligation to ensure that recommendations made to clients are suitable for the client and in accordance with the client's investment objectives and risk tolerance cannot be overstated. The Respondent's failure to read the prospectus, before getting his clients into those investments, exposed them to a level of risk that was inappropriate that led directly to their incurring significant losses. The contravention must, therefore, be viewed as a serious one.

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 his contraventions, accepted his responsibilities and has shown remorse;

(3) While the Respondent's conduct was deficient it was neither manipulative nor fraudulent;

(4) Other than the commissions he earned, the Respondent was not enriched by his conduct; and

(5) He has already been under close and strict supervision for a significant period of time.

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:

- Fine: Minimum of $10,000.
- Disgorgement of profits.
- Re-write of CPH.
- Period of Close and/or Strict supervision.
- Period of suspension (in most egregious cases involving elements of deception and misrepresentations).

¶ 12 Decisions in other cases can often be of assistance by helping to indicate what might be a reasonable range of penalties. Counsel referred us to a number of cases which involve conduct and circumstances not dissimilar which are in issue in this case. Those cases are *Re Axford*, [2013]; *Re Bereskin*, [2010] IIROC No. 37; *Re Dyck*, 2012 LNIIROC 31; *Re Hanna*, 2012 LNIIROC 71; *Re Jones*, 2012 LNIIROC 48; *Re Beaulne*, 2012 LNIIROC 61; *Re Gareau*, [2005] I.D.A.C.D. No. 25; *Re Kasten-Brown*, [2001] LNIIROC 73; *Re Delcourt*, 2011 IIROC 69. 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 settlement 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 penalty, composed of a fine of $40,000 and costs of $2,500, is a significant penalty to this person. 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 exercise due diligence when making investment recommendations to clients will attract significant consequences.

¶ 14 We note that while the Guidelines call for a period of close and/or strict supervision, Staff advised that the Respondent had been under close supervision after transferring to his new firm for a period of time and Staff were satisfied that continuation of this level of supervision was no longer required.

DECISION

¶ 15 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 28th day of August, 2013.

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

Richard Austin, Industry Representative

Nick Savona, Industry Representative

APPENDIX A

INVESTMENT INDUSTRY REGULATORY ORGANIZATION OF CANADA

IN THE MATTER OF:

THE RULES OF THE INVESTMENT INDUSTRY REGULATORY ORGANIZATION OF CANADA (IIROC)

AND

STEVEN FRANK CARINCI

SETTLEMENT AGREEMENT

I. INTRODUCTION

1. IIROC Enforcement Staff and the Respondent, Steven Frank Carinci, 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. Carinci.

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 Rules, Guidelines, Regulations or Policies:

   a) From June 2008 to August 2010, the Respondent failed to use due diligence to ensure that recommendations made with respect to certain securities were suitable for his clients, contrary to IIROC Dealer Member Rule 1300.1(q).

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

   a) A suspension from approval in any registered capacity with IIROC for a period of one month beginning August 12, 2013;

   b) Fine of $40,000, which includes disgorgement of commissions for the trades at issue; and

   c) Successful re-write of the Conduct and Practices Handbook Course within 6 months of the acceptance of this Settlement Agreement.

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

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) Overview

9. The Respondent recommended the purchase of high risk securities, including leveraged Exchange Traded Funds (LETFs), to clients who had no tolerance for speculative/high risk on their New Account Application Forms (NAAFs). The Respondent disregarded the investment objectives of these clients and placed their funds in investments that were unsuitable for them.

(iii) Factual Background

A. Registration History

10. Carinci was first registered with the IDA in 1996 and became a registrant of IIROC on June 1, 2008. His registration history is as follows:

Date	Dealer Member	Registration Category
March 2012 – present	Desjardins Securities Inc.	Registered Representative (RR)
October 2005 – March 2012	Canaccord Genuity Corp.	RR
December 2000 – October 2005	HSBC Securities (Canada) Inc.	RR
August 1998 – December 2000	CIBC World Markets Inc. (CIBC Wood Gundy)	RR

11. The conduct at issue took place while Carinci was employed with Canaccord Genuity Corp.

C. The Leveraged Exchange Traded Funds ("LETFs")

12. In 2008, the Respondent learned of certain LETFs from representatives of the manager of the Horizons BetaPro LETFs.

13. The Respondent reviewed a fund fact sheet and reviewed research on the LETFs, however, he did not read the prospectus for the LETFs.

14. The Respondent recommended that clients purchase the LETFs because in his view, the market was in a major decline and these products were doing well.

15. Had the Respondent reviewed the prospectus, he would have been made aware that these particular LETFs are identified as being speculative and high risk investments by the issuer. The prospectus for certain Horizon LETFs which the Respondent recommended to his clients stated:

> *Investing in Units of an ETF can be speculative, can involve a high degree of risk and may only be suitable for persons who are able to assume the risk of losing their entire investment.*

16. The prospectus further stated:

> *The risk of loss in trading derivatives can be substantial. In considering whether to buy Units of an ETF, the investor should be aware that trading derivatives can quickly lead to large losses as well as large gains. Such trading losses can sharply reduce the net asset value of an ETF and consequently the value of an investor's Units in the ETF. Market conditions may also make it difficult or impossible for an ETF to liquidate a position.*
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> ***
>
> ***Leverage Risk.*** *Leverage offers a means of magnifying market movements into larger changes in an investment's value and provides greater investment exposure than an unleveraged investment.*

Leverage will cause an ETF to lose more money in market environments adverse to its investment objective than an ETF that does not use leverage. It is important to understand the effects of compounding when investing in any mutual fund, especially funds which use daily rebalanced leverage as part of their investment strategy.

D. SG and DG

17. DG and SG are husband and wife. DG owns his own electrical contracting business and SG does not work outside the home. At the time the accounts described below were opened, DG's annual income was $125,000. At the time the accounts were opened at Canaccord, DG and SG were in their late thirties.

18. Prior to opening their accounts with the Respondent at Canaccord, SG and DG had not had accounts with a Dealer Member. All of their prior investing experience was with a bank. DG purchased mutual funds in his RSP through his bank.

19. DG and SG opened accounts with the Respondent in October 2007. DG and SG state that at the time the account was opened, they had advised the Respondent that they were looking for slow growth in their RRSP accounts.

20. Specifically, four accounts were opened, with the following investment objectives and risk tolerance recorded on the New Account Application Forms ("NAAFs"):

    i. Joint Cash Account – 100% Moderate Growth/Medium Risk;

    ii. DG Cash Account – 10% Income/Low-Medium Risk and 90% Moderate Growth/Medium Risk;

    iii. DG RRSP Account – 100% Moderate Growth/Medium Risk; and

    iv. SG RRSP Account – 100% Moderate Growth/Medium Risk.

21. "Moderate Growth" is defined in the NAAF as:

    Investments that provide long-term growth in the form of capital gains and/or investment income with medium risk of principal loss. This category includes income trusts, high quality common shares listed on senior exchanges, equity mutual funds and structured products. (emphasis added)

22. The NAAF for the joint cash account also indicated that SG and DG had moderate experience with common shares and money market, but no experience in any of the other types of investments listed.

Purchase of the LETFs

23. The Respondent recommended and executed the purchase of several LETFs in SG and DG's respective RRSP accounts.

24. The Respondent generally discussed these LETFs with DG and advised that the LETFs 'predicted the market' and that the Respondent would need to watch these particular securities and 'trade through them'.

25. However, the Respondent did not advise SG and DG of the risk factors in detail outlined in the prospectus and did not explain the impact of leverage on the risk profiles of the products.

26. Despite the fact that the LETFs were high risk products, the Respondent recommended their purchase for his clients SG and DG who had no tolerance for high risk as recorded on their respective NAAFs.

27. Consequently, SG and DG suffered losses of approximately $75,000 from their purchases of the LETFs. SG and DG were compensated for their losses.

D. SM and AM

28. SM and AM are husband and wife. SM is a self-employed salesman. His wife, AM, ceased working

outside the home in 2008. At the time the accounts described below were opened, SM and AM were in their thirties and SM's approximate annual income was $150,000. SM and AM also had net worth of approximately $300,000.

29. The Respondent had been AM and SM's financial advisor at his previous firm. AM and SM transferred their accounts to Canaccord when the Respondent moved from his previous firm in 2005.

30. SM and AM state that the funds invested at Canaccord were intended to be for their retirement and they state that they advised the Respondent of this and told him they were looking for long term growth. SM did not have a pension.

31. AM and SM opened three accounts with the Respondent at Canaccord in November 2005. The following investment objectives and risk tolerance recorded on the New Account Application Forms ("NAAFs"):

    i. AM RRSP Account – 70% Moderate Growth (Medium Risk) & 30% Short term Trading (Medium-High Risk)

    ii. AM Spousal RRSP Account – 70% Moderate Growth (Medium Risk) & 30% Short term Trading (Medium-High Risk)

    iii. SM RRSP Account – 70% Moderate Growth (Medium Risk) & 30% Short term Trading (Medium-High Risk)

32. For each NAAF, some percentage had been indicated for Speculative (High Risk), but was subsequently crossed out and the NAAF was revised to reflect the values set out above.

The Unsuitable Trades

33. The Respondent recommended to SM and AM the purchase of certain LETFs, including Horizons MSCI Bear Plus ETF. As well, the Respondent recommended the purchase of shares of Oilexco Inc. and Migao Corp., which were also high risk securities.

34. The Respondent purchased at least five different LETFs in their accounts. SM and AM state that they had no idea of what an ETF was at the time they were purchased by the Respondent.

35. The Respondent also purchased an Exchange Traded Note ("ETN") in AM's RRSP account, which was unsuitable for her.

36. Both SM and AM suffered losses in their respective accounts, including realized losses of $63,000 from the purchases of the LETFs and the ETN.

Other Clients Invested in LETFs

37. The Respondent purchased the same LETFs in the accounts of other clients who similarly had no tolerance for high risk investments as recorded on their NAAFs.

38. The Respondent had at least 45 other clients who purchased the same LETFs as the clients discussed above during the same period of time. Over 90% of those clients indicated on their NAAFs that they wanted 0% high risk.

Conduct During the Investigation

39. The Respondent voluntarily resigned from Canaccord in March 2012. Prior to that date, he had been placed under close supervision by Canaccord for approximately 10 months.

40. As a condition of his continued registration approval with Desjardins, in May 2012, IIROC imposed formal terms and conditions on Mr. Carinci's registration and approval and required him to be placed under strict supervision at Desjardins at a location with a qualified supervisor with monthly reporting to IIROC. This required Mr. Carinci to change the location of his employment to another branch, which had significant impact on his personal life.

41. Strict supervision requires pre-approval of all trades, and monthly supervision reports are also required to be filed with IIROC.

42. The Respondent has continued under strict supervision to the present time.

43. The Respondent fully cooperated with IIROC in its investigation.

44. The Respondent has no disciplinary history with IIROC.

IV. TERMS OF SETTLEMENT

45. 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.

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

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

48. 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.

49. 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.

50. 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.

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

52. 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.

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

54. 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 24th day of July, 2013.

"Witness"	"Steven Frank Carinci"
Witness	Respondent

AGREED TO by Staff at the City of Toronto in the Province of Ontario, this 25th day of July, 2013.

"Witness"	"Diana Iannetta"
Witness	Diana Iannetta 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 7th day of August, 2013 by the following

Hearing Panel:

Per: "Patrick Galligan"
Panel Chair

Per: "Richard Austin"
Panel Member

Per: "Nick Savona"
Panel Member