

Re Raymond James Ltd.

IN THE MATTER OF:

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

and

Raymond James Ltd.

2013 IIROC 03

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

Heard: November 22, 2012
Decision: December 17, 2012

Hearing Panel:

John Rogers, Chair, Bob Sutherland and James Harkness

Appearances:

Rob DelFrate, Enforcement Counsel, for the Investment Industry Regulatory Organization of Canada
Ron Pelletier, Harper Grey LLP, Barristers and Solicitors, for the Respondent

DECISION

¶ 1 A Hearing Panel of the Investment Industry Regulatory Organization of Canada (“IIROC”) was convened on November 22, 2012 in accordance with Rule 15 of the IIROC Dealer Member Rules of Practice and Procedure to review a settlement agreement (“Settlement Agreement”) dated the 22nd day of November, 2012 negotiated between the Enforcement Department of IIROC and Raymond James Ltd. (“Respondent”) in accordance with Rule 20.35 of Part 10 of the IIROC Dealer Member Rules (the “Rules”) and Rule 15 of the Dealer Member Rules of Practice and Procedure.

Statement of Facts

¶ 2 The Settlement Agreement contains certain facts agreed to by IIROC Staff and the Respondent for the purpose of the Settlement Agreement. A summary of these facts is as follows:

1. Between May 14, 2008 and October 31, 2008, (“the Relevant Period”) Mr. Kostas Arapis (“Mr. Arapis”) was the Branch Manager at a Saskatoon, Saskatchewan branch of the Respondent.
2. As Mr. Arapis was a Branch Manager, Mr. John Whyte (“Mr. Whyte”), a Branch Manager at a Toronto, Ontario branch of the Respondent, was responsible for supervising Mr. Arapis’ trading activities. Mr. Whyte delegated this supervisory responsibility to his assistant Branch Manager, Mr. Daniel MacKay (“Mr. MacKay”). The supervisory responsibility delegated to Mr. MacKay included a daily and monthly review of Mr. Arapis’ trading activity and account opening approvals.
3. The policies and procedures of the Respondent required that when option trading is added to an account, the account is assigned a level that identifies the allowable option activity on that account. The level is based upon the client’s intended strategy and his/her investment experience, risk tolerance, and financial capability.

4. The option levels employed by the Respondent during the Relevant Period were substantially similar to the option levels as set out in the Options Supervisors Course prepared and published by the Canadian Securities Institute, being:
- | | |
|----------------|--|
| Level 1 | Purchase Options |
| Level 2 | Purchase and Sell Covered Options |
| Level 3 | Purchase and Sell Covered/Spread Options |
| Level 4 | Purchase and Sell Covered/Spread/Uncovered Options |
5. The Respondent's policies and procedures enabled a Respondent's Branch Manager to approve Level 1, 2, or 3 option accounts. However, as Level 4 options trading represented the highest risk/reward client trading possible at the Respondent, all Level 4 accounts had to be approved by both a Branch Manager and either the Designated Registered Options Principal ("DROP") or the Alternate Registered Options Principal.
6. During the Relevant Period, Mr. Arapis solicited several clients to add option trading to their trading accounts. Mr. MacKay approved four of these accounts for trading in Level 3 options and the balance of these accounts for trading in Level 2 options. None of these accounts were approved for trading in Level 4 options.
7. Mr. MacKay reviewed all of these transactions for issues such as suitability and credit risk as part of his daily review of Mr. Arapis' trading, but his review did not include a review of the option account approval level. It was the belief of both Mr. MacKay, and his boss, Mr. Whyte, that the Respondent's electronic trading platform contained a "hard edit" which would prevent a trade from being processed in an account if the trade were outside the approved option trading level for that account.
8. Messrs. MacKay and Whyte were incorrect in their belief that the Respondent's system contained this feature. Although the Respondent's electronic trading system identified when an intended trade was outside the approved option level for the account, the system included a feature which enabled an Approved Person to bypass this warning and to enter the trade.
9. In June, 2008, Mr. Arapis processed put trades in the RRSP accounts of two clients. As well as being outside the approved option trading level for these accounts, these Level 4 trades were not trades eligible for RRSP accounts under the Canadian *Income Tax Act*. Mr. MacKay identified these trades during his daily review of Mr. Arapis' trading. Subsequently, together with Mr. Whyte, he reviewed Mr. Arapis' other RRSP client accounts to ensure that these other accounts did not hold any Level 4 trading option positions.
10. This review was limited to the RRSP Accounts for which Mr. Arapis was responsible. It did not include a review of all of Mr. Arapis' client accounts. Had it done so, Messrs. MacKay and Whyte would have discovered that during June 2008, in addition to the RRSP accounts, 7 of Mr. Arapis' client accounts held 19 Level 4 option positions despite these accounts not being approved for Level 4 option trading.
11. Following the discovery of the ineligible trades in the RRSP accounts, between June 12, 2008 and October 31, 2008, Mr. Arapis effected 89 option transactions in 18 client accounts which were outside the account's approved trading option level.
12. In all, during the Relevant Period, Mr. Arapis effected 111 option transactions in 23 client accounts outside of the account's approved option level by trading 94 uncovered puts, 10 uncovered calls, and 7 spread trades.
13. The spread trades were Level 3 option trades and the uncovered puts and calls were Level 4 option trades. The accounts effecting the spread trades were not approved for Level 3 option trades and the accounts effecting the uncovered puts and calls were not approved for Level 4 option trades.

14. It was not until November 18, 2008 when the Respondent's DROP identified 3 client accounts that held options which were outside the accounts' approved options trading level and notified Messrs. MacKay and Whyte of that fact that the Respondent suspended Mr. Arapis' option trading privileges.
15. Two of Mr. Arapis' clients complained of the option trading effected in their accounts and the Respondent and Mr. Arapis reached a settlement with these clients.
16. Mr. Arapis entered into a settlement agreement with IIROC with respect to the trading conduct above referred to.
17. The Respondent's trading system now automatically blocks proposed option transactions that are outside the account's approved option trading level and the Respondent's policies and procedures now expressly require that a Branch Manager's daily supervision include a review to detect option transactions that are outside an account's approved option trading levels.

Contravention

¶ 3 The Settlement Agreement contains the Respondent's admission that between May 14, 2008 and October 31, 2008, the Respondent failed to ensure adequate supervision of the option trading in twenty three (23) client accounts of Kostas Arapis, an Approved Person of the Respondent, contrary to IDA Regulations 1300.1 (o), 1300.2 and IDA Policy No. 2 and Dealer Member Rules 1300.1 (o), 1300.2 and 2500.

Terms of Settlement

¶ 4 In the Settlement Agreement, IIROC and the Respondent agree to the following terms of settlement:

1. That the Respondent would pay a fine in the amount of \$50,000; and
2. That the Respondent would pay costs to IIROC in the amount of \$10,000.

Decision

¶ 5 We accept the Settlement Agreement agreeing with the submissions of IIROC Staff and the Respondent that it is in the public interest to do so.

Reasons

¶ 6 Rule 20.36 empowers a Hearing Panel upon the conclusion of a settlement agreement hearing to either accept or reject the settlement agreement under consideration. Neither in Rule 20.36 nor elsewhere in the Rules is there guidance for what criteria a Hearing Panel should use in making this decision.

Appropriateness of Penalty

¶ 7 Past decisions of Hearing Panels determining whether or not to accept a settlement agreement are of assistance. In *Milewski* [1999] I.D.A.C.D. No. 17, Bulletin No. 2605, August 5, 1999, and *Re: Bereskin* [2010] IIROC No. 37 the test for a Hearing Panel to use in determining whether or not to accept the sanctions contained in a settlement agreement was one which considered a number of criteria. These criteria include whether or not the agreed upon sanctions strike a reasonable balance between fairness to the respondent in the circumstances but at the same time encouraging the prevention of a repetition of the acknowledged offense; and the need to protect the investing public, the industry membership, the integrity of the disciplinary process, and the integrity of the securities markets.

¶ 8 In addition, the Hearing Panel should determine whether or not a penalty clearly falls outside a "reasonable range of appropriateness". If in the opinion of the Hearing Panel the penalty falls outside this reasonable range, the Hearing Panel should not accept the settlement agreement. Otherwise it should do so. The rationale behind this approach is that a Hearing Panel should be cognizant of the settlement process and should not interfere in a negotiated settlement by attempting to substitute its discretion for that of the parties.

Disciplinary Sanction Guidelines

¶ 9 IIROC Staff counsel referred us to Disciplinary Sanction Guideline numbered 4.3 entitled "Failure to

Supervise – Dealer Member Rule 29.27, 1300.2, 2500 and 2700” and suggested that the applicable considerations under this guideline were:

- a) Harm to the Clients: The Respondent’s supervisory failure exposed clients to potentially more risk than they had agreed to accept in their accounts. However, the Respondent mitigated this harm by reaching a settlement agreement with the clients who filed formal complaints;
- b) Blameworthiness: The Respondent’s conduct was not manipulative, fraudulent or deceptive. Mr. Arapis’ supervisors, Messrs. Whyte and MacKay were reviewing his conduct. The missing element in this review was to ensure that Mr. Arapis’ trading activities in the option accounts in which he was effecting his trades were approved for the option trading levels within which the trades qualified.
- c) Enrichment: There is no evidence that the Respondent profited from the option trading that occurred outside the approved levels.
- d) Voluntary Rehabilitative Efforts: When the matter came to light, the Respondent accepted responsibility and took remedial action. It immediately suspended Mr. Arapis’ option trading privileges and then subsequently worked with its service provider to change the feature set of its trading system to remove the override capability and revised its Policies and Procedures Manual to expressly require the daily supervision of option transactions to include a review of the account’s approved option level. The changes to its trading system and Manual will lessen the likelihood that the complained of activity will be repeated in the future.
- e) Acceptance of Responsibility, Acknowledgement of Misconduct and Remorse: The Respondent has admitted its conduct to be in violation of the Rules, has carried out the rehabilitative efforts referred to above, and has entered into this Settlement Agreement.

Relevant Precedents

¶ 10 IIROC Staff counsel provided us with the following decisions of IIROC Hearing Panels who had dealt with matters relevant to the one before us: *Re Deslongchamps Raymond James Ltd.* [2006] R.S.D.D. No 3; *Re: Raymond James Ltd.* [2007] I.D.A.C.D. No.55; *Re:Arapis* [2011] IIROC No. 37; *Re: Berkshire Securities Inc.* [2011] IIROC No. 57; and *Re: CIBC World Markets* 2012 IIROC 57.

¶ 11 In *Re:Arapis*, as referred to above, Mr. Arapis entered into a settlement agreement with IIROC Staff whereby he admitted that he had acted contrary to Rule 1300.1(o) of the Rules in that he failed to use due diligence to ensure that the option transactions were within the bounds of good business practice. He agreed to a fine of \$10,000; costs of \$5,000; a 6 month suspension from acting as a Supervisor; to successfully complete the Options Supervisors Course; and to be subject to a 12 month period of close supervision, during which he was prohibited from trading in or advising on Level 4 option accounts.

¶ 12 *Re Deslongchamps Raymond James Ltd.* involved a settlement whereby the respondent admitted that its institutional trading supervision and compliance system was not reasonably designed to prevent and detect certain breaches of IIROC’s Universal Market Integrity Rules and agreed to a fine of \$400,000 and costs of \$125,000.

¶ 13 *Re Rayment James Ltd.* as well involved a settlement agreement whereby the respondent’s informal supervision system failed to detect an RRSP stripping scheme which resulted in significant client losses. The respondent in this matter agreed to a fine of \$140,000 and costs of \$10,000.

¶ 14 In *Re. Bershire Securities Inc.* the respondent admitted in a settlement agreement that it had failed to adequately supervise one of its Registered Representatives who had made unsuitable leverage recommendations to a group of clients and had also agreed to protect a client from losses in his account. The respondent agreed to a fine of \$120,000 and costs of \$10,000.

¶ 15 *Re CIBC World Markets* similarly involved a failure to supervise a Registered Representative who was making unsuitable recommendations with respect to options trading. The respondent agreed to a fine of \$85,000 and costs of \$10,000.

Mitigating Factors

¶ 16 In his submissions, Respondent's counsel stressed the fact that that there was not a failure of either the Respondent's electronic trading system nor of the overall supervisory environment of the Respondent. Rather that the matter before us involved a set of unusual circumstances which had not been anticipated by the Respondent. The Respondent has cooperated fully with IIROC Staff and has made changes to both its electronic trading system and to its supervisory procedures to ensure that it is unlikely that a similar supervisory failure would again occur.

Sanctions Reasonably Appropriate

¶ 17 In considering the sanctions agreed to by IIROC Staff and the Respondent in the Settlement Agreement, we note that they are less than those agreed to in the similar fact precedents cited to us by IIROC Staff counsel.

¶ 18 However, in the matter at hand the agreed upon facts do not reflect a direct failure to supervise. Rather, they appear to us to show an incorrect understanding by Mr. Arapis' supervisors of the features contained in the Respondent's electronic trading system, a misunderstanding which led them to fall short in their supervisory obligations. The facts demonstrate that Messrs. MacKay and Whyte were in fact supervising the trading activities of Mr. Arapis. Where they failed in their obligations was in the scope of that supervision. They assumed, incorrectly as it turns out, that the Respondent's trading system was limiting the trading activities of Mr. Arapis to only those within the pre-approved option trading limits. Unfortunately, this reliance upon technology proved to be wrong and the breach of the Rules occurred.

¶ 19 The facts before us also demonstrate that the Respondent has taken steps to both compensate the clients who complained of losses and to amend its systems both at the technical level and at the procedural level to reduce the possibility of such supervisory oversight happening again.

¶ 20 In this context, the agreed upon sanctions meet the test of being within a reasonable range of appropriateness and we have, therefore, approved the Settlement Agreement.

Dated at Vancouver, British Columbia, this 17th day of December, 2012.

John Rogers, Chair

James Harkness

Bob Sutherland

Copyright © 2013 Investment Industry Regulatory Organization of Canada. All Rights Reserved.