

Re Jory Capital

IN THE MATTER OF:

**An Application for a Review of a Decision of the Investment Industry
Regulatory Organization of Canada pursuant to Section 31.1(4) of the
Securities Act, C.C.S.M. c. S50**

and

**Dealer Member Rule 20.29 of the Investment Industry Regulatory
Organization of Canada (IIROC)**

and

Jory Capital Inc

2012 IIROC 20

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

Hearing: February 2, 2012
Decision: February 14, 2012
Reasons for Decision: April 11, 2012

Hearing Panel:

Richard L. Yaffe (Chair), Martin Davies, Kathleen Jost

Appearances:

Lorne Herlin, for IIROC

Art Stacey, for Jory Capital Inc.

REASONS FOR DECISION

¶ 1 We were constituted as a Panel of the Investment Industry Regulatory Organization of Canada (“IIROC”) to consider an application by Jory Capital Inc. (“Jory”) for the removal of certain enhanced business restrictions (“EBRs”) that had previously been imposed on Jory by IIROC. A hearing (“Hearing”) was held in Winnipeg, Manitoba on February 2, 2012 at 10:10 a.m.

¶ 2 IIROC Rule 20 prescribes the rules relating to IIROC hearing processes, and Part 9 thereof applies specifically to Early Warning review proceedings. IIROC Rule 20.29(4) prescribes the options available to an IIROC hearing panel with respect to the disposition of such matters, and provides that the panel may:

- i. affirm the order;
- ii. quash the order;
- iii. vary or remove any prohibitions imposed on the Dealer Member; and
- iv. make any decision that could have been made by IIROC pursuant to IIROC Rule 20.28 (IIROC Rule 20.28 is the rule pursuant to which IIROC may impose EBRs).

¶ 3 In order to comply with the deadline imposed by The Manitoba Securities Commission (the “MSC”) in

its reasons for judgement delivered on January 11, 2012, we issued our decision (“Decision”) in this matter on February 14, 2012 and indicated that reasons (“Reasons”) for our Decision would follow. Certain information set out in our Decision will be restated in these Reasons for the sake of completeness.

¶ 4 The EBRs had been imposed by IIROC pursuant to IIROC Rule 20.28 and were communicated to Jory in a letter from IIROC staff to Jory dated June 29, 2009 (the “June 29 Letter”). At the relevant time, Jory was in the category of Early Warning Level 2 pursuant to IIROC Dealer Member Rule 30, which is the more serious of the two categories under IIROC’s Early Warning System that is intended to identify IIROC members that are in danger of having a capital deficiency.

¶ 5 The EBRs imposed on Jory by IIROC in the June 29 Letter prohibited Jory from:

- i. opening any new branch offices;
- ii. hiring any new registered representatives or investment representatives (the “New Rep Restriction”);
- iii. opening any new customer accounts (the “NCA Restriction”); or
- iv. changing its inventory position in any material respect.

¶ 6 By letter from IIROC staff dated December 17, 2009 (the “December 2009 Letter”), IIROC provided clarification regarding the interpretation of the NCA Restriction. IIROC staff confirmed that the NCA Restriction prohibits the opening of new accounts for new customers, but, subject to certain restrictions and conditions, it does not prohibit the opening of a new account for an existing customer of Jory provided that the new account is opened in the same name as the existing account.

¶ 7 Pursuant to the December 2009 Letter, Jory does not require approval from IIROC to open a new account for an existing customer in the same name if the new account is

- i. a tax-free savings account;
- ii. a registered retirement savings or other registered plan account; or
- iii. a cash, margin, or COD account.

However, pursuant to the December 2009 Letter, Jory must request approval from IIROC to open any new accounts not satisfying the above conditions. The December 2009 Letter stipulates that accounts requiring approval include, but are not limited to:

- i. corporate or business accounts, where the corporation or business does not have an existing account with Jory, even if the shareholder or business owner is an existing client of Jory;
- ii. accounts for spouses and family members of existing clients, including spousal RRSP and other registered plan accounts.

¶ 8 Finally, pursuant to the December 2009 Letter, Jory is required to report to IIROC by email, within 5 business days of opening a new account, the client name, type of account, and account number assigned of each new account Jory opens (in addition to submitting daily commission detail and summary reports).

¶ 9 Our understanding of the history of this matter is as follows:

- i. On September 27, 2010, Jory applied to the MSC to have the NCA Restriction and the New Rep Restriction (together, the “Contested Restrictions”) removed. In response, IIROC brought an application to the MSC to have Jory’s application dismissed.
- ii. By way of a preliminary ruling dated December 31, 2010, the MSC denied IIROC’s application and ruled that it would hear Jory’s application. On January 11, 2012, IIROC applied to the MSC to have an IIROC hearing panel consider the review of the EBRs. We were provided with an excerpt of the transcript of the MSC’s reasons for judgement, which ordered that an IIROC hearing panel conduct the review. The MSC imposed certain conditions, as follows:

“It is the condition of our decision that the IIROC hearing panel convene and hear Jory’s application based on materials already prepared by the parties within four weeks from today. The decision must be reached within two weeks thereafter and communicated to the parties.”

¶ 10 According to counsel for Jory, there have been various failed requests made by Jory to IIROC since June, 2009 for the relaxation of the NCA Restriction to allow Jory to open certain types of new accounts without the need to seek prior approval from IIROC. IIROC’s refusal to relax the restrictions led Jory to its application to the MSC referred to in paragraph 7 above. Counsel summarized various jurisdictional and procedural issues that have arisen and that have resulted in a significant delay to a resolution of Jory’s requests.

¶ 11 Jory submits that because it is a Type 2 introducing broker and delegates its back office services to National Bank Financial, it does not control or have direct access to its clients’ funds and the Contested Restrictions are inappropriate and unnecessary. In fact, counsel for Jory referred to the affidavit of Mr. Warren Funt, the Vice President, Western Canada of IIROC, which in paragraph 19 acknowledges that because Jory is a Type 2 introducing broker there is minimal risk to client accounts. Further, under IIROC rules Jory is required to have on deposit with National Bank Financial the amount of \$250,000. Counsel for Jory pointed out that the Risk-Adjusted Capital (“RAC”) requirements imposed by IIROC are over and above the aforementioned deposit, and submits that the RAC requirements are, accordingly, excessive. Counsel argued that neither existing nor new clients of Jory would be at risk if the Contested Restrictions were removed.

¶ 12 Counsel for Jory submits that the imposition of the Contested Restrictions on Jory is intended by IIROC to be punitive, in that their effect is to render it impossible for Jory to carry on business. Counsel argued that in order for Jory to meet the RAC requirements imposed by IIROC, Jory must be able to attract investors and/or grow its revenue. Counsel argued that it is impossible to attract investment in a firm that is precluded from opening new accounts for new clients and from hiring new registered representatives, and that the inability to open new accounts severely limits Jory’s ability to earn revenue and improve its capital position. Counsel submits that the situation is confounded by the fact that any new investment in Jory is subject to IIROC approval. Counsel also summarized the series of communications between IIROC and Jory or its counsel, beginning in early 2009, pursuant to which certain of the EBRs were alternately relaxed and reimposed but which have not resulted in Jory’s desired outcome of being able to open new accounts.

¶ 13 Jory maintains that, contrary to the position enunciated by IIROC, there would be absolutely no risk to the integrity of the capital markets if Jory were entitled to open new accounts. Counsel for Jory pointed out that there has not been a single client complaint against Jory since it began business in 1999.

¶ 14 Counsel for Jory provided the Panel with an overview of Jory’s regulatory history. Counsel identified those times when Jory’s RAC has been deficient and Jory’s efforts to remedy such RAC deficiencies. Counsel also provided an explanation as to why Jory paid a bonus at a time when it contravened the restrictions imposed by IIROC, and pointed out that the bonus was returned to Jory. Counsel referred to IIROC’s decision to prohibit Mr. Cooney from acting as Jory’s chief compliance officer, the effect of which was that Jory’s expenses increased as a result of having to hire and pay for an appropriately trained individual to serve in that role. Counsel made the point that the various restrictions imposed by IIROC have had the effect of preventing Jory from increasing its RAC, which is the very goal that IIROC expects and requires Jory to achieve. Counsel also referred specifically to a period in May and June of 2009 when IIROC initially refused to lift certain of the EBRs and then changed its position and relaxed the restrictions after receiving a letter (the “TDS Letter”) from Jory’s corporate/securities counsel that highlighted the “significant improvements” made by Jory since the imposition of the EBRs and that alleged that Jory’s ability to improve its capital position was “directly and severely inhibited” by the EBRs. The EBRs were reimposed shortly thereafter.

¶ 15 Of great significance is the allegation by counsel for Jory that the restrictions imposed on Jory as a result of its various contraventions have been draconian and the suggestion that Jory has been treated unfairly by IIROC. This allegation and these comments are of much concern to us, and the Panel has taken them very seriously in its deliberations.

¶ 16 IIROC counsel began his case by explaining the significance and purpose of the concept of RAC as a

tool for monitoring the financial status of dealer members. He confirmed that the \$250,000 amount on deposit with National Bank Financial is distinct from the RAC requirement. He also pointed out that an IIROC member can be made subject to the early warning system either automatically (and objectively) as a result of failing to meet IIROC's financial tests, or discretionarily (and subjectively) by IIROC staff.

¶ 17 IIROC counsel then reviewed Jory's regulatory history, its disciplinary history, and in particular Jory's history of failing to meet IIROC's financial compliance requirements beginning as early as two months after Jory was granted membership in IIROC. Counsel provided evidence that of the 146 months from October 1999 to November 30, 2011 Jory was automatically (objectively) placed into early warning 67 times, and Jory was discretionarily (subjectively) placed into early warning 64 times. IIROC counsel next reviewed Jory's revenue and expenses for the period from 2005 to 2011, pointing out that Jory incurred net operating losses in several years even prior to the imposition by IIROC of the EBRs.

¶ 18 IIROC counsel then reviewed the history surrounding the imposition by IIROC of the EBRs, the attempts by Jory to have the EBRs lifted, the occasions when certain of the EBRs were lifted or relaxed, and the re-imposition of the EBRs as a result of ongoing capital deficiencies. Of particular significance is the letter from IIROC staff to Jory dated January 28, 2009 warning Jory that further contraventions of RAC requirements would not be tolerated, that such contraventions would result in the imposition of EBRs, that IIROC's "...leniency has not had the desired effect of improving Jory's long-term capital position..." and that in the future "...IIROC will make no exceptions to any prohibitions imposed." IIROC counsel provided an explanation as to why IIROC staff lifted the EBRs following receipt of the TDS Letter, and why IIROC staff re-imposed the EBRs on June 29, 2009 following Jory's failure to satisfy the condition imposed by IIROC that Jory maintain RAC in excess of \$100,000.

¶ 19 IIROC counsel referred to the affidavit of Warren Funt to establish the risks to clients resulting from capital deficiencies of IIROC members, even in a situation where the member is a Type 2 introducing broker. According to Mr. Funt's affidavit, these risks are minimal. In summary, the risks are (i) that an IIROC member that is capital deficient and is suspended or becomes insolvent "...will not be able to trade and meet client obligations..."; and (ii) that a member facing financial difficulties "...will be under pressure to generate revenue, which might place client investment objectives second..." No evidence was presented to suggest that Jory's conduct was improper in this regard.

¶ 20 IIROC counsel did, however, present compelling evidence rebutting Jory's position that the opening of new accounts is essential to improving Jory's RAC. The position of IIROC staff is that inappropriately high expenses are at the root of Jory's ongoing RAC deficiency. Counsel referred to the affidavit of Robert DeGoeji, C.A., the Manager of Financial and Operations Compliance, Prairie Region of IIROC, and presented an overview of Jory's actual revenue and expenses for 2009 and 2010 and Jory's estimated revenue and expenses for 2011 and 2012. Counsel highlighted the significant promotional and salary/benefits expenses. In 2009 the average expense per day was \$9,700, and in 2010 the average expense per day was \$9,500. Estimated promotional expenses for 2011 were \$240,000; actual expenses for advertising/promotion/seminars for the first nine months of 2011 were \$283,705, or \$43,705 over the estimate for the entire year. These promotional expenses were incurred during a period when Jory was prohibited from opening new client accounts. Counsel focussed on extraordinarily high expenditures for client entertainment, often exceeding \$1,000 per day, during a period when Jory was prohibited from opening new client accounts. Counsel for Jory offered the explanation that in a period when Jory is prohibited from opening accounts for new clients, retention of existing clients becomes even more important.

¶ 21 Estimated salary/benefits for 2011 were \$467,000; actual expenses for salaries /benefits for the first nine months were \$594,942, or \$127,942 over the estimate for the entire year.

¶ 22 We have carefully considered the affidavit evidence and submissions presented by counsel, both of whom did commendable jobs in their presentations. We agree with counsel for Jory that the risks associated with Jory's financial position may very well be minimal. However, it is clear from a reading of IIROC rules that the Early Warning System applies and operates uniformly across IIROC's membership, and that no distinction or accommodation is made under IIROC rules for Type 2 introducing brokers. It is our

understanding that the Early Warning System was designed to allow IIROC staff to be proactive with a view to reducing risk associated with its members' actions, even in the case of Type 2 introducing brokers. Further, we recognize that IIROC, as a self-regulatory organization, has capable staff available to it as well as the experience of dealing with its members on a regular and ongoing basis. IIROC staff has compiled information and data with respect to Jory that is of serious concern and which, in our opinion, supports the actions taken by IIROC including the imposition of the EBRs. Counsel for Jory has not provided evidence to support its allegation that Jory has been treated unfairly by IIROC.

¶ 23 On the basis of the foregoing, it was the unanimous decision of this Panel on February 14, 2012 that Jory shall be subject to the EBRs as set out in the June 2009 Letter, as modified and clarified by the December 2009 Letter.

Dated at Winnipeg, Manitoba this 11th day of April, 2012.

Richard L. Yaffe

Martin Davies

Kathleen Jost