

Re Johnson

IN THE MATTER OF:

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

and

The By-Laws of the Investment Dealers Association of Canada (IDA)

and

Paul Laverne Johnson

2012 IIROC 19

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

Heard: March 28, 2012
Decision: March 28, 2012

Hearing Panel:

Leon Getz, Q.C., Brian Worth and Brian Field

Appearance:

Natalija Popovic for the Investment Industry Regulatory Organization of Canada

Ronald Pelletier for Paul Johnson

DECISION

¶ 1 The question before us is whether to accept a settlement agreement (the “Settlement Agreement”) negotiated between the Enforcement Department of the Investment Industry Regulatory Organization of Canada (“IIROC”) and Mr. Johnson. The necessity for such acceptance and the jurisdiction to decide upon it are provided for in IIROC Rules 20.36 to 20.40.

¶ 2 The Settlement Agreement is annexed to this Decision. In it, Mr. Johnson has acknowledged that between June 2003 and December 2008, while he occupied the position of Branch Manager, he failed, in circumstances fully set out in the Agreement, to supervise adequately the account activities of a client of a registered representative to ensure that the recommendations made were appropriate for the client. This was a breach of Regulation 1300.2 and Policy 2 of the predecessor Investment Dealers’ Association and IIROC Rules 1300.2 and 2500.

¶ 3 Mr. Johnson has agreed to pay a fine of \$20,000 and to contribute \$1,000 to IIROC on account of its costs in connection with this matter.

¶ 4 The test applicable to a decision whether to accept or reject a settlement is well-known. Simply put, a panel should accept such an agreement unless it considers the penalty provided for clearly to fall outside a reasonable range of appropriateness.

¶ 5 At a hearing held in Vancouver on March 28, 2012 we received and considered the joint submissions of counsel for IIROC and for Mr. Johnson and reviewed the provisions of the Settlement Agreement. Following

that we indicated orally our conclusion that rejection of the Settlement Agreement would be inconsistent with the test set out. Accordingly, we accepted it.

¶ 6 These are our reasons for doing so.

¶ 7 IIROC Dealer Member Rule 1300.2 provides, in substance, that every Dealer Member must take appropriate steps for the supervision of client accounts so as to ensure that “the handling of client business is within the bounds of ethical conduct, consistent with just and equitable principles of trade and not detrimental to the interests of the securities industry.” It is difficult to overstate the importance of substantive compliance with this requirement. The detailed provisions designed to ensure that it is satisfied, including those applicable to someone like Mr. Johnson as the branch manager of a local office of the dealer, are found in Dealer Member Rule 2500.

¶ 8 The factual underpinning of Mr. Johnson’s admitted breach is set out in paragraphs 13 to 28 of the Settlement agreement and can be relatively shortly stated. He was the supervisor of a registered representative, John Skelton. In January 2001 Mr. Skelton opened an account with an initial value of \$10,000 for an 85 year old widow who described her investment knowledge as “good”, indicated that she had a risk tolerance of “90% medium and 10% high” and that her investment objectives were 40% income, 50% growth and 10% short term trading. In June 2003 the value of the account was dramatically increased to some \$500,000 as the result of a deposit of cash, fixed income, preferred share and mutual fund securities. Mr. Johnson did not at this time make any enquiries as to whether the new facts necessitated any change in the clients investment objectives or risk tolerance.

¶ 9 Shortly after the increase in value, Mr. Skelton began to implement in the account what is described as his “unconventional investment philosophy”. By 2006, approximately 50% of the account was invested in gold and other precious metals securities and the value of the account had risen to approximately \$845,000.

¶ 10 In March 2006, when the client was about 90 years old, a new NCAF was completed, which increased her risk tolerance from 40% income, 50% growth and 10% short term trading to 60% growth and 40% speculative. The revised NCAF conformed to the composition of the client’s account at that time. Mr. Johnson failed to make any enquiries of Mr. Skelton as to whether there were any facts justifying the revised risk tolerance or investment objectives or the suitability for the client of such significant holdings of gold and other precious metals.

¶ 11 The Disciplinary Sanctions Guidelines promulgated by IIROC (the “Guidelines”) suggest that where someone such as Mr. Johnson has failed in the performance of his supervisory responsibilities, a minimum fine of \$25,000 is generally appropriate, together with a requirement to rewrite the partners’, directors’ and officers’ examination and to undergo a suspension for some period of his authority to perform supervisory responsibilities. These are recommended sanctions only. They are not mandatory.

¶ 12 The Guidelines also suggest a framework for assessing the gravity of a particular breach of the rules and for determining which sanctions are reasonable in the circumstances. Included in this framework are some “key considerations” to be taken into account and we refer below to some of those we think are relevant.

¶ 13 First, prior to the events that occurred here, Mr. Johnson has had a spotless record over the more than 40 years he has been a registrant and 24 years he has been a branch manager. See Settlement Agreement, paragraph 12. That is obviously a consideration that works in his favour.

¶ 14 Secondly, Mr. Johnson had been Mr. Skelton’s supervisor for some 10 years and had known him for about 30 years. He apparently had great respect for Mr. Skelton’s “investment philosophy”, understood it and believed that it had some validity, thought he did not share it. Because he believed that Mr. Skelton only worked with clients who were completely conversant with the philosophy and agreed to its implementation, Mr. Johnson never questioned the suitability of the portfolio for a 90 year-old lady. This, too, works in his favour if only in the sense that there is no evidence that his failures were attributable to illicit or dishonest motives, to calculation or a desire for personal benefit. On the contrary, they seem rather to be attributable to his seriously flawed judgment in relying, when he did not himself believe in it, on Mr. Skelton’s investment philosophy.

¶ 15 Third, Mr. Johnson has acknowledged his defaults, cooperated with IIROC’s enquiries into the matter (a fact that may explain why the Settlement Agreement only provides for a relatively nominal contribution to IIROC’s costs) and, we were informed, has “voluntarily” stepped down from his position as branch manager.

¶ 16 Among the key considerations contemplated by the Guidelines is the absence of harm to the client and in this connection we have noted the statement in paragraph 32 of the Settlement Agreement that by February or March 2009, when the client transferred her account to another dealer, the account “had a net increase of approximately \$25,000”. We have assumed, though we cannot be certain of this, that the statement is thought to lay the foundation for the conclusion that the client suffered no harm and that this, too, should be considered as a factor favourable to the acceptance of the proposed settlement. Without knowing how or over what period the \$25,000 increase was calculated or whether and if so how and to what extent a more favourable result would have been attained if a different and more conventional “investment philosophy” had been adopted, we do not think that any conclusions can be drawn from the fact stated.

¶ 17 It is not to Mr. Johnson’s credit, on the other hand, that as is revealed in paragraph 30 of the Settlement Agreement, notwithstanding his knowledge from March 2008 of the client’s expressed concerns about the holdings in her account, it was not until almost a year later that he met with the client to canvass those concerns with her.

¶ 18 In support of the submission that we should accept the Settlement Agreement, our attention was drawn to several previously decided cases having in one respect or another similar features to the present, in which a hearing panel had imposed, or accepted a settlement agreement providing for, fines in the general range of the \$20,000 that Mr. Johnson has agreed to pay. Among them are *Re Gareau*, [2005] I.D.A.C.D. No. 25 (\$20,000 but this was not a settlement agreement), *Re Racine*, [2006] I.D.A.C.D. 24 (\$30,000 plus a six month suspension and a requirement to rewrite the Branch Manager’s course); and *Re Schillaci*, [2007] I.D.A.C.D. No. 6 (\$15,000 and a requirement to rewrite certain examinations within a year, failing which a suspension from approval – but this was also not a settlement agreement).

¶ 19 It is trite to say that no two cases are exactly alike. Each depends on its particular facts. The guidance to be obtained from previously decided cases is, therefore limited and we do not think that much is to be gained from a detailed exploration of the minutiae.

¶ 20 Making the best judgment of which we are capable having regard to the principles that govern decisions of this kind, the facts, the Guideline recommendations and key considerations and prior decisions to which we have referred, we considered that the sanctions provided for in the Settlement Agreement are within a reasonable range of appropriateness and for that reason we accepted the settlement agreement.

As of March 28, 2012.

Leon Getz, Panel Chair

Brian Field, Panel Member

Brian Worth, Panel Member

SETTLEMENT AGREEMENT

I. INTRODUCTION

1. IIROC Enforcement Staff and the Respondent, Paul Laverne Johnson, 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. Johnson (“the Respondent”).
3. On June 1, 2008, IIROC consolidated the regulatory and enforcement functions of the Investment

Dealers Association of Canada (“IDA”) 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 contravention of IIROC Rules:

From or about June 2003 to December 2008, the Respondent, as Branch Manager of a Member of IIROC, failed to adequately supervise the account activities of a client of a Registered Representative to ensure the recommendations made were appropriate for the client, contrary to Association Regulation 1300.2 & Policy No. 2 and IIROC Rules 1300.2 & 2500.

8. Staff and the Respondent agree that the Respondent will:
 - (a) pay IIROC a fine in the amount of \$20,000;
and
 - (b) pay IIROC \$1,000 toward the costs of the investigation and prosecution of this matter.

III. STATEMENT OF FACTS

Acknowledgment

9. 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.

A. Overview

10. The Respondent, as branch manager, relied upon John Skelton [Skelton], a registered representative and his unconventional investment philosophy, to such a degree that he failed to adequately supervise the account activity of one of Skelton’s clients. The client, who was over the age of 85, held a portfolio in which approximately half of the investments were in gold and other precious metals securities.

B. Registration History

11. The Respondent has been a registrant since 1977 and was at all material times employed as Branch Manager in the Kelowna B.C. office of Raymond James Ltd., a Member of IIROC.
12. The Respondent has never been the subject of an IIROC discipline proceeding over his approximately 43 years as a registrant, and approximately 24 years as a branch manager.

C. Responsibility to Supervise Skelton and His Client Accounts

13. At all material times the Respondent was responsible for the supervision of Skelton, who was a registered representative at Raymond James Ltd., and Skelton’s client accounts.
14. In or about January 2001 Skelton opened an account for his client BT. The value of the account was approximately \$10,000 at that time. The New Client Application Form (NCAF) for the account indicated as follows:
 - DOB: January 16, 1916
 - Status: retired and widowed
 - annual income: \$60,000+
 - net worth: \$600,000+
 - investment knowledge: “Good”

- risk tolerance: 90% medium and 10% high
- investment objectives: 40% income; 50% growth; 10% short term trading

D. Activity in BT's Account

15. Between the opening of BT's account in 2001 and June of 2003 there was minimal activity in the account. In or about June 2003 BT made a deposit of cash and securities into the account and thereby increased the value of the account to approximately \$500,000.
16. Of the securities transferred into BT's account in June 2003, the vast majority were fixed income, preferred shares and mutual fund investments.
17. Notwithstanding the substantial increase in the value of BT's account in 2003, the Respondent failed to make inquiries about whether this change necessitated an update of the NCAF. Specifically, he did not ask Skelton whether the change in the value of the account resulted in any changes to the purpose of the account, the investment objectives, or risk tolerance for the account.
18. Starting in or about June 2003, Skelton implemented his investment philosophy and consequently, on Skelton's recommendations, BT's account acquired holdings in gold and other precious metals securities. By 2006 approximately 50% of BT's account was invested in gold and other precious metals securities and the value of the account had risen to approximately \$845,000.
19. In or about March 2006, when BT was approximately 90 years of age, a second NCAF was completed which, among other things, increased her risk tolerance to 45% high, and her investment objectives to 40% speculative. Specifically, the NCAF indicated as follows:
 - annual income: \$40,000+
 - net worth: \$1,250,000 (\$950,000 in liquid assets and \$300,000 in fixed assets);
 - investment knowledge: "Good"
 - risk tolerance: 55% medium and 45% high
 - investment objectives: 60% growth and 40% speculative.
20. While the Respondent failed to request a change to BT's NCAF in 2003, conversely there was no change in BT's circumstances March in 2006 to warrant the changes to the NCAF. The updated NCAF conformed to the holdings of gold and other precious metals securities in BT's account at the time.

E. The Respondent's Respect for Skelton and his Unconventional Investment Philosophy

21. The Respondent has known Skelton for over 30 years and has been his direct supervisor for over 10 years.
22. The Respondent was fully aware of, and had the greatest respect for, Skelton's knowledge and expertise in an unconventional investment philosophy that focused on investments in gold and other precious metals securities. Even though he did not subscribe to Skelton's investment philosophy himself, the Respondent understood it and believed it had validity.
23. The Respondent was aware that the types of investments underlying Skelton's investment philosophy were typically considered high risk.
24. Notwithstanding that Skelton employed this unconventional investment philosophy; the Respondent's supervision of Skelton was no different than his supervision of any other registered representative.

F. Respondent's Failure to Supervise Account Activity in BT's Account

25. Although the Respondent had been aware for a number of years prior to 2006 of the significant holdings of gold and other precious metals securities in BT's account, he was not concerned that such investments were not suitable for BT. The Respondent believed that Skelton only worked with clients who were completely conversant with, and agreed to, his philosophy.
26. The Respondent did not question Skelton about the changes to the NCAF in 2006; nor did he contact the

client to ensure that she was content with the changes to the NCAF and holdings in the account.

27. Further, the Respondent did not make any inquiries of Skelton about how he determined BT's risk tolerance; nor did he talk with BT about the issue.
28. The Respondent relied upon Skelton and failed to make inquiries of Skelton, including inquiries about:
 - BT's risk tolerance and investment objectives
 - any required changes to her profile and NCAF as a result of the influx of cash and securities in 2003
 - the suitability of the significant holdings of gold and other precious metals securities in her account from 2003 onward
 - the changes to her NCAF in 2006
 - client complaints from BT, detailed below

G. Client Complaint

29. From 2007 to 2009 the following communications and client complaints took place:
 - On or about July 26, 2007 --BT had a discussion with Skelton and informed him that she would be transferring her account to another dealer in order to change the nature of her investments; however after further discussions with him, she ultimately did not do so.
 - On or about March 14, 2008--BT expressed concerns to Skelton that her account was not generating sufficient income; however the account was not moved to another dealer at this time.
 - On or about March 25, 2008—In a letter to Skelton, BT wrote that her children had reviewed her portfolio and were “very insistent” that she “have investments that are less aggressive and less risky”. Therefore, she was going to transfer her account to another dealer. After receiving the letter, Skelton spoke to BT and she elected to not transfer the account. The Respondent was made aware of this letter from BT but took no action as a result.
 - December 22, 2008—In a letter to Raymond James, BT's son complained that given BT's advanced age it was inappropriate that a high percentage of the securities in her account were speculative. BT's son further noted that BT was completely dependent on Skelton's advice.
 - January 14, 2009----BT wrote in a letter to Skelton and the Respondent, that she held no malice toward Skelton, but that she was not a sophisticated investor and her trust in Skelton was complete. She further wrote that though she had asked him to move her investments into GICs it appeared that he had not followed her directive.
30. Notwithstanding the Respondent's knowledge of BT's communications from March 25, 2008 onward at no time did he question Skelton about the client's concerns about her investment holdings; or did he question whether the investments were suitable for BT.
31. It was not until early January 2009, after receipt of the December 22, 2008 letter of complaint, that the Respondent met with BT to discuss her concerns. While the Respondent discussed BT's complaint letter generally, he did not specifically ask BT about her risk tolerance at this time.
32. In or about February to March 2009, BT transferred her account to another dealer. By this point in time BT's account had a net increase of approximately \$25,000.

IV. TERMS OF SETTLEMENT

33. 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.
34. The Settlement Agreement is subject to acceptance by the Hearing Panel.

35. The Settlement Agreement shall become effective and binding upon the Respondent and Staff as of the date of its acceptance by the Hearing Panel.
36. 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.
37. If the Hearing Panel accepts the Settlement Agreement, the Respondents waive their rights under IIROC rules and any applicable legislation to a disciplinary hearing, review or appeal.
38. If the Hearing Panel rejects the Settlement Agreement, Staff and the Respondents may enter into another settlement agreement or Staff may proceed to a disciplinary hearing in relation to the matters disclosed in the Investigation.
39. The Settlement Agreement will become available to the public upon its acceptance by the Hearing Panel.
40. Any suspensions or other terms of the Settlement Agreement shall commence on the day the Settlement Agreement is accepted by the Hearing Panel.
41. Staff and the Respondent agree that they, or anyone on their behalf, will not make any public statements inconsistent with the Settlement Agreement if the Hearing Panel accepts the Settlement Agreement.

AGREED TO by the Respondent at the City of Kelowna in the Province of British Columbia, this 15th day of February, 2012.

“WITNESS SIGNATURE”

“PAUL JOHNSON”

WITNESS

PAUL LAVERNE JOHNSON

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

“Witness signature”

“Natalija Popovic”

WITNESS

NATALIJA POPOVIC

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

ACCEPTED at the City of Vancouver in the Province of British Columbia, this 28th day of March, 2012, by the following Hearing Panel:

Per: “Leon Getz”

Panel Chair

Per: “Brian Worth”

Panel Member

Per: “Brian Field”

Panel Member