

Re Husebye

IN THE MATTER OF:

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

and

Kim Husebye

2016 IIROC 21

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

Penalty Hearing: May 16, 2016
Decision: May 26, 2016

Hearing Panel:

Martin L. Friedland, C.C., Q.C. (Chair), Charles Macfarlane, T. Hugh McNabney

Appearances:

Rob DelFrate, Senior Enforcement Counsel for IIROC

Michael Byers, for the Respondent

DECISION AND REASONS FOR PENALTY

Background

¶ 1 The Investment Industry Regulatory Organization of Canada (“IIROC”) issued a Notice of Hearing on June 10, 2015, alleging that Kim Husebye (“Mr. Husebye” or the “Respondent”) committed the following contravention:

“Between November 2009 and December 2010, the Respondent failed to use due diligence to ensure that investment recommendations were suitable for his clients, contrary to IIROC Dealer Member Rule 1300.1(q).”

¶ 2 A hearing was held last January 2016. At that hearing, IIROC submitted in its closing statement that the “Respondent recommended high risk, leveraged exchange traded funds (‘ETFs’) to several of his clients. He failed to use due diligence to assess the risks associated with these ETFs. The Respondent overlooked or disregarded clear, unambiguous disclosure of the significant risks associated with an investment in the ETFs, and concentrated a significant amount of his clients’ accounts in these securities.”

¶ 3 The Panel at the January hearing concluded (paragraph 8 of *Re Husebye* 2016 IIROC 05) that the Respondent had contravened Rule 1300.1(q), and stated: “For the reasons that follow, the Panel finds that the evidence that the Respondent failed to use due diligence to ensure that investment recommendations were suitable for his clients is clear, convincing and cogent.” For full details of why the Panel came to that decision, readers should examine the earlier decision.

¶ 4 A Penalty Hearing was later scheduled and heard on May 16, 2016. The same counsel appeared at the Penalty Hearing. The Panel reserved its decision. This is our decision and the reasons for that decision.

Proposed Penalties

- ¶ 5 Staff submitted that the following penalties were warranted in this case:
- i. a fine in the amount of \$40,000;
 - ii. a four month prohibition on the Respondent's re-registration with IIROC; and
 - iii. costs in the amount of \$25,000.

- ¶ 6 The Respondent proposed the following penalties:
- i. a fine of \$5,000;
 - ii. a six month prohibition on the Respondent's re-registration with IIROC; and
 - iii. costs in the amount of \$5,000.

- ¶ 7 The Panel has concluded that the appropriate penalties in this case are the following:
- i. a fine of \$20,000;
 - ii. a six month prohibition on the Respondent's re-registration with IIROC;
 - iii. a requirement that the Respondent successfully complete the Conduct and Practices Handbook course prior to seeking re-registration; and
 - iv. costs in the amount of \$10,000.

Reasons for the Panel's Decision on Penalties

¶ 8 **The Respondent.** This is not a case of a fraudulent or incompetent representative who took improper advantage of his clients. At the earlier hearing, we heard at some length the testimony of the Respondent. He struck us as an intelligent, dedicated, registered representative. In our earlier reasons (para. 9) we stated: "The Panel accepts counsel for the Respondent's statement that 'Mr. Husebye has an extensive background in technical and fundamental financial analysis and possesses extensive knowledge of a wide range of financial products and concepts.'"

¶ 9 He was sincerely trying to do his best for his clients. As we stated (para. 81), the Respondent "sincerely believed that his Strategy was suitable for his clients." He believed that the rise in the market after the severe turndown in 2008 was temporary and that it would go down again. He had been proven correct just before the 2008 crash when he advised his clients to hold cash or its equivalents. Moreover, he did not profit to a greater extent from his Strategy in purchasing Inverse Leveraged Exchange Traded Funds than he would have if he had purchased more conservative products.

¶ 10 The problem was that his judgment was faulty in the use of these risky products for the three investors who complained – investors who were not sophisticated investors and, particularly in the case of one investor, had a very small nest egg as she was nearing retirement and did not fully understand how these products operated. Although, as we stated (para. 62), "[t]here is no bright line test to determine when a security is high risk," we concluded that the "leveraged inverse products in question here were relatively high risk securities". There is no evidence that the Respondent's other clients who purchased these securities complained about the use of these products. The products may have been suitable for them. They may have been sophisticated investors and had other less risky assets in their portfolios. As an Alberta Securities Commission Panel has stated, "Suitability determinations will always be fact specific." (*Re Lamoureux* 2001 A.S.C.D. No. 613 at page 21.)

¶ 11 These products were not simple inverse funds. They were leveraged in that they provided double the impact of a simple inverse fund. As the prospectuses of these funds made clear, these were risky investments. Moreover, the three clients who complained had all of their investments with Mr. Husebye (not including cash) in Leveraged Inverse ETFs that had double the impact on increases and decreases in value than did simple inverse ETFs. There was no need to use double leverage because inverse ETF products without leverage were available. The Respondent certainly knew the products well. It was bad judgment to choose such risky products.

¶ 12 **Deterrence.** It is clear that deterrence is a factor in setting an appropriate penalty. (See *Re Cartaway Resources Corp* [2004] 1 S.C.R. 672.) But a tribunal – whether a securities commission or an IIROC hearing panel – has to be careful that it does not give deterrence undue weight. As the Supreme Court of Canada stated in *Cartaway* (at para. 64):

“The weight given to general deterrence will vary from case to case and is a matter within the discretion of the Commission. Protecting the public interest will require a different remedial emphasis according to the circumstances. Courts should review the order globally to determine whether it is reasonable. No one factor should be considered in isolation because to do so would skew the textured and nuanced evaluation conducted by the Commission in crafting an order in the public interest. Nevertheless, unreasonable weight given to a particular factor, including general deterrence, will render the order itself unreasonable.”

In the present case, the Panel considers that a fine of \$20,000 would be giving appropriate weight to deterrence. One has to be careful not to impose too high a penalty which might have the effect of discouraging or having a chilling effect on innovation and contrarian thinking in the securities industry. Moreover, the Respondent has paid a heavy price for his bad judgment. He has not been employed in the securities industry since he was forced to leave Raymond James in 2013. We were shown his tax returns indicating that after these events his income, never high at any time, plunged to a very low level in the past few years.

¶ 13 **The Case Law.** Staff and counsel for the Respondent cited a large number of cases to us. We have examined them. No case is, as lawyers say, “on all fours” with the present case. In many of them, there were other aggravating factors leading to a higher penalty, such as churning, discretionary trading, a previous conviction for forgery, clients with a zero high risk tolerance, or the representative not knowing the product. In some cases the Respondent did not appear for the hearing. Very few of the cases dealt with the type of ETFs in question here. Many of the cases were Settlement Agreements, which are often difficult to use as precedents because one is never sure if the true picture has emerged in such cases. As far as we could determine, as we stated in the earlier decision (para. 60): “The present case appears to be the first contested IIROC hearing relating to the suitability of inverse or leveraged Exchange Traded Funds.” We were, however, struck by the fact that many of the comparable cases on suitability cited to us imposed a fine of \$20,000, as we have in this case.

¶ 14 **Other Factors.** There are many other factors that we could consider in assessing the penalty. Some of them are listed in the 2015 *IIROC Sanction Guidelines*, under the heading “Key Factors in Determining Sanctions. The list, the Guideline states “is intended to be illustrative, not exhaustive.” The first three factors are: “The number, size and character of the transactions at issue”; “Whether the respondent engaged in numerous acts and/or a pattern of misconduct”; and “Whether the respondent engaged in the misconduct over an extended period of time.” As we see it, this case involved only three clients for about a year. When the Respondent’s firm expressed concern about the concentration of these products, the Respondent ceased offering them to new clients, although he did not advise the complainants to dispose of the products. Most of the other cases cited to us that imposed a greater penalty than we are imposing involved many more clients.

¶ 15 Another factor listed is “whether the respondent accepted responsibility for and acknowledged the misconduct to his or her employer or regulator.” Mr. Husebye did not do so, but this is because he believed that his strategy was the right one. He continued to believe he was right and defended his position at the first hearing. It was his right to do so and it should not be a reason for increasing the penalty. For the same reason the failure to show remorse is not relevant when he believed he was right in his approach.

¶ 16 A further factor on the list is “Whether the respondent failed to heed regulatory guidance with respect to the misconduct at issue.” He can certainly be faulted for not paying heed to what the regulators in Canada and the United States were saying about these products, as we pointed out at paragraphs 53-59 in our earlier decision.

¶ 17 The Guidelines state that “Inability to pay is a relevant consideration in determining the appropriate

financial sanction to be imposed on a respondent.” Although the Respondent raised this issue, we have not taken it into account because no clear evidence was submitted regarding the state of his assets. We did, however, take into account his personal financial situation in determining the hardship he suffered as a result of his conduct.

¶ 18 **Prohibition from re-registration.** We determined that a prohibition from re-registration for six months is appropriate. It was the length of time suggested by the Respondent. We also require the Respondent to successfully complete the Conduct and Practices Handbook course prior to seeking re-registration. We understand that this would no doubt be required by IIROC in any event, because the Respondent has not been a registrant for three years.

¶ 19 **Costs.** What costs should be awarded? The actual costs incurred by IIROC in these proceedings were at least \$80,000, according to an affidavit put in evidence by Staff. Counsel for IIROC has suggested that costs be set at \$25,000. The Respondent suggests \$5,000. A number of cases that we examined have set costs at an even lower figure than \$5,000. Some of them were at the \$2,000 level.

¶ 20 There is not a set formula for determining what appropriate costs should be. The amount is left to the judgment of the tribunal. In the circumstances of this case, we think that the appropriate figure is \$10,000. The Respondent has had very low or no income for a number of years as a result of these proceedings and has submitted an affidavit that “the payment of any amount will be beyond my present means.” As we stated earlier, this is the first contested case on the issue of the suitability of these products. There is a public interest in having a Panel give guidance on the suitability of these type of securities. A higher figure than \$10,000 might be seen by some as the equivalent of an added punishment. It would certainly be so considered by the Respondent. This is not a case of egregious conduct by an unscrupulous representative. It was mistaken judgment by a conscientious person trying to do his best for his clients.

Conclusion

- ¶ 21 As stated above, the Panel has concluded that the appropriate penalties in this case are the following:
- i. a fine of \$20,000;
 - ii. a six month prohibition on the Respondent’s re-registration with IIROC;
 - iii. a requirement that the Respondent successfully complete the Conduct and Practices Handbook course prior to seeking re-registration; and
 - iv. costs in the amount of \$10,000.

Dated at Toronto this 26th day of May, 2016

Martin L. Friedland, C.C., Q.C., Chair

Charles Macfarlane

T. Hugh McNabney

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