

Re St-James

IN THE MATTER OF:

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

and

Elizabeth St-James

2021 IIROC 02

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

Hearing: September 28, 2020 in Montréal, Québec

Decision: February 2, 2021

Hearing Panel:

Alain Gélinas, Chair, François Gervais and Yves Julien

Appearances:

Fanie Dubuc, Enforcement Counsel

Julie-Martine Loranger, Counsel for Elizabeth St-James (hereinafter, the Respondent)

DECISION ON PENALTY

I. Introduction and Summary

¶ 1 In its liability decision dated February 2, 2020, the Hearing Panel found the Respondent guilty on both of the counts described in the Notice of Hearing dated May 8, 2018.

¶ 2 Staff of the Investment Industry Regulatory Organization of Canada (IIROC) had made the following allegations:

Count 1

From August 2009 to September 2012 and from December 2012 to July 2013, the Respondent failed to adequately supervise activities in a customer account by a registered representative under her responsibility, in accordance with supervision conditions imposed on this registered representative by the Approval Committee of the Québec District Council, contrary to Rule 38.4 (a) and Rule 2500 of the IIROC Dealer Member Rules; and

Count 2

From July 2013 to March 2014, the Respondent failed to adequately supervise a registered representative under her responsibility in accordance with supervision conditions imposed on this

registered representative by the Approval Committee of the Quebec District Council, contrary to Rule 38.4(a) and Rule 2500 of the IIROC Dealer Member Rules.

¶ 3 The matter concerned whether the supervision made by the Respondent at the Montréal office of Mackie Research Capital (Mackie) from 2009 to 2014 was appropriate.

¶ 4 The hearing on penalties was held on September 28, 2020.

¶ 5 Final written submissions and authorities were received by the Hearing Panel on October 14, 2020.

Joint recommendations

¶ 6 From the outset of the hearing, the parties unanimously agreed to make joint recommendations regarding the penalties in this matter.¹

¶ 7 For count 1, the parties recommend a penalty of fifteen thousand dollars (\$15,000).

¶ 8 For count 2, the parties recommend a penalty of ten thousand dollars (\$10,000).

¶ 9 The parties recommend costs in the amount of ten thousand dollars (\$10,000) for the whole of the hearings.

¶ 10 The parties recommend prohibition of registration in any supervision capacity for a period of six months, and that re-registration with IIROC be conditional on prior successful completion of the Branch Managers Course examination or its equivalent, depending on course availability.

¶ 11 Finally, the parties recommend that payment of the monetary penalties and costs be made within thirty (30) days following the Hearing Panel's decision.

The Facts

¶ 12 The investigation into this matter was initiated on September 3, 2014 and focused initially on the supervision made by the Respondent at the Mackie branch in Montréal. The relevant period extends from September 2008 to March 2014.

¶ 13 The Respondent held supervision duties at the Montréal branch from September 2008 to March 2014. From September 22, 2008 onwards, her registration category was "branch manager and registered representative".

¶ 14 At the relevant time, the Respondent had the supervision of four or five representatives.

¶ 15 The triggering event that allegedly led the investigator to question the Respondent's supervision is the investigation of the representative Samuel Kloda (Kloda) following a client complaint. The investigator noted that Kloda had been placed under close supervision by IIROC at the time of his transfer to Mackie. The close supervision had already been imposed with his previous employer (Exhibit P-1, pages 1.25, 1.27 and 1.28). Furthermore, the representative Kloda had been dismissed for cause by his previous employer.

¶ 16 A ComSet event report was filed by Mackie on May 28, 2013 regarding the client complaint against representative Kloda. It mentions that the matter was settled on August 23, 2013 for the sum of \$17,333. At the time of the complaint, the client, a woman, was 62 years old.

¶ 17 Regarding count 2, a decision by the Registration Committee of IIROC's Québec District Council dated November 28, 2011 imposed close on-site supervision conditions on the representative Daniel Dubois (Dubois). His supervision was to be made by the supervisor at the Montréal branch. According to the NRD records, between November 9, 2011 and March 21, 2014, the Respondent was the supervisor at that branch. (Exhibit P-48).

¹ Stenographer's Notes of September 28, 2020, p. 5

¶ 18 The representative Dubois was required to be under close on-site supervision for the entire duration of his employment at Mackie.

Analysis and jurisprudence

¶ 19 The alleged facts having occurred prior to September 2016, the legal basis for imposing sanctions in this matter is Rule 20.33². The new rules provide a higher fine for each contravention.

¶ 20 The powers of a hearing panel at a settlement hearing are limited. It may either accept or reject the settlement, but it may not modify it.

¶ 21 This Hearing Panel is of the opinion that it has the necessary discretion to impose an appropriate sanction in this matter, since there has been no settlement agreement. Though the decision was rendered in a different context, the following passage from *Re Ahrens*³ accurately summarizes the assessment that a hearing panel must generally make:

“¶ 11 The authorities indicate ... that the penalty imposed must reflect the panel’s assessment of what penalties are appropriate ... to accomplish the above goals. The penalty must take into account the seriousness of the respondent’s conduct, and the principles of general and specific deterrents. An appropriate balance must be struck.

¶ 12 In *Re Mills*, (2001) IDACD No. 7, a case involving a failure to supervise by a branch manager, the panel assessed a penalty of a fine of \$50,000.00, costs of \$35,000.00, and the respondent rewrite and pass the partners, directors and officers examination. In the course of its decision, the panel stated:

- 6 Industry expectations and understandings are particularly relevant to general deterrence³ [at the end of document]. If a penalty is less than industry understandings would lead its members to expect for the conduct under consideration, it may undermine the goals of the Association’s disciplinary process; similarly, excessive penalties may reduce respect for the process and concomitantly diminish its deterrent effect. Thus the responsibility of the District Council in a penalty hearing is to determine a penalty appropriate to the conduct and respondent before it, reflecting that its primary purpose is prevention, rather than punishment.
- 7 An appropriate penalty will achieve both specific and general deterrence. The primary focus of the District Council, however, is the respondent; the appropriateness of the penalty relates most directly to the nature of the respondent’s violation, the circumstances in which it was committed and other aggravating and mitigating factors relevant to the respondent’s conduct and its consequences, like those identified in the TSE Guidelines. Such considerations may lead the District Council to conclude that a respondent should be prohibited from participation in the securities industry or that a lesser penalty is sufficient to prevent repetition of the misconduct. The emphasis is thus on specific deterrence on the assumption that general deterrence will follow from an appropriate decision; cf., e.g. In the Matter of CCI Capital Canada Ltd., (1999) 22 O.S.C.B. 6289 (October 8) at 6291.
- 8 Although the seriousness of a respondent’s conduct may incline a District Council toward increasing a penalty in order to enhance its general deterrent effect⁴ [at end of document], any temptation to treat general deterrence as providing an independent

² Stenographer’s Notes of September 28, 2020, pages 15 and 16

³ 2014 IIROC 46

basis for an additional penalty should be resisted. A penalty based on general deterrence, considered separately, may result in a greater penalty than would otherwise be imposed on a respondent in order to influence the conduct of others who are not before the District Council. In the District Council's view, this would be unfair to the respondent; cf. R.A. Duff, *Trials and Punishments* 235-36 (1986), quoted in A. Manson, *supra.* at 52. An appropriate penalty should satisfy the demands of general deterrence without having to bump it up.

- 9 General deterrence may, however, provide a means of assessing the appropriateness of a penalty. In the course of its deliberations the District Council may consider the adequacy of a penalty in terms of its likely effect on others.

Such consideration may indicate that a penalty is too low, or possibly too high, in the circumstances. General deterrence may thus serve as an additional factor assisting a District Council to weigh the appropriateness of a penalty under consideration and to relate it more closely to industry understandings and expectations.

- 10 A penalty decision thus inevitably involves an exercise of judgment by the District Council reflecting the values of the securities industry, as well as the goals embodied in the Association's Constitution. It must also be tailored to the circumstances of the matter before the District Council, see, e.g. *DSI*, 23 O.S.C.B. at 5068-69, but not in isolation, as one aspect of fairness is that like cases be treated alike.
- 11 Comparison with penalties imposed in similar cases may provide another means of ensuring proportionality, always recognizing that the imposition of sanctions is premised in large part on factors specific to the circumstances of each case and that only rarely will there be correspondence on all matters between two cases. As the penalty in each case must be determined on its own merits, precedents can serve only a limited function; cf. *In re National Gaming Corp.*, (2000) 9 A.S.C.S. 4592 (November 10) at 4598. While they, like the TSE Guidelines, may assist in an attempt to treat similar cases similarly, they are no more than factors to be taken into account, whose weight varies with the degree of correspondence to the facts under consideration.
- 12 Although the preceding comments also apply to the settlement process, there is a distinction between penalties agreed to in a settlement and those imposed in a hearing such as this one. As has been previously stated, a penalty under a settlement agreement is likely to be at the low end of the spectrum. The difference is highlighted by the District Council's responsibility to determine an appropriate penalty in a hearing such as this one, as opposed to accepting a penalty agreed to in a settlement; see, e.g. *Milewski*, 22 O.S.C.B. AT 5407; *In the Matter of Scott Alexander Clark*, [1999] I.D.A.C.D. No. 40 (P.D.C.) ("settlement process is one of negotiation and compromise", *Quicklaw* at 3). Penalties imposed under settlement agreements thus cannot define the parameters of the penalties available. These are defined in paragraph 20.10 of the Association's By-laws. Within these parameters, the District Council's responsibility is to determine the penalty that it believes is the correct one, taking into account relevant principles and factors, in the circumstances of the case before it."

...

13 The Guidelines set forth key considerations for determining sanctions under various headings. Those headings are appropriate for the facts of this case.”

¶ 22 Except in special circumstances, a hearing panel should, however, avoid deviating from a joint recommendation negotiated by the parties’ experienced legal counsel⁴.

¶ 23 *Re Suppal*⁵, relying on the cases *Re Wilson*⁶ and *Re Harding*⁷, places special emphasis on specific and general deterrence. Sanctions should be based on the specific misconduct of the respondent with an aim of general deterrence. The appropriate sanction will strike a fair balance between the specific misconduct and industry expectations.

¶ 24 Disciplinary sanctions are preventative in nature and are not intended to punish the individual. The aim is to ensure that the specific misconduct does not recur, and to deter other industry members from engaging in similar misconduct.

¶ 25 The parties highlighted certain aggravating and mitigating factors.

¶ 26 The Hearing Panel retained the following aggravating factors:

- The objective gravity of the supervision failures is significant.
- These failures are harmful to the reputation of the securities industry.
- These failures caused unsuitable investments to result in losses for one representative’s client.
- The Respondent did not exercise the expected due diligence.
- The supervision was incomplete and inadequate.
- The absence of written documentation concerning the actions taken by the Respondent with respect to the representative Kloda, along with the responses received, revealed a significant weakness in the supervision, especially since the supervision was supposed to be close.
- The representative Kloda was placed under close supervision by IROC the moment he transferred to Mackie.
- The close supervision of Kloda had been imposed while he was still with his previous employer. What’s more, the representative Kloda had been dismissed for cause by his previous employer.
- The account had already suffered heavy losses before being transferred to Mackie, the representative Kloda had been terminated for cause at CIBC Wood Gundy, and close supervision had been imposed on him at Mackie.
- At the time of the transfer to Mackie, the securities in the portfolio had already lost over \$30,000 in value, having a book value of \$79,250.75 compared to a market value of \$37,744.73 (Boyce report, p. 5, par. 16).
- In September 2009, the Respondent did not request an update of the client’s New Client Application Form, which had been signed on August 3, 2009, but noted a discrepancy between the account’s composition and the initial investment objectives. The client’s investment funds had been sold in order to purchase, among other things, shares in a high-tech firm. The Respondent admitted that the portfolio was riskier from then on. The representative Kloda,

⁴ See notably, *Poulin c. R.* 2010 QCCA 1854 and *Dumont c. R.* 2013 QCCA 576. These judgments are mentioned in *Re Brophy* 2018 IROC 52

⁵ 2014 IROC 35

⁶ 2011 IROC 47

⁷ 2011 IROC 65

instead of changing the portfolio's content, allegedly spoke to the client and requested that she update her objectives.

- The Respondent approved the form's update dated November 2, 2009, which increased the objectives of Kloda's client's account to 100% high risk, and henceforth allowed small-cap purchases on the TSX Venture Exchange, and she admitted that purchases on this Exchange had already been made.
- For the period 2008, 2009 and until 2012, the Respondent testified that there was just one entry for representative Kloda concerning the client's account in the supervision system (share drive). It was a mention to the effect that the client's account was in a debit position for a sum of \$20,000.
- The Respondent had access to a "share drive" supervision system. For part of her supervision period, namely from January 2013 to January 2014, no mention appears regarding either representative Kloda or the client.
- Having approved the New Client Application Form and its update, the Respondent failed to use due diligence and became the witness of a spiral of unsuitable trading.
- The Respondent did not speak with the complainant before the latter filed her complaint.
- She did not attend the meetings with the clients or communicate with them concerning their investment objectives.
- She had noticed the higher risk factor in other accounts managed by representative Kloda.
- She allegedly sent a letter to the complainant inquiring whether the date of the latter's account had been changed.
- She regularly had to send reminders to the representative Kloda about what he had said he was going to do.
- Regarding the risk perception, she was comforted by the fact that the representative Kloda was tracking the gold securities very closely.
- She relied entirely on the representative Kloda's explanations.
- The evidence has shown that the supervision file for the client's account did not meet IIROC's requirements. Simple checkmarks, scraps of paper kept by the representative concerning the trades made, or the proximity of the offices do not meet the quality standards required in a highly regulated industry.
- The representatives were subject to close supervision measures.
- The representative Kloda clearly fell in the category of a representative whose activities required heightened supervision by the Respondent, with adequate documenting of the actions taken to fulfill her responsibility. There should have been explanatory notes concerning questions she may have had, notably regarding the veracity and exhaustiveness of the information on the New Client Application Form and the client account updates. These explanatory notes should have laid out the representative Kloda's reasoning and that of the Respondent with respect to the high degree of risk and the aggressive trading strategy employed in the client's account. These notes should have mentioned the actions taken by the Respondent as part of her supervision.
- The complainant's New Client Application Form at the time of the transfer should have been

scrutinized more closely by the Respondent, as well as documented. From the outset, the New Client Application Form raised questions. The client opened an RRSP account on August 3, 2009. When the account was opened, the client was 58 years old, divorced and retired. She had \$200,000 in assets and an annual income of \$30,000. Her risk tolerance was set at “50% low risk” and “50% high risk”. Her investment knowledge was listed as average. The form indicates that her objectives were 80% short-term capital gains and 20% medium-term capital gains.

- Representative Kloda’s client’s account was subsequently composed of mining and oil securities, as well as two funds. Is an objective of 80% short-term capital gains compatible with the RRSP account of a retired person with a \$30,000 annual income? The question deserved to be analyzed and documented.
- The sale of the high-income and dividend funds, which accounted for approximately 45% of the portfolio’s value, and the purchase that same day, from the proceeds of the sale, of more volatile securities should have raised some supervision questions. These trades were made only sixteen (16) days after the account was opened.
- Having approved the New Client Application Form and its update, the Respondent failed to use due diligence and became the witness of a spiral of unsuitable trades.
- The Respondent signed the form increasing representative Kloda’s client’s account objectives to 100% high risk, henceforth enabling small-cap purchases on the TSX Venture Exchange, and she admitted that purchases had already been made on this Exchange.
- In matters of excessive trading (churning), we generally rely on the Looper formula (Boyce report, p. 9, par. 35). The Looper formula measures annual turnover by dividing the total cost of purchases made during a given period by the average amount invested during that period. As a rule, a rate of two (2) suggests churning, a rate of four (4) is indicative, and over six (6+) is conclusive that there is churning in the account. In this matter, the rate is 10.9.
- Regarding the excessive trading, the year 2011 was especially problematic. For the 12-month period ended December 31, 2011, 34 trades were made. The portfolio suffered a 41% loss. It went from a value of \$39,351 as at December 31, 2010 to \$23,108 as at December 31, 2011. The client was charged \$4,375 in commissions.
- The 27 trades made between July 25, 2011 and September 14, 2011 led to a net loss of \$564.54 for the client (Tanguay report, p. 13, par. IV).
- The expert Tanguay equates the strategy to « day trading » (Tanguay report, p. 22, par. 66).
- So many trades, and their scope within such a short lapse of time, should have been a red flag for the Respondent.
- The portfolio value fell to \$55,298.09 in late 2010. The portfolio at the time was composed, in a proportion of 93%, of two junior tech securities and one junior gold security (Boyce report, p. 6, par. 21).
- After that, there was little trading until June 2011, the portfolio being invested in junior securities. In late June 2011, the portfolio was composed of two junior securities and its net value stood at \$31,797.41 (Boyce report, p. 6, par. 22).
- In late September 2011, the portfolio value was \$25,577.87, including \$5,477.07 in cash and one junior gold security. In September 2014, the portfolio value was only \$13,939.72 (Boyce report, p. 6, par. 25).

- The Hearing Panel is of the opinion that all of the red flags mentioned in paragraphs 18 and 19 of the Statement of Allegations were present for representative Kloda. They do not all have the same impact when taken individually, but as a whole they paint a very clear picture for the Hearing Panel.
- All the red flags are the result of two principal actions, namely: faulty supervision of the representative Kloda by the Respondent when the account was opened on August 3, 2009, and the perpetuation of this faulty supervision when the New Client Application Form was updated on November 2, 2009. The incorrect assessment of the Know-Your-Client rule and the investment suitability rule led to high-risk trading, excessive commissions, an excessive concentration of securities, an excessive number of trades, inappropriate trading strategies and, finally, a quality downgrading of the client's holdings.
- The Respondent did not supervise representative Dubois' trades from July 2013 until the latter's departure in March 2014. She was present on site but everyone's trades, including representative Dubois', were reviewed by DL from the Toronto office. If there was no problem, the Respondent signed the report (notes for December 10, 2018, p. 200).
- The representative Dubois was required to be under close on-site supervision for the entire duration of his employment at Mackie.
- The fact of signing a monthly supervision report which attested that the Respondent had made close on-site supervision of the representative Dubois was of a nature to mislead IIROC.
- The Respondent made no effort to withdraw her registration as an on-site supervisor of representative Dubois's activities from the NRD, or to inform IIROC.

¶ 27 The Hearing Panel observed the following mitigating factors:

- The absence of a disciplinary record.
- The Respondent wanted to stop being a supervisor in the fall 2012, in order to return to being a sales assistant.
- The Respondent no longer has any supervision duties.
- The client was reimbursed by the firm.
- The Respondent showed no malicious intent.
- The failures were not meant to be dishonest.
- The failures were not meant to benefit the Respondent.
- As a branch manager, the Respondent was paid a fixed salary and was not entitled to a performance (productivity) bonus.
- Entrusting the Respondent, who was a sales assistant and trader, with the powers of a branch manager in order to supervise certain representatives who were under close supervision, was probably not an ideal situation.
- The Respondent looked at the information regarding the client, his/her place of residence, age, occupation, personal circumstances and experience before signing the New Client Application Forms.
- The Respondent talked with the representative Kloda when the complainant's account was opened in August 2009 and she looked at the portfolio content.

- In the present case, the representative Kloda had known the client for approximately 18 years.
- In terms of supervision, the Respondent looked at the commissions reports every morning.
- The Respondent would ask the representative Kloda to submit notes describing the time of the call with the complainant, the purpose of the call and the steps taken.
- Given the fact that representative Kloda's and her offices were in proximity to each other, the Respondent could hear representative Kloda's phone conversations.

Supervision

¶ 28 In the decision on liability, our Hearing Panel reiterated the importance of supervision in the financial industry. We review some of the principles here in order to demonstrate the significant objective gravity.

¶ 29 Supervision and, more generally, compliance is intended to protect the client, the firm and the financial industry. It is an essential line of defence to ensure the adequate regulation of financial intermediaries.

¶ 30 Rule 38.4(a), titled Compliance and Supervision, imposes on a supervisor the obligation to fully and properly supervise each Partner, Director, Officer, Registered Representative, Investment Representative or Agent in accordance with IROC Rules and the written policies and procedures of the Dealer Member.

¶ 31 Such full and proper supervision must, in our opinion, be heightened in the case of close supervision.

¶ 32 The Hearing Panel is of the opinion that full and proper supervision imposes a duty of competence and diligence to raise questions, show transparency and document the supervision made.

¶ 33 The supervisor must be able to rely on adequate policies and procedures, an appropriate structure, sufficient means and the constant support of the firm.

¶ 34 The work of the supervisor is complex and involves numerous challenges. The supervisor must be able to assert himself/herself, to ask difficult questions and to question the actions and trades made on the clients' behalf.

¶ 35 In *Re MacDonald* (2012 IROC 68), another hearing panel commented as follows on the important role of the supervisor:

“Dealer Member Rule 2500 sets out the minimum standards for retail customer account supervision and are not repeated in their entirety in this decision. The Respondent, as a branch manager, was responsible for first-tier reviews to detect on a daily and then monthly basis various types of compliance breaches. The Respondent was also responsible for the review of new client application forms. A review of new client application forms must include a review to ensure that recommendations made for any account are appropriate for the client and in keeping with his or her investment objectives. Branch management supervision includes a review of suitability, a review of any inappropriate or high risk trading strategies and excessive trade activity.”

¶ 36 The decision *Youden (Re)*, [2005] I.D.A.C.D. No. 52, at paragraph 95, refers to the *Re Mills* decision that commented on the duties of a branch manager. In *Re Mills* the panel described the role of branch managers as follows:

“Branch managers have an important role under the self-regulatory system in our securities markets. The obligations requiring supervision of retail customer accounts are intended to ensure appropriate handling of customer accounts for the benefit of both the customer and the firm....

... A branch manager should be alert to facts that, even with honest and trustworthy registered

representatives, may indicate a need for further investigation. It is sometimes necessary that a manager go beyond discussions with a registered representative and address an issue directly with the customer.”

- ¶ 37 Full and proper supervision does not demand perfection, however. It seeks a balance between the protection of the clients, the legitimate interests of the firm and the efficiency of capital markets.
- ¶ 38 Rule 2500 – Minimum Standards For Retail Customer Account Supervision (hereinafter Rule 2500) – decrees the minimum requirements necessary to ensure that a Dealer Member has in place procedures to properly supervise retail client account activity.
- ¶ 39 However, the Rule does not preclude Dealer Members from establishing a higher standard of supervision and, in certain situations, a higher standard may be necessary to ensure proper supervision (Rule 2500 – Introduction). The Hearing Panel is of the opinion that the imposition of close supervision and, even more so, of close on-site supervision demands heightened supervision.
- ¶ 40 Rule 2500 recognizes that compliance with the Know-Your-Client rule and suitability of investment requirements is primarily the responsibility of the Registered Representative. The supervision aspect is very important, however.
- ¶ 41 An effective supervisory environment promotes the business objectives of the Dealer Member and enables the Dealer Member to meet regulatory requirements and its obligations to its clients.
- ¶ 42 A Dealer Member, via the supervisor, must conduct enhanced supervision of trading by Approved Persons who have had a history of questionable conduct (Rule 2500 – section I.C.4).
- ¶ 43 This requirement is heightened when imposed in a specific manner.
- ¶ 44 A Dealer Member must maintain records of supervisory review for seven years. It must be possible to transfer these records to IIROC promptly. The records must include the name of the person who conducted the review and when, the inquiries made, the replies received and the actions taken (Rule 2500 – I.F). Well-documented written records of supervisory review protect the client, the Approved Person, the Dealer Member, as well as the industry’s image.
- ¶ 45 The evidence has shown that the supervision review record for the complainant’s account did not meet these requirements. Simple checkmarks, scraps of paper kept by the representative concerning the trades made, or the proximity of the offices do not meet the quality criteria required in a highly regulated industry.
- ¶ 46 The supervision review records are the daily history of a major compliance aspect in the firm. To be effective, these records must be complete, accurate and verifiable, and documented.
- ¶ 47 The Know-Your-Client rule is also essential in the financial industry. The new client application process is an important benchmark, because it allows the Registered Representative and the supervisory staff to maintain accurate and complete information on each client, and to conduct the necessary review to ensure that the recommendations made are suitable for the client and in keeping with his investment objectives (Rule 2500 – II Introduction).
- ¶ 48 A Dealer Member must have systems and procedures to supervise trading activity in all retail accounts. The systems and procedures must provide reasonable assurance that the Dealer Member is meeting its regulatory obligations, including those to clients (Rule 2500 – III.B).
- ¶ 49 Procedures must be able to identify patterns of activity that are not apparent by reviewing trades singly (Rule 2500 – III.B.3).
- ¶ 50 The Dealer Member’s procedures must be risk-based, as specified in Rule 2500 I C.4:

At a minimum, a Dealer Member must conduct enhanced supervision of trading by Approved Persons who have had a history of questionable conduct. Evidence of such conduct can include trading activity that frequently raises questions in account reviews, frequent or serious customer complaints, regulatory investigations, frequent account credit problems or failure to take appropriate remedial action on account problems identified.

(Our emphasis)

¶ 51 The first-tier review of the trades made must be able to detect unsuitable trading, undue concentration of securities, excessive trade activity, inappropriate or high-risk trading strategies and quality downgrading of client holdings (Rule 2500 – IV.A). Each of these elements was present in the representative Kloda’s case.

¶ 52 The supervisor cannot rely entirely on the information provided. The Hearing Panel is of the opinion that a holistic approach which examines the supervision question from an overall standpoint is to be preferred. This approach recognizes the evolving nature of the client’s investment objectives and risk tolerance, as well as the features of the products and markets.

¶ 53 When a new account is opened, whether or not it is a transfer, the supervisor must ask himself/herself whether the information that is provided and the account features seem logical. The same goes for the update. In most cases, the answer will be easy. When in doubt, the supervisor must make inquiries and document the answers obtained.

¶ 54 Supervision, and more broadly speaking, compliance, requires having a global vision of the client’s circumstances and the actions taken on his/her behalf.

¶ 55 A deficiency of supervision and, more generally, compliance cannot be excused by the vagaries of the market. A deficient supervision system jeopardizes investor protection, the stability of the firm and the image of the industry. The persons whose job it is to ensure supervision and compliance are the sentinels of protection and stability.

IIROC Sanction Guidelines

¶ 56 One of IIROC’s missions is to set high quality regulatory and investment industry standards and to support the efficiency of Canadian capital markets. Its objectives are many, including the protection of investors, and strengthening the integrity and competitiveness of the financial marketplace.

¶ 57 IIROC achieves these regulatory objectives through setting and enforcing rules regarding the proficiency, integrity, business and financial conduct of dealer firms and their registered employees.

¶ 58 IIROC’s disciplinary procedures are intended to protect investors and marketplace integrity by maintaining high standards of conduct within the securities industry.

¶ 59 When determining an appropriate penalty, a hearing panel is invested with broad discretionary powers. An appropriate penalty will depend on the facts in the matter, the enabling provisions and the circumstances of the misconduct.

¶ 60 The Sanction Guidelines are often useful, but the Hearing Panel still retains the discretionary authority to impose the sanctions that it considers appropriate. It should be noted that the general principles and key factors outlined in the Sanction Guidelines are not intended to hinder the exercise of the hearing panel’s discretionary authority when determining appropriate sanctions.

¶ 61 It is important to keep in mind that disciplinary sanctions are preventative in nature and must notably strive to protect the investing public, strengthen the integrity of the marketplace and generally improve professional standards and practices. The primary aim is prevention, not punishment. The goal is to prevent

the respondent's behaviour from continuing, but also to send a clear message to those who might be tempted to follow suit that such conduct will not be tolerated.

¶ 62 Both specific and general deterrence for a corporate entity must take into account the size of the Dealer Member, its financial resources and the nature of its activities to ensure that the imposed sanctions are sufficient to achieve deterrence. Similarly, in the case where the respondent is an individual, personal circumstances and the ability to pay the fine must be taken into account.

¶ 63 The Supreme Court of Canada reminds us in *Committee for the Equal Treatment of Asbestos Minority Shareholders v. Ontario (Securities Commission)*, [2001] 2 SCR 132, par. 43 that to achieve general deterrence, sanctions must establish an appropriate balance between the specific misconduct with which the regulated person is charged and the industry expectations.

¶ 64 The imposed sanctions must be adapted to the conduct at issue and should be similar to sanctions imposed on respondents for similar contraventions in similar circumstances. Relevant mitigating or aggravating factors must also be taken into account, of course.

¶ 65 Evidently, disciplinary sanctions will be more severe for respondents with a prior disciplinary history and even more so for those who disregard the rules intended to protect clients. A prior disciplinary record generally becomes less relevant as it becomes more dated.

¶ 66 In the face of multiple violations, the total sanction must correspond to the overall misconduct. Where there are multiple violations, the overall sanction imposed should not be excessive or disproportionate to the gravity of the total misconduct at hand. The existence of multiple contraventions may be treated as an aggravating factor.

¶ 67 A sanction must be significant enough to be a general deterrent but also proportional in order to gain the support of market participants because the sanction is fair.

¶ 68 It is fundamental that wrongdoers should not benefit from their wrongdoing. A hearing panel will take into account the fact that a respondent benefited financially from the misconduct and the reimbursement of the victim's losses.

¶ 69 As much as possible, the sanction must seek to wipe out the financial benefit received by the wrongdoer. Benefit should be broadly interpreted as including, directly or indirectly, the profit received, any loss avoided, and commissions and other benefits received.

¶ 70 The Sanction Guidelines state that a hearing panel should consider suspension in the following cases:

- There have been one or more serious contraventions;
- There has been a pattern of misconduct;
- The respondent has a disciplinary record;
- The contravention involved fraudulent, wilful and/or reckless misconduct;
- The misconduct in question has caused some harm to investors, the integrity of a marketplace or the securities industry as a whole.

¶ 71 It should be emphasized that, for a respondent acting in a supervisory capacity, a suspension may be necessary in the event that the supervisory failings are so severe as to call into question the respondent's general fitness to act in a registered capacity.

¶ 72 The Sanction Guidelines state that a permanent bar should be considered where:

- the contraventions involve significant harm to the investing public, the integrity of the market or the securities industry;

- the misconduct had an element of criminal or quasi-criminal activity; or
- there is reason to believe that the respondent cannot be trusted to act in an honest and fair manner in their dealings with the public, their clients, and the securities industry as a whole.

¶ 73 Given that there were serious compliance-related violations, the Hearing Panel is of the opinion that the joint recommendation to impose a prohibition of registration in any supervision capacity for a six-month period is adequate in this matter. We are also of the opinion that reregistration should be conditional on the prior successful completion of the Branch Managers Course examination or its equivalent, depending on course availability.

¶ 74 The Sanction Guidelines provide that in addition to ordering a permanent bar, the Hearing Panel may, in the most serious cases that cause considerable harm to the investors and the securities industry, impose a fine and disgorgement.

¶ 75 The Hearing Panel is of the opinion that a fine of fifteen thousand dollars (\$15,000) for count 1, and ten thousand dollars (\$10,000) for count 2, with costs in the amount of ten thousand dollars (\$10,000) for the proceedings as a whole, meets the objectives of specific and general deterrence.

¶ 76 The Sanction Guidelines state that the burden is on the Respondent to raise the issue of financial hardship and provide evidence thereof.

¶ 77 The Hearing Panel notes that no such evidence was submitted.

¶ 78 The Sanction Guidelines state that the Respondent's proactive and exceptional cooperation in the investigation may constitute a mitigating factor in determining sanctions.

¶ 79 The Hearing Panel is of the opinion that we are not in the presence of proactive and exceptional cooperation. The Hearing Panel notes, however, that the Respondent cooperated and made numerous admissions in the matter.

¶ 80 The sanction must be individualized based on the facts of the matter, the involvement of the person in question, and the aggravating and mitigating factors.

¶ 81 Beyond the fine, disgorgement or suspension, The Sanction Guidelines indicate that a hearing panel might consider the following sanctions:

- Demand that the Dealer Member implement heightened supervision of certain persons, certain branches or certain of the firm's services;
- Limit the activities of a regulated person, notably suspend the ability of a registered person to carry on the duties of supervision or prohibit him or her from exercising such duties;
- Demand a renewal of a person's qualifications by requiring the person to pass an exam or successfully complete a remedial course.

¶ 82 This list is not exhaustive and must be adapted to the facts of the matter.

¶ 83 In this matter, the joint recommendation of the parties to impose a prohibition of registration in any supervision capacity for a period of six months is reasonable. Reregistration is, moreover, conditional on prior successful completion of the Branch Managers Course examination or its equivalent, depending on course availability.

¶ 84 There is also another list of factors in the Sanctions Guidelines to help determine the appropriate sanction. Once again, it is not exhaustive and must be adapted to the facts of the matter. Here are some of the factors mentioned in the Sanction Guidelines and the Hearing Panel's response:

1. The number, size and character of the transactions at issue;

- Response: The number of trades was considerable.
2. Whether the respondent engaged in numerous acts and/or a pattern of misconduct.
Response: The Respondent did not have a pattern of misconduct.
 3. Whether the respondent engaged in the misconduct over an extended period of time.
Response: The allegations cover a fairly lengthy period.
 4. Whether the misconduct was intentional, willfully blind, or reckless with respect to regulatory requirements.
Response: The supervision was performed in negligent fashion but does not appear to have been willfully blind.
 5. Extent of harm to clients or other market participants.
Response: The complainant suffered losses. However she was compensated by the firm.
 6. The extent of harm to market integrity or the reputation of the marketplace, or both;
Response: A failure of supervision is often harmful to the reputation of the marketplace.
 7. The level of vulnerability of the injured or affected client.
Response: The client was a vulnerable person.
 8. The respondent's relevant disciplinary history.
Response: The Respondent has no prior disciplinary history.
 9. Extent to which the respondent obtained or attempted to obtain a financial benefit from the misconduct
Response: The Respondent did not obtain or attempt to obtain a financial benefit from the misconduct.
 10. In the case of individuals, whether the respondent accepted responsibility for and acknowledged the misconduct to his or her employer or the regulator prior to detection and intervention by the Dealer Member or the regulator.
Response: No
 11. Whether an individual respondent was subject to internal discipline by the Dealer Member (see Staff Policy Statement on "Internal Discipline by a Dealer Member").
Response: The Respondent no longer has supervision responsibilities.
 12. Whether an individual respondent or Dealer Member respondent voluntarily employed subsequent corrective measures to revise general and/or specific procedures to avoid recurrence of misconduct.
Response: The Respondent modified the information requested when opening a new client account.
 13. Whether the respondent made voluntary acts of compensation, including voluntary disgorgement of commissions, profits, other benefits and/or payment of restitution to clients.
Response: The Respondent did not receive any profits or other benefits.
 14. Whether the respondent provided proactive and exceptional assistance to IIROC in the investigation of the misconduct (See General Principle No. 8 and see also Staff Policy Statement

on “Credit for Cooperation”).

Response: No. The Respondent did, however, cooperate fully in the investigation.

15. Whether the respondent attempted to delay IIROC’s investigation, to conceal information from IIROC, or intentionally provided inaccurate or misleading testimony or documentary information to IIROC.

Response: No

16. Whether the respondent attempted to conceal his or her misconduct or to lull into inactivity, mislead, deceive or intimidate a client, regulatory authorities or, in the case of an individual respondent, the member firm with which he or she is/was associated.

Response: No

17. Whether the respondent failed to heed regulatory guidance with respect to the misconduct at issue.

Response: The supervision was not consistent with the regulatory guidance.

18. Whether the Respondent engaged in the misconduct at issue notwithstanding warnings from IIROC, another regulator or a supervisor (in the case of an individual Respondent) that the conduct contravened firm policies, IIROC rules or applicable securities, laws or regulations where it was not in the best interest of the client or public.

Response: No

¶ 85 The following decisions were submitted to the Hearing Panel in support of the joint recommendations:

- *Re Mitchell*⁸, the respondent was responsible for the supervision of a representative who had generated substantial switch and redemption fees. The gross amount of the switch fees totalled \$367,459, and the gross redemption fees, \$125,402. Mr. Mitchell had questioned the representative and contacted at least two of the clients. However, he took insufficient action in response to the representative’s trading activities. The respondent had no prior disciplinary history and cooperated in the investigation. The hearing panel accepted the following settlement agreement: a fine in the amount of \$17,000, a three-month prohibition on reapproval in a supervisory capacity, and successful completion of the Branch Managers Course.
- *Re Brophy*⁹, the respondent was responsible for the supervision of a representative who aroused concerns about the level of commissions being generated. The value of new issues purchases made by the representative had almost doubled, from \$42 million to over \$81 million between March 2014 and June 2015. The hearing panel accepted the following settlement: a fine of \$75,000, rewrite the Branch Managers Course examination, attend a full day of one-on-one training on supervision, and costs in the amount of \$5,000.
- *Re Buisson*¹⁰, the respondent had failed to adequately supervise a registered representative under his responsibility, in accordance with supervision conditions imposed by the Approval Committee of the Québec District Council. As well, the respondent had failed to ensure that a registered representative under his supervision met the stipulated training requirements. The hearing panel accepted the settlement which provided for a fine in the amount of \$15,000, the

⁸ 2019 IIROC 4

⁹ 2018 IIROC 21

¹⁰ 2017 IIROC 31

obligation to successfully rewrite the Branch Managers Course examination, and costs.

- *Re Menzel*¹¹, the respondent was the Ultimate Designated Person, Chief Compliance Officer and a supervisor at the firm. The hearing panel found that the respondent had failed to exercise the due diligence required of a registered representative when opening certain client accounts. The respondent was aware that the representative worked outside the office. The respondent failed to question the representative about securities that were trading on the Over-the-Counter Bulletin Board and which were not legally qualified for distribution in Ontario or Québec. The hearing panel accepted the following joint settlement recommendation: a fine in the amount of \$20,000, suspension of registration as a supervisor for six weeks, plus costs.
- *Re Brunet*¹², the respondent had delegated his supervisory responsibilities to a credit and compliance officer within the firm, but failed to ensure that the tasks thus delegated were performed adequately. This officer had little or no experience in compliance. The hearing panel noted the long period of inadequate supervision of two representatives and that the respondent had no prior disciplinary history. The hearing panel accepted the following settlement: an aggregate fine in the amount of \$40,000, a three-year temporary prohibition from approval as a supervisor, the obligation to successfully complete the Branch Managers Course, plus costs.
- *Re MacDonald*¹³, the respondent failed to take the supervisory steps that were reasonably required with respect to the suitability of holdings in the accounts of six clients. The latter (three married couples), who were all inexperienced investors and retired or approaching retirement, suffered losses of between 50% and 74%. The hearing panel accepted the following settlement: an aggregate fine of \$40,000, prohibition from acting in a supervisory capacity for five years, plus costs.
- *Re Ahrens*¹⁴, the respondent, as branch manager, failed to adequately supervise a registered representative for a period of four months. There was no evidence of harm to clients and the respondent had no prior disciplinary history. The hearing panel imposed the following sanctions: suspension from registration in any supervisory capacity for a period of four consecutive weeks, a fine of \$15,000, the obligation to rewrite the Branch Managers Course examination, and costs in the amount of \$5,000.

¶ 86 The case law submitted demonstrates that the joint recommendations are consistent with these earlier decisions.

Decision

¶ 87 After analysis of the case file, the case law, the Sanction Guidelines and the joint recommendations of the parties, the Hearing Panel hereby renders the following decision:

- For count 1, orders a penalty of fifteen thousand dollars (\$15,000) on the Respondent;
- For count 2, orders a penalty of ten thousand dollars (\$10,000) on the Respondent;
- Orders costs in the amount of ten thousand dollars (\$10,000);
- A prohibition from registration in any supervision capacity for a six-month period;

¹¹ 2015 IIROC 6

¹² 2013 IIROC 34

¹³ 2012 IIROC 68

¹⁴ 2014 IIROC 46

- Reregistration is conditional on prior successful completion of the Branch Managers Course examination, or its equivalent, depending on course availability.

¶ 88 Payment of the monetary penalties and costs must be made within thirty (30) days following the Hearing Panel's decision.

Dated at Montréal, Québec, this 2nd day of February 2021.

Alain Gélinas

François Gervais

Yves Julien

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