

Re Floyd & McDonald

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

Charles Floyd & James Gordon McDonald

2013 IIROC 04

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

Heard: October 1-4, 2012
Decision: January 22, 2013

Hearing Panel:

Shelley L. Miller, Q.C. (Chair), Martin Davies, William Welton

Appearances:

Paul Smith, Counsel for IIROC

Respondents Appearing for Themselves

DECISION AND REASONS

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INTRODUCTION

¶ 1 This hearing proceeded in accordance with a Notice of Hearing that alleged 3 contraventions and included a Statement of Particulars (SOP”) consisting of 51 paragraphs. Counts 1 and 2 against Mr. Charles Floyd (“Floyd”) are:

Count 1: Between April and December 2008, Floyd acted contrary to IIROC Dealer Member Rule 1300.1(q) [before June 2008 –IDA Regulation 1300.1(q)] by failing to ensure recommendations he made for a client were suitable for the client.

Count 2: Between September and November 2008, Floyd acted contrary to IIROC Dealer Member Rule 1300.4 by using discretion with respect to purchases in a client account.

¶ 2 Count 3 against Mr. James Gordon McDonald (“McDonald”) is:

Count 3: Between April and December 2008, McDonald acted contrary to IIROC Dealer Member Rule 1300.1(p) [before June 2008-IDA Regulation 1300.1(p)] and IIROC Dealer Member Rule 2500 [before June 2008-IDA Policy 2] by failing to adequately supervise a client account to ensure that holdings in the account were suitable for the client.

¶ 3 IIROC Dealer Member Rules 1300.1(q) and 1300.4 and 1300.1 (p) read as follows:

1300.1(q) Each Dealer Member, when recommending to a customer the purchase, sale, exchange or holding of any security, shall use due diligence to ensure that the recommendation is suitable for such customer based on factors including the customer’s financial situation, investment knowledge, investment objectives and risk tolerance.

1300.4 A Registered Representative may not exercise discretionary authority over a customer account unless

- (a) the Dealer Member has designated a Supervisor or Supervisors to be responsible for discretionary accounts;
- (b) the customer has given prior written authorization in compliance with Rule 1300.5;
- (c) the Registered Representative authorized to effect discretionary trades for the account has actively engaged in, advised or performed analysis for a period for two years with respect to all types of products which are to be traded on a discretionary basis and
- (d) the account is maintained at the Dealer Member of the Registered Representative.

1300.1(p) Subject to Rule 1300.1(r) and 1300.1(s), each Dealer Member, shall use due diligence to ensure that the acceptance of any order from a customer is suitable for such customer based on factors including the customer's financial situation, investment knowledge, investment objectives and risk tolerance.

¶ 4 By the SOP IROC contended that one Leonard Stokes ("Stokes") opened an account at the Edmonton branch of Union Securities Ltd. ("Union") at the invitation of Floyd in spring of 2008 to invest the proceeds of his inheritance from his parents' estates and that although Stokes wanted to invest for his retirement with a view to attain, *inter alia*, 70% capital preservation, Floyd placed the bulk of the inheritance funds in one stock, that is, BCE, which was subject to a takeover bid that Floyd represented would come to fruition in the fall of 2008 but in the event did not do so.

¶ 5 By the SOP IROC contended that in mid-September, 2008 when financial stocks were increasing and decreasing at a high rate, Floyd recommended Stokes convert his regular cash account to a margin account and Floyd then made significantly more and larger purchases of stocks. At its peak, the amount borrowed was over \$480,000. IROC contended that in the circumstances Floyd was in breach on Count 1 for placing Stokes' funds in an overconcentration in one stock and then using the margin account excessively in September and October. Moreover, IROC contended three such trades in September 2008 were not authorized by Stokes before they occurred with the result that Stokes learned of the particulars of the trades after the fact.

¶ 6 By the SOP IROC contended as to Count 3 against McDonald, that as branch manager he failed to ensure proper supervision of the account, there was no evidence to show he had approved the New Client Application Form ("NCAF"), or the investment objectives, or to correct or address any of the alleged unsuitable securities in the account, or to query the application to add a margin account for Stokes and took no action to address the amount of margin used in the account.

¶ 7 The panel in advance of the hearing received written responses from Floyd and McDonald which admitted or disputed various particulars in the SOP. At the outset of the hearing the panel received binders of documents tendered by each party with consent of the opposing party which included various email communications, transaction account statements, and industry articles and news accounts. IROC's binder also included recorded statements of Stokes and each Respondent.

¶ 8 At the hearing IROC presented *viva voce* evidence of Stokes and Mr. Gil Gauthier, an IROC investigator ("Gauthier"). Floyd gave direct oral evidence and submitted to cross examination by McDonald and Counsel for IROC. Both Respondents cross-examined the IROC witnesses. During one point in his cross examination and prior to opening his case, the panel cautioned McDonald that none of his statements from counsel table could be received as evidence. In the event, McDonald elected not to testify or call any additional witnesses. At the conclusion of the hearing, the matter was adjourned at the Respondents' request to make written submissions. Those were received in November from both sides and Rebuttal submissions from the Respondents were received December 17, 2012.

¶ 9 Although some of the events in question occurred prior to June 1, 2008 when the IDA transitioned into IROC, there was no dispute by the Respondents that at all times material, the Respondents were continuously registered with the IDA and IROC and subject to the same regulatory requirements under both organizations.

APPLICABLE LAW AND CASE AUTHORITIES

(a) *Standard of Proof*

¶ 10 The parties do not dispute and this panel accepts that the standard of proof in these proceedings is the civil standard of a balance of probabilities. (*Law Society of Upper Canada v. Neinstein* [2007] O.J. No. 958 (Ont. Div. Ct) at paragraph 54. As was stated in *Re Boulieris* (2004) 27 OSCB, affirmed [2005] O.J. No. 1984 (Ont. Div. Ct):

"[33] The degree of proof required...is such that before a tribunal reaches a conclusion of fact, the tribunal must be reasonably satisfied that the fact occurred; and whether the tribunal is so satisfied depends on the totality of the circumstances including the nature and consequences of the facts to be

proved, the seriousness of an allegation made, and the gravity of consequences that will flow from a particular finding. See *Bernstein and College of Physicians and Surgeons of Ontario* (1977), 15 O.R. (2d) 447 at 470(Ont. Div. Ct.); and *Re Coates et al. and Registrar of Motor Vehicle Dealers and Salesmen* (1988), 65 O.R. (2d) 526 at 536 (Ont. Div. Ct.)

[34] *Bernstein* stands for the proposition that grave charges against a person cannot be established to the reasonable satisfaction of a discipline committee by fragile or suspect testimony. The evidence to establish the charges have to be of such quality and quantity as to lead a discipline committee acting with care and caution to the fair and reasonable conclusion that the person is guilty of those charges. The degree of proof must be nothing short of clear and convincing and based on cogent evidence which is accepted by the tribunal. See *Bernstein* at 485 and *Coates* at 536.”

(b) Supervisory obligations of branch managers

¶ 11 *Re Mills* [2000] IDACD 41 described the supervisory obligations of branch managers as follows (at page 3):

“...paragraph 1300.1 ...requires each member to use due diligence to learn the essential facts relating to every customer and to every account and order that it accepts (the “know-your-client obligation”) and to ensure that recommendations made for any account are appropriate for the client and in keeping with its investment objectives (the “suitability” obligation).

... (the Policy) requires completion of a NAAF for each new account so that the registered representative and supervisory staff are able to “conduct the necessary review to ensure that the recommendations made for any account are appropriate for the client and in keeping with his investment objectives” and to ensure that “all recommendations made for any account are and continue to be appropriate for a client’s investment objective”...

The Policy also obligates branch managers to review ongoing activities in branch accounts. ...The daily review must “attempt to detect, among other things,” lack of suitability, undue concentration of securities, excessive trading activity, inappropriate/high risk trading strategies and quality downgrading of client holdings. In addition, branch managers must inform themselves on other client related matters, such as complaints, undisclosed short sales and trading under margin.”

¶ 12 *Re Mills* establishes that the test to be applied is one of reasonableness (at page 10):

“Did Mr. Mills take the supervisory steps that were reasonably required in light of the information available to him and his obligations under the Policy? The answer...must be based on the facts relating to the accounts, taking into consideration the standards of the industry during the relevant period and the practices followed at (the firm).”

(c) Suitability obligation

¶ 13 The jurisprudence on the “suitability” obligation of a registrant to determine whether an investment is appropriate for a client often includes reference to the Alberta Securities Commission (“ASC”) decision in *Re Lamoureux* [2001] A.S.C.D. No. 613. The decision sets out applicable principles that should guide this panel’s decision and the following lengthy extract (at *Part V (B) (3) (d)*) is apt:

“The obligation to ensure that recommendations are suitable or appropriate for the client rests solely with the registrant. This responsibility cannot be substituted, avoided or transferred to the client, even by obtaining from the client an acknowledgment that they are aware of the negative material factors or risks associated with the particular investment.

The obligation on a registrant to ensure that each investment recommended to a client is suitable is a particularly important protection for those clients whose investment experience and sophistication may be insufficient to enable them to fully recognize or assess the risks inherent in an investment. As noted below, disclosure to the client of the negative material factors of an investment, however important, is not necessarily relevant to a suitability determination and cannot replace a registrant’s obligation to

assess suitability. Acknowledgment on the part of an investor of awareness of the material negative factors or risk does not convert an unsuitable investment into a suitable one.

Our view is consistent with the OSC's decision in *Marchment & MacKay*, supra. There, the OSC considered whether the respondents, who had sent a variety of documents to their clients, could rely on this documentation to satisfy their obligation to ensure that securities sold to their customers were suitable and that they had adequately disclosed to the clients the risks associated with investing in the securities recommended. The OSC, in deciding that the obligation to determine suitability rests with the registrant and cannot be transferred to the client, stated [at p. 4735]:

We reject this attempt to rely on these procedures as an effort to transfer to the customers the burden of determining whether the high risk investments being recommended to them by Marchment salespersons were suitable for purchase by them. The obligation to determine suitability clearly rests with the registrant.

The suitability of an investment product for any prospective investor will be determined to a large measure by comparison of the risks associated with the investment product with the risk profile of the investor. This comparison is probably the most critical element in the registrant's suitability obligation.

Understanding an investor's risk profile is not a simple matter of looking at numbers on an NCAF. Some of the assessments recorded in the NCAFs can have a range of meanings, depending on the context. For example, a wealthy investor indicating a tolerance for "medium risk" might contemplate a tolerance for a larger dollar risk than another investor with a small net worth who selects the same risk category. In neither case does the term make clear what probability of loss is acceptable to the investor. A registrant must truly "know his client".

A risky investment may fit nicely with an investor who has an appetite for risk, the ability to understand the risks associated with an investment product and the capacity to withstand the potential additional outlays or losses associated with the investment. The same product would, however, be inappropriate for an investor with less appetite for risk, less investment sophistication or less capacity to withstand the potential loss.

During this hearing, it was suggested that these Partnership investments failed as a result of fraud and that, but for that fraud, they would have been successful and therefore, suitable investments. There was insufficient evidence for us to reach any conclusion as to what led to the failure of these Partnerships, but we reject any suggestion that the subsequent performance of an investment or the actual reasons for its success or failure are relevant to the suitability assessment.

As the OSC stated in *Re Dime*, supra, [at p. 2693]:

It is no answer to say that none of the intended customers lost any money. The credibility of the securities markets is damaged - perhaps irrevocably, as to each of the complaints in this case - by conduct such as Dime's.

A registrant's obligation is to "know his client" and to ensure that any recommendations made by them are appropriate for the client based on the factors, both negative and positive, reasonably known to a diligent registrant at the time the investment is contemplated. Only those factors that are reasonably foreseeable at the time the investment is contemplated are relevant to the suitability determination. If a suitable investment actually fails due to some unforeseeable circumstance, that does not retroactively make it an unsuitable investment. If an unsuitable investment is recommended by a registrant, the fact that the investment is in fact proven to be successful does not retroactively make it suitable. It would be improper and unreasonable to assess a registrant's performance of his duties, which arise at the outset, in light of subsequent unforeseeable events."

¶ 14 In *Re Gareau*, [2011] IIROC No 53 at page 7, the panel succinctly articulated the suitability obligation as follows:

“The salient points concerning the “suitability” obligation can perhaps be stated as follows:

- The obligation rests solely with the registrant and cannot be transferred to the client.
- The obligation is a particularly important protection for clients whose investment experience and sophistication is limited.
- An investor’s risk profile is not simply a matter of looking at numbers on an NCAF.
- The “know your client” and “suitability” obligations must be measured at the time the investment is contemplated. It is not measured in light of subsequent unforeseeable events of either a positive or negative nature.

...

In determining the obligations of investment advisors the courts and regulatory bodies have not limited themselves only to a consideration of the rules of the respective regulatory body. In addition, fiduciary obligations imposed by general common law have been relied upon. Again, the *Lamoureux* case addressed this issue by reference to a Supreme Court of Canada decision. The ASC panel stated at Part IV (B) (2) the following:

Determining whether a registrant has satisfied their regulatory obligations in relation to an individual client depends upon the particular circumstances of each case. It requires close analysis of the client’s situation and the relationship between the registrant and the client. Both the fiduciary and the regulatory obligations of a registrant may be more or less onerous depending upon the extent of the client’s reliance upon the registrant.”

The Supreme Court of Canada discussed the issue in *Hodgkinson v. Simms et al.* (1995) 117 D.L.R. (4th) 161 saying [at p. 183]:

...in *Varcoe v. Sterling* (1992), 7 O.R. (3d) 204, ...in an effort to demarcate the boundaries of the fiduciary principle in the broker-client relationship. Keenan J. stated, at pp 234-36:

The relationship of broker and client is not per se a fiduciary relationship...Where the elements of trust and confidence and reliance on skill and knowledge and advice are present, the relationship is fiduciary and the obligations that attach are fiduciary. On the other hand, if those elements are not present, the fiduciary relationship does not exist... The circumstances can cover the whole spectrum from total reliance to total independence. An example of total reliance is found in the case of *Ryder v. Osler, Wills, Bickle Ltd.* (1985), 49 O.R. (2d) 609, 16 D.L.R. (4th) 80 (H.C.J.). A \$400,000 trust for the benefit of an elderly widow was deposited with the broker. An investment plan was prepared and approved and authority given to operate a discretionary account... At the other end of the spectrum is the unreported case of *Merit Investment Corp. v. Mogil*, Ont. H.C.J., Anderson J.. March 23. 1989 [summarized at 14 A.C.W.S. (3d) 378] in which the client used the brokerage firm for processing orders. He referred to the account executive as an “order-taker”, whose advice was not sought and whose warnings were ignored.

...

The relationship of the broker and client is elevated to a fiduciary level when the client reposes trust and confidence in the broker and relies on the broker’s advice in making business decisions. When the broker seeks or accepts the client’s trust and confidence and undertakes to advise, the broker must do so fully, honestly and in good faith. ... It is the trust and reliance placed by the client which gives the broker the power and in some cases, discretion, to make a business decision for the client. Because the client has reposed that trust and confidence and has

given over that power to the broker, the law imposes a duty on the broker to honour that trust and respond accordingly.

In my view, this passage represents an accurate statement of fiduciary law in the context of independent professional advisory relationships, whether the advisers be accountants, stockbrokers, bankers, or investment counselors. Moreover, it states a principled and workable doctrinal approach. Thus, where a fiduciary duty is claimed in the context of a financial advisory relationship, it is at all events a question of fact as to whether the parties' relationship was such as to give rise to a fiduciary duty on the part of the advisor.

¶ 15 This panel considers further reference to the reasoning in *Re Lamoureaux* on this subject to be apposite (at page 10):

“La Forest J. continued [at page 184]:

Apart from the idea that a person has breached a trust, there is a wider reason to support fiduciary relationships in the case of financial advisors. These are occupations where advisors to whom a person gives trust has power over a vast sum of money, yet the nature of their position is such that specific regulation might frustrate the very function they have to perform. By enforcing a duty of honesty and good faith, the courts are able to regulate an activity that is of great value to commerce and society generally.”

Similarly, in *Burke v. Cory* (1959), 19 D.L.R. (2d) 252 (Ont. C.A.), Schroeder J.A. [at p. 258] in quoting the trial Judge Gale said:

Because of the nature of the defendant's business and because he endeavored to induce the plaintiff to believe that he had exceptional skill and ability to furnish valuable advice in respect of shares to be bought and sold, a different and special relationship was, to my mind, developed; one, which required the defendant to advise fully, honestly and in good faith when undertaking to either give advice or proffer recommendations.

The Ontario Court of Appeal in *Maghun v. Richardson Securities of Canada* (1987), 58 O.R. 92d) 1, finding that a broker had undertaken to advise a client what to do and knew the client was looking to him for advice and guidance, discussed the duties of the broker [at p. 15]:

The duty resting on a stockbroker or commodities future trader who stands in the position of a fiduciary to his client is to advise the client carefully, fully, honestly and in good faith and to carry out the client's intention. He must exercise care, skill and diligence in the transaction of the business entrusted to him and is liable for the loss resulting from his failure to do so.

In considering an action brought by a retired couple against their former brokers, the Court of Appeal for British Columbia in *Rhoads v. Prudential-Bache Securities Canada Ltd.* [1992] 2 WWR 630 (B.C.C.A.) said the following [at p. 635 - 6]:

A stockbroker who merely makes sales and purchases on the instructions of clients may well have no responsibility for the wisdom of the transactions involved. The broker may, if asked, agree to give opinions on purchases or sales, and may make it apparent to the client, if not already well understood between them, that these constitute no more than personal opinions, and are not in the nature of considered investment advice. Where, however, as here, the firm and its employees seek to enhance their business by offering guidance to would-be investors - on “growing and managing retirement wealth” and “keeping investments safe,” and to serve in “ways that no one else can” through the advice of “two financial advisors with 22 years of combined investment and taxation experience” - they must expect that their advice may be relied on as that of skilled, independent professional advisors. Stockbrokers who carry on business in this way accept responsibilities beyond those involved in bringing together buyers and sellers. They undertake the duty of providing careful, competent, considered professional advice of a

sort in which clients, especially those who have no experience of their own to guide them, may well place their complete reliance.

...

In such circumstances a financial advisor must be taken to assume duties similar to those of any other professional advisor - doctor, accountant, engineer, lawyer - in the sense of being obliged to take reasonable steps to ensure that customers or clients are aware of the available options, and of the main potential benefits and risks associated with them.

The Ontario Court of Justice - General Division in *Nesbitt Thomson Deacon Inc. v. Haupt*, [1992] O.J. No. 552 [at p. 6] discussed the duty of care owed by a registrant in advising a client:

The relationship between a stockbroker and customer is one of simple agency in the first instance. The broker's primary duty is to carry out the instructions of his client. His remaining obligations are few and simple: like any agent, he has a duty to act in the interests of the principal and is not permitted to allow personal interest to conflict with the interest of the principal unless this is done with the full consent of the principal. But, like any relationship it can evolve into more varied or complex duties and responsibilities, both in scope and intensity.

If a stockbroker, in his arrangements with his customer, undertakes to provide advice or does provide advice with respect to transactions within the customer's account, the stockbroker then has imposed on him a duty to advise fully, carefully and honestly and will be liable if he does not, although this is qualified to the extent that he will not be liable for honest errors in judgement.

...

We noted that fiduciary and regulatory obligations are not identical. A registrant who would not be in a fiduciary relationship at common law is, nonetheless, generally obliged to conform to Policy 3.1 unless formally relieved of that obligation. Grounds for such relief may parallel the common law assessment of the fiduciary nature of a relationship. For example, some limited service "discount brokers" have recently obtained discretionary regulatory exemptions from some of the obligations imposed by Policy 3.1 in cases in which those registrants and their clients have agreed that the registrants will not provide advice or recommendations to their clients. In the circumstances more likely to prevail between registrants and typical "retail" clients, the extent of the regulatory obligations imposed by Policy 3.1 will vary according to the degree to which clients reasonably place their reliance upon and trust in the registrant. In our view, the regulatory obligations imposed by Policy 3.1 are at least as extensive as the fiduciary duties imposed by the common law in these circumstances.

¶ 16 *Re Lamoureux* (at page 13) also holds that the "know your client" and "suitability" obligations while conceptually distinct are closely connected in practice, such that the former is the obligation to learn about the client, their personal financial situation, financial sophistication and investment experience, investment objectives and risk tolerance. The latter is the obligation to determine if an investment is appropriate for a particular client and assessment of suitability requires both that the registrant understands the investment product and knows enough about the client to assess whether the product and client are a match.

¶ 17 *Re Lamoureux* explains that suitability is to be assessed prior to making a recommendation to a client and involves a three stage process:

1. The first stage is the due diligence steps undertaken by the registrant to know the client and to know the product.
2. Apply sound professional judgment to the information elicited from state one and make a reasonable determination whether specific investment products are suitable for that client.
3. The third stage obliges him to make the client aware of the negative material factors involved in the transaction as well as the positive factors. (at page 18)

¶ 18 In *Re Foresight Capital Corp.* [2007] BCSECCOM 101, the Commission quoted with approval in support of the proposition that risk must be objectively, not subjectively assessed, the following extract from *Re Bilinski* (2002) BCSECCOM 102)

...Risk assessment cannot be based on the principal's or the registrant's optimism in the venture or themselves. Assessment of risk must be based on a realistic and objective assessment of the circumstances of the investment and the investor. Clients are entitled to receive from their registrant an objective assessment of risk... (para 346).

¶ 19 *Re Lamoureux* held that determining whether the registrant met the "suitability" requirement depended on the facts of each case with specific regard to the client's situation and his relationship with the registrant and noted the distinction but also overlap between a registrant's common law fiduciary obligations and his regulatory obligations.

¶ 20 *Re Lamoureux* (at page 18) held that a proper assessment of suitability will generally require consideration of such factors as a client's income, net worth, risk tolerance, liquid assets and investment objectives as well as an understanding of particular investment products. The registrant must apply sound professional judgment to the information elicited from the "know your client" inquiries.

¶ 21 The ASC in *Re Lamoureux* agreed with the description of the suitability obligation stated as follows in *Re Forester* [1997] LNBCSC 26 at page 13:

The second step in complying with the know your client rule is determining that the proposed investment is suitable for the client, that is, that it will achieve the investment objectives of the client while keeping within the level of risk dictated by the client's comfort level and overall circumstances."

¶ 22 *Re Lamoureux* (at page 20) further held that the suitability of an investment product for any prospective investor will be determined to a large measure by comparison of the risks associated with the investment product with the risk profile of the investor. This comparison is probably the most critical element in the registrant's suitability obligation.

(d) *Trading on margin as it relates to suitability*

¶ 23 On the subject of margin, in *Re Daubney*, (2008) 31 OSBC 4817, the OSC stated at paragraphs 24-25 that the leveraging strategy recommended by the registration was part of the "product" and that when leveraging is recommended, i.e. borrowing money to invest in a recommended product, a registrant is obligated to assess whether the client's circumstances are such that they have the ability to meet debt obligations and tolerate losses under different market scenarios. It further stated that because leveraging can magnify losses, it is critical that the registrant ensures the client understands the risks of borrowing to invest, in particular the risks of using collateral, including investments made with monies borrowed as security for loans.

(e) *Discretionary trading*

¶ 24 In *Re Phillips*, [2011] IIROC No. 34, (at para 61) the panel decision adopted the meaning of discretionary trade set out in *Re Wenzel* [2005] A.S.C.D. No. 153 in which the ASC stated that:

"when a person effects a securities transaction for a client without obtaining from the client, in advance, specifics as to four elements of the transaction- quantity, security, price and timing- that person is exercising "discretion". (para 26)

POSITIONS ASSERTED BY THE PARTIES

(a) *IIROC's position on Counts 1, 2 and 3*

¶ 25 As to Count 1 against Floyd, IIROC counsel submitted that the evidence established the following:

1. Stokes relied on Floyd's advice and all of the holdings in the account were recommended by Floyd.
2. The holdings in the account were off side the stated investment objectives on the NCAF.

3. The initial purchase of BCE shares was for such a large amount and represented such a high percentage of the Stokes Account that it increased the risk in the account to such a point that the account was unsuitable for Stokes because the account was overly concentrated in one security.
4. The subsequent extensive use of margin was unsuitable for Stokes.
5. Subsequent purchases of BCE shares were unsuitable for Stokes because of overconcentration in that security.

¶ 26 As to Count 2 against Floyd, IIROC counsel contended there were three specified transactions (see paragraphs 35, 36 and 45 of the SOP) where Floyd used discretion as to the timing, price and amount of shares to purchase.

¶ 27 As to Count 3 against McDonald, IIROC counsel submitted that the evidence established the following:

1. The holdings in the account were off side the stated investment objectives on the NCAF.
2. There are no documented inquiries about any purchases made in the Stokes' account when the purchases were clearly contrary to the account objectives on the NCAF.
3. At no point did McDonald contact Stokes to discuss any of the activity in his account.
4. McDonald authorized the opening of a margin account and made no queries about the extensive use of margin when margin use - or at least the amount of margin used - was clearly contrary to the account objectives on the NCAF for the Stokes' account.

¶ 28 IIROC counsel further argued that Stokes had clearly reposed trust and confidence in Floyd and relied on Floyd's advice requiring more diligence than a mere agency relationship. IIROC counsel did not dispute that the information about Stokes and recorded on the NCAF was consistent with Stokes' expressed expectations, but contended Floyd's recommendations did not meet the suitability requirement.

¶ 29 IIROC counsel contended that introducing a product option to a client and then securing the client's agreement does not render an unsuitable product suitable. IIROC counsel contended that the objectives recorded in the NCAF were consistent with Stokes' contention that he wanted secure income for retirement and that if the intention was for aggressive active trading or solely to purchase the BCE shares it could have been noted on the NCAF. The Respondents disagreed.

(b) Position of Floyd on Counts 1 and 2

¶ 30 Floyd tendered his written submissions and a joint rebuttal submission with McDonald. Floyd denied any contravention of Rules 1300.1(q) or 1300.4 on the following bases:

1. Stokes was a knowledgeable and sophisticated investor who was actively involved in the determination of trades made on his account.
2. Floyd knew Stokes very well from their pre-existing social relationship during which interval, Stokes was educated about and adopted Floyd's aggressive and unconventional style of investing.
3. At the date of completion of the NCAF, the intention of Stokes was not to open a portfolio investment account.
4. All trades were made with Stokes' knowledge and consent and the wording on the Transaction statements advises the client that any irregularities must be communicated to Union within 10 days of receipt of the statement.
5. Stokes' losses were all due to unforeseeable global market conditions that resulted in worldwide market meltdowns.

6. The culture in the Union office in Edmonton was that of a small closely knit community in which all the brokers and the supervisor were well informed of the nature and extent of each other's client trades practices.
7. McDonald reviewed the accounts daily.
8. As to opposing versions of the relevant events, Floyd was more credible than Stokes as the latter's evidence was inconsistent and unreliable.

(c) *Position of McDonald on Count 3*

¶ 31 The Respondents say that the nature of the Union office in Edmonton was small such that it permitted regular dialogue between McDonald and the RRs including Floyd, that there had been discussion of the initial purchase of blue chip stock, McDonald reviewed accounts daily and the Union compliance department reviewed the transactions and “had no problems with the situation”.

¶ 32 McDonald argued that the case at hand is distinguishable from *Mills* in that Mills was an “aggressive momentum trader” who emphasized resource issuers and ...only took active accounts that suited his trading style. McDonald said that although Floyd, if his style was aggressive at times, was keen to recommend stocks that were not highly speculative, he often dissuaded clients from investing if he thought it inappropriate for that person, here there was no evidence of churning or no unusual trading activity considering the environment of the day and the client objectives.

¶ 33 McDonald argued that talking to Floyd was the extra step said by *Re Mills* to be required. Further he argued that more supervision would have changed nothing once he had confirmed with Floyd that “BCE was a specific idea” and since he had met Stokes twice, there was no need for further communications.

(d) *Joint Rebuttal Position of Respondents*

¶ 34 The Respondents claim Stokes was a sophisticated business person even if the relationship was “evolving” and contend it was the most basic of agency relationships. The Respondents point to the language in his emails, the testimony, his professional work, his explanation of various sophisticated concepts, his comfort at filing his own tax returns and his ability to say when he relied on Floyd and lacked knowledge when it suited him to do so.

¶ 35 On the issue of which party originated the trades, in response to IIROC's contention that it was Floyd in every case; the Respondents say Stokes effectively did so as he was copying Floyd's strategy which he had learned about during the previous year's social relationship.

¶ 36 The Respondents repeated that Stokes wanted to engage in the “obvious turmoil” and like Floyd, perceived the opportunities to make money. They further contend that a good registrant must respond quickly in the dynamic business of investing and that the relationship had evolved more quickly than was reflected in the documentation. As to the initial BCE trade, they responded that as Stokes was copying Floyd's investment style designed to profit from market downturns by “bottom feeding”, Floyd was obligated to take Stokes' instructions for that order or he would be wrongly exercising discretion contrary to the Regulation. The Respondents responded that no one foresaw that the market would drop as far as it did in the fall of 2008 and Stokes' losses were due to failure to stay in the market until it recovered which it would have done in time. In response, the Respondents claim that BCE was an entirely suitable product and cited its storied history, some of its well respected board directors, and Floyd's contact with other investment professionals and disagreed with IIROC counsel's position on the intention to be derived from the objectives listed in the NCAF.

¶ 37 It is noted by this panel that in anticipation of this argument by the Respondents IIROC cited *Rhoads*, *supra*, in which registrants argued that the October 19, 1987 “Black Monday” market collapse was “unique, unpredictable and an unpredictable catastrophe which affected all stock market investments, ... and against which they could not have been expected to warn. IIROC noted that the court in *Rhoads* concluded that it was readily foreseeable to the registrant but not to the client that if the client were to invest in equity market funds they were advised to buy that there might be a market downturn that result in a substantial capital loss for them, loss well

beyond what they would have suffered if they invested in income based mutual funds and that no loss at all would probably be suffered if they continued to keep their money on deposit under investment certificates at the bank. The court also found the market downturn was a danger from which the client was entitled on the basis of their instructions as found by the trial judge to be protected and from which the registrant could and should have protected them by advising them not to invest in the equity market at all. (at page 8-9)

¶ 38 At page 9 the court noted that the trial judge was entitled to conclude that the loss suffered by the client when he decided in the absence of advice to sell everything flowed directly and foreseeably from the negligence of the registrant in giving the advice originally given and failure to provide appropriate advice thereafter ... (but was nothing) other than an effort on their part to effect reasonable mitigation of their losses.

¶ 39 IIROC counsel also cited *Re Daubney (supra)* which held at paragraph 205 that the registrant's recommendations were unsuitable in that his testimony that he would advise investors to "run to cash" in the event of a market downturn was aimed at calming their concerns of having excessive leverage and in practice he could not execute that part of the strategy.

REASONS FOR DECISION

(a) *Preliminary applications to dismiss*

¶ 40 McDonald applied to dismiss the case against the Respondents on two grounds. First, he alleged defective service by reason that Notice of the Hearing was not delivered by registered mail. Second, he sought dismissal due to lack of timeliness of prosecution of the charges. This panel was informed on May 16, 2012 that the notice of hearing had been confirmed to proceed on July 17-20, 2012 with the Respondents represented by counsel.

¶ 41 Rule 5.2 of the IIROC Rules of Practice and Procedure (ROP) dated January 2010 provides:

A Notice of Hearing shall be served by one of the following methods:

- (a) by personal service on the Respondents
- (b) by delivering a copy of the Notice of Hearing by registered mail to the Respondent's last known address as recorded in the Organizations' Registration file; or
- (c) where a Respondent is represented by counsel, by delivering a copy of the Notice of Hearing to the Respondent's counsel with the consent of counsel.

¶ 42 A new Notice of Hearing was issued June 13, 2012 for the dates of October 1-4, 2012. The Panel was informed by IIROC counsel on July 26, 2012 that Friday (July 27, 2012) was scheduled for a conference call with the panel because the then counsel for McDonald advised he was not available for the October hearing dates and would not be acting; and to hear a request from McDonald for a new hearing date because his new prospective lawyer was not available during the first week of October. That conference call was cancelled because that lawyer was not able to confer with McDonald before July 27, 2012.

¶ 43 IIROC counsel contended that he had served the Notice of Hearing on counsel for both Respondents and had emailed notice of the hearing to both Respondents. It appeared from the communications transmitted to this panel in advance of the hearing that McDonald was represented by counsel at the date the Notices of Hearing for the July dates and the October dates were issued. He admitted personally having received service of the notices of hearing by electronic mail. In these circumstances this panel denies the application to dismiss based on defective service.

¶ 44 As to lack of timeliness, the Respondents were aware that the initial complaint was made to IIROC on December 8, 2008 (IIROC binder 1, Tab 8) and that IIROC was investigating from that date to March and April of 2010 as at those times they each gave oral compelled statements. (IIROC binder 2, Tabs 1 and 2) A Notice of Hearing was initially issued for July 17-20, 2012 with the Respondents represented by counsel but the hearing date was adjourned to October 1-4, 2012 at which dates the Respondents appeared and represented themselves, with McDonald having a legally trained friend in attendance to assist him with documents.

¶ 45 **This panel found nothing in the Rules that stipulates the time period within which an investigation must be undertaken.** There was no evidence that pending the investigation the Respondents were prevented from carrying on their businesses. There was nothing presented in the evidence to suggest the Respondents were misled to the belief that the investigation would no longer proceed or that the Respondents were otherwise prejudiced. This panel was satisfied that the adjournment from July to October 2012 proceeded with the Respondents' consent. Having regard to these factors, we deny the application for dismissal of the charges due to laches.

(b) *Allegations of Breach of Duty of Fairness*

¶ 46 The Respondents contend there is evidence that Stokes falsified a document by backdating a complaint to imply it had been sent earlier than it had been generated and this evidence should have been presented by IIROC. The Respondents also contend that IIROC should have complied with their demand for Stokes' income tax returns for the purpose of revealing any bankruptcy, capital losses, gains or recaptures which the Respondents say would have been pertinent to this hearing in that they would show the tax losses offset the capital gains.

¶ 47 Floyd claimed in his written submissions on the first point that Stokes' original complaint letter was sent to Union on December 2, 2008. He then noted that in one of Stokes' responses in the complaint process Stokes' contended that he responded earlier than December 2, 2008 and then attached a letter with a date of November 10, 2008. Floyd's contention seemed to be that the latter was the same letter that Union received on December 2, 2008 which was backdated by Stokes and which evidences deceit. Floyd did not reference a tab number in IIROC's or his written materials that contained a copy of the November 10, 2008 letter nor did this panel find the letter in question attached to the Respondents' supplementary filed materials. However this panel located in IIROC binder #1 at tab 4 a letter from Stokes to Floyd with a copy to McDonald and Martin Lang ("Lang") which bears no date. This panel can conclude only that that document may have been the letter Floyd was referencing. This panel has insufficient evidence to determine whether Stokes sent a letter without a date and while attaching it to a subsequent letter, noticed the date was missing and added it then, or whether he intentionally backdated it to enhance his credibility.

¶ 48 The Respondents claimed that IIROC counsel ought to have called Lang, the compliance officer of Union, given his dealings with Stokes and if Lang had been called he would have testified that Stokes had lied about backdating a document. The Respondents say the cost of calling Lang as their own witness, were he to agree would prove prohibitive.

¶ 49 Stokes did not admit in cross examination to any such backdating. On the evidence before this panel, there was no probative evidence of intent to mislead Union or IIROC or this panel on this issue and other than a potential question as to Stokes' credibility, this panel concluded that this issue had no material bearing on the issues in the hearing or IIROC counsel's conduct of the prosecution.

¶ 50 Without deciding whether IIROC or Stokes had an obligation to produce tax returns to evidence whether Stokes formally declared bankruptcy, or enjoyed capital gains or losses or incurred capital losses, given that he had purchased Mavrix, a tax driven investment, this panel concluded that such omission was not relevant to the issues in the hearing since the test of suitability must be applied at the time of the trades in question and are not to be evaluated on the basis of success or failure of the result. As a result, this panel rejected the contention that IIROC failed in any duty of fairness in declining to produce the alleged backdated letter or the tax returns, if requested, as alleged.

(c) *Extraneous considerations*

¶ 51 This panel received in the Respondents' joint submission reference to certain correspondence that passed between Stokes' legal counsel and the Respondents after the oral hearing concluded but before the decision was rendered. This panel considered such evidence as inadmissible and irrelevant to the hearing and the contents and effect of such correspondence were disregarded in its deliberation and in reaching its conclusions.

(d) *Whether Stokes was a sophisticated investor*

¶ 52 The evidence established that Stokes held an engineering degree, was a specialist in information technology, a resident of Kelowna, British Columbia and working temporarily in Edmonton on a private consulting contract when he became acquainted with Floyd in a social gathering of friends who met approximately weekly for dinner and drinks typically at a local restaurant. His investment experience at that time consisted of having a financial manager at TD Waterhouse manage RRSPs and locked in retirement amounts invested 100% in mutual funds, the contents of which he had never examined and which totaled around \$140,000. He had clear title to a jointly owned home with his common law wife valued at about \$650,000. He had a line of credit on his bank account. He used a software program to file his income tax returns. He had never hired a stockbroker and said the extent of his understanding of the stock market was that stocks go up or down in price depending whether the company had money. He had never had common or preferred shares in his account. He denied any accounting or investment expertise at the time he met Floyd, sometime in 2007, when he was nearing age 60.

¶ 53 Stokes recalled that after he met Floyd at the dinners, Floyd explained his job, explained that he had been in the business for 42 years, what he could do to help people and sounded credible. Stokes drove Floyd to some of the dinners and said that Floyd was an enthusiastic market participant and liked to talk about the stock market business. Stokes told Floyd he planned to retire at age 65.

¶ 54 When they met, Floyd had been a licenced investment advisor since 1968, had taken a Canadian Securities course, worked at a stock and bond trading desk, trained at Merrill Lynch, and had 27 clients, mostly corporate and institutional, experience with large transactions and a \$12 million book of business. Floyd testified that he had experienced in 1974 market conditions similar to those of September and October of 2008.

¶ 55 When initially cross examined at the hearing about any prior disciplinary history with IDA, and whether as a result he had been fired, Floyd testified that he did not recall. When his memory was refreshed, Floyd conceded he had been twice disciplined for discretionary trading without prior authority and fined on each occasion but could not recall the dates. He admitted that in one instance he had asked his employer to be suspended, but instead was fired.

¶ 56 Floyd and Stokes both agreed that as a result of the regular social restaurant dinners, they formed a personal friendship. Floyd testified that he told Stokes he was a stockbroker and at the dinners, he made no secret of his business. In about December 2007 he would state his opinion that there was too much pessimism in the market and this was the time to be aggressive and bold. He said he thought everyone in the group agreed. He began to discuss with Stokes his views about EPCOR stock and about 6-9 months into the relationship, Floyd raised the subject of BCE with Stokes.

¶ 57 Stokes recalled that in their discussions, Floyd was very dominant, always angling for Stokes to invest and subtly soliciting his business. However, Stokes formed no intention to use Floyd's services until his parents fell ill. When he found he was about to come into an inheritance he informed his restaurant friends. He said his bank manager advised him to talk to an investment advisor at TD Waterhouse about any desired plans. Stokes testified that Floyd, as a friend, convinced him that he should not invest his inheritance in mutual funds but instead it should go into new securities. Stokes understood from the discussions with Floyd that this route presented minimal risk to build sufficient funds to retire at age 65. He said Floyd suggested Stokes open an account with him. Stokes did not recall Floyd discussing his other clients other than generally and Stokes did not inquire if any of the other dinner attendees were clients of Floyd. He did not recall Floyd stating he acted for corporations or discussing his own portfolio. He did not recall Floyd discussing the effect of interest rates, or that he held BCE stock or had a margin account and was using it to leverage his stock position. He had no recall of discussing with Floyd any of Stokes' own ideas about stocks to buy, investment ideas of his own or wanting to take advantage of short term profits.

¶ 58 Floyd's evidence was that when Stokes advised him about his pending inheritance, Floyd told him he had a similar family estate money situation and what he was doing with his inheritance. Floyd recalled this discussion ensued for a couple of months. He said in due course Stokes told Floyd he wanted to do the same

with his inheritance and asked if he could do it at his bank. Floyd advised that he could do so but his firm was open for business and Floyd needed to generate commissions.

¶ 59 Stokes contended that in this phase of the relationship, Floyd solicited his business. McDonald thought that Floyd probably solicited Stokes' business. Floyd denied such solicitation claiming he had merely expressed his views to the restaurant group. Later in his evidence however Floyd agreed that he had suggested the purchase of BCE stock before the account was opened.

¶ 60 Floyd also offered evidence of his method of bringing in business. When making a recommendation, suggestion or idea, he did so to give the client a feel for the stock because the price fluctuating and business reports such as on the internet would show patterns, such as a "double bottom". He said he educated Stokes to understand that a low price does mean a bad company because that would be where the value was. He said Stokes agreed. Floyd said he would not solicit or recommend but would buy stocks at the low end of the cycle when they came down in price but not value. Floyd testified that he believed in his statements and as a result his clients, including Stokes, trusted him. He explained to Stokes that a shareholder was a part owner of a company and Stokes would pick up knowledge from Floyd and from watching BNN.

¶ 61 McDonald had met Stokes only once on a social occasion and could not recall if that date was before or after Stokes had become a firm client. Clearly McDonald had no helpful first-hand information of the level of sophistication of Stokes as an investor.

¶ 62 The Respondents cite *Re Shanks*, and *Scotia McLeod Inc. v. Relova ("Scotia McLeod")* in support of their contention that Stokes was a sophisticated investor. One of the issues in *Re Shanks* was the extent of the client, Grue's investment knowledge, objectives and risk factors. Grue could not remember what he told the registrant Shanks were his investment objectives at the time the account was opened. The evidence was that he gave instructions to Shanks or his accountant to see if stocks should be sold to generate capital losses to offset his capital gains and he prepared a trading analysis from his confirmation slips using an excel spreadsheet which analysis was used at the hearing.

¶ 63 Prior to opening the subject account Grue had participated in at least two private placements for start-up ventures and had made two purchases of speculative securities in the CCC account on the basis of hot tips from friends and business acquaintances. Grue testified that the money he deposited in the CCC account was extra cash on which he was getting only 1-2% at the bank and wanted a return in the range of 10-15%. Shanks said Grue was constantly asking Shanks for "hot tips" and that Grue told him the funds provided were excess cash.

¶ 64 The Committee found as facts that Grue was not seeking a balanced portfolio in his account but wanted to take more risk to get a better return and the funds were not viewed by Grue as part of his retirement funds. The Committee noted that both counsel agreed that trading in speculative securities was not suitable if the client was unsophisticated even if the client expressly requested those types of trades. The Committee found that Grue was not an unsophisticated investor and had the necessary sophistication to understand both the trading strategy and the use of margin.

¶ 65 On the matter of another account with a client named Bailey, the issue was whether oil and gas income trusts were high risk and if so outside the stated objectives of the clients who were conservative investors and did not want high risk or speculative securities. The Committee ultimately concluded they were a medium risk and that for Bailey to obtain the higher income he desired it was necessary to introduce an element of risk either through an equity mutual fund or a basket of income trusts and that Shanks set out in a letter both alternatives and a rationale for choosing energy trusts over an equity mutual fund. The Committee found that the letter from Shanks was a reasonable explanation of the risks involved and that Bailey with his background would have understood that the income trusts were not risk free and that he accepted the additional medium risk security. Further the Committee accepted Shanks' evidence that he contacted the Baileys to advise that they would have to either sell the income trusts or revise the NAAF which correctly reflected the Baileys' original investment intent and thus the purchase was appropriate given their investment objectives.

¶ 66 This panel finds that the facts in *Re Shanks* are distinguishable from the case at hand. There the Committee did accept Grue's evidence and concluded based on his conduct that Grue was a sophisticated

investor. Those facts do not match the case at hand. In respect of Bailey, the evidence of Shanks showed that he clearly set out in a letter the risks attendant upon purchase of a medium risk security which the Committee found Bailey with his investment experience was able to understand. As well, Shanks advised the client in advance that they would have to sell or revise the NAAF. This panel found no evidence that Floyd ever gave such advance warnings of risks or options to Stokes.

¶ 67 In *Scotia McLeod*, Relova was a successful trader on the Chicago Mercantile Exchange through the plaintiff in futures and was caught in a market collapse in October, 1989 as a result of which he had to pay his liabilities in excess of lodged securities and margin. He denied the indebtedness and claimed the losses occurred by reason of undue influence of Parker, an executive of the Plaintiff who handled the account. There was also an allegation of breach of fiduciary duty in failing to give proper advice.

¶ 68 The court noted that the trader in futures is gambling, who bets on the rise and fall of the market and the broker with access to information as to the economic trends gives him the form. The court noted that Relova showed himself to be an astute player in the futures market and as he had been gambling in this market in 1985 he was not inexperienced in a financially dangerous game when he first heard Parker give one of his daily radio market reports. At their first meeting Relova used business jargon which indicated he was familiar with trading in futures, as the court found he was. As well, the court noted that Relova had another like account with another brokerage firm where he was represented by one Stephen Lo. Although Relova alleged that when the account was opened Parker induced the Defendants to enter into it without pointing out the dangers, but the Court concluded instead that Relova was well aware of what he was doing. The court found that Relova, despite endeavoring to portray himself as a babe in the woods, was on the contrary, a shrewd operator in the market, an informed gambler who employed a reasonable “system, averaging his positions up and down as he thought best from time to time, and refraining from excitement at temporary setbacks. The court found that Parker did not talk to Relova and seek new instructions and an increased margin when the potential for loss approached \$50,000 but such failure did not amount to negligence in the case of a customer who has shown himself to be an astute and fortunate operator in the market. The court noted that it may well be that a stockbroker who takes it upon himself to advise his customers as to his purchases and sales in the market could become a fiduciary to his customer. The court found that Relova was well aware of the pitfalls of trading in futures and gave his own orders to Parker. On occasion Parker proffered advice but it was not always taken. Parker exercised no discretion but simply gave information and followed instructions. On one occasion at least he suggested Relova slow his trading activities. The court found Relova was vulnerable to the market in which he was operating himself, rather than vulnerable to Parker. The court also said if Relova was led astray at all, it was by his own cupidity which has his success in playing the market game to be almost habitual, became a dominant factor.

¶ 69 This panel finds the facts of the *Scotia McLeod* case entirely distinguishable from the case at hand given that Relova was held to be in essence an order giver, and as Parker was merely an order taker, there was no duty of care, fiduciary or otherwise. Stokes had little previous market experience, and this panel is satisfied that the subject of opening the client account, opening the margin account, buying and holding the BCE shares, buying more BCE shares and every potential trade was introduced to Stokes by Floyd. In our view Stokes would never have initiated even one of these steps without Floyd’s counsel.

¶ 70 This panel does not accept the contention that Stokes was a sophisticated investor at the material times, despite his professional background, his interest in the stock market as Floyd’s student after Floyd befriended him, and the fact that he may have been a quick study. We are of the view that Stokes fell under the impression that because he and Floyd had become personal friends, Floyd would take special care with Stokes’ inheritance to ensure that he would fulfill Stokes’ wish to have sufficient funds in his account for a steady income stream at age 65. This panel concludes that Stokes reposed his full trust in Floyd during the course of that year before the account was opened, and believed based on statements that Floyd made to him that he would earn more money putting it under Floyd’s management than if he kept it with his financial advisor at TD Waterhouse.

¶ 71 This panel concludes from the testimony given by both Stokes and Floyd as to their social relationship prior to opening the cash account that Floyd knew, or should have known, in all the circumstances that Stokes was relying on Floyd’s experience and stated skills and Floyd’s bold statements that following his advice had

been proven in previous cycles to be the smart thing to do. Moreover this panel accepts on the consideration of the oral testimony of both Stokes and Floyd that following the opening of the cash account, Floyd knew and intended that Stokes trust him in respect of trading decisions. Thus while Stokes likely demonstrated to Floyd an appetite to gain profits from stock purchases that Floyd was raising for discussion, there is no evidence to suggest that Floyd had included in his “education” of Stokes or that Stokes had learned on his own that he must understand the risks associated with any stock purchases or what was his capacity for added outlays or short or medium term losses. There was nothing in the evidence to suggest Floyd had cautioned Stokes of any risk that following his advice may result in losses in the near term, or at all.

¶ 72 This panel does not accept Floyd’s evidence that he did not solicit Stokes’ account. This panel noted that he was evasive in answering this question in his compelled statement. In testimony, he stated that he had “merely expressed his views” at the restaurant gathering. Instead, this panel accepts the evidence of Stokes on this point which is more consistent with the other evidence of Floyd, the evidence of Stokes and the evidence of McDonald.

¶ 73 Considering the foregoing, this panel concludes that Stokes’ conduct does not fit the category of an “order giver” like Relova who did not consistently seek, alternatively, who ignored his investment dealer’s warnings. In our view this case is elevated to the fiduciary relationship because Stokes reposed trust and confidence that Floyd’s securities acquisition philosophy, albeit aggressive, would be applied with such expertise that that Stokes, as his friend, would be protected from any unreasonable risk of loss. Although he denied that he undertook to advise, but instead claimed he was just giving ideas or suggestions or recommendations, the evidence indicated that Floyd gave Stokes only selected information always to substantiate his previously expressed positions. This panel is satisfied that in this stage of the relationship, Floyd endeavored to induce Stokes to believe Floyd had exceptional skill and ability to furnish valuable advice in respect to shares to be bought and sold as a result it gave rise to a duty to provide advise fully, honestly and in good faith. This panel concluded that Floyd’s sale pitch and “education” of Stokes was so successful that Floyd persuaded himself that it was Stokes’ own trading philosophy and only coincidentally, identical to his.

(e) *Whether the parties intended to rely on the stated objectives of the NCAF*

¶ 74 Stokes’ evidence was that when he discussed the issues of account objectives and risk factors with Floyd upon opening the account, he was looking for safe, stable investments that would give him a steady return and preserve his capital as it would be a major source of income on retirement in 2005. He said that Floyd recommended the investment objectives recorded in the NCAF of 70% capital preservation, 20% income and 10% long term growth. He said Floyd also advised him upon the recorded risk factors of 50% low and 50% moderate. Stokes understood there were problems in the financial industry at that time but said Floyd said he would take care of his investments and told him not to worry.

¶ 75 Floyd testified that his usual practice was to investigate his prospective client’s investment experience. He knew the value of Stokes’ Kelowna property, the value of his inheritance and his annual income. However, despite their 12 month social relationship, and the discussions leading to the opening of the account, Floyd claimed that Stokes never described his investment knowledge to Floyd, or whether he had traded stocks or mutual funds on his own or with a financial advisor or say how extensive his experience was with those products. Floyd testified in chief that he regarded Stokes investment knowledge level as “average”, that he believed Stokes held shares in Dome Petroleum and Nortel, that he was familiar with the stock market and well read. However, under cross examination Floyd admitted that he did not believe the TD Waterhouse brokerage, Dome Petroleum or Nortel accounts were active at the time of opening Stokes’ account, knew only that Stokes had RRSPs, mutual funds and GICs and knew of no other brokerage firm that dealt with Stokes and that he did not know how much money Stokes had in his outside accounts.

¶ 76 Floyd’s evidence on this subject was not consistent or forthcoming. He said that Stokes said he wanted 70% capital preservation, 20% income and 10% long term growth and that the breakdown of proportion of stocks to risk factors was arrived at by combined suggestions of Floyd and Stokes. However in cross examination, Floyd admitted to authoring the NCAF and that he recorded Stokes’ investment knowledge as “limited”. Floyd also testified that Stokes opened the account for the sole purpose of the purchase of BCE stock

and thus no investment program was ever discussed when the NCAF was completed. He said that Stokes at that time wanted a margin account later for other subsequent recommendations.

¶ 77 Given Floyd's testimony that he and Stokes had many discussions about the stock market during their 12 month friendship, his stated usual practice of investigating prospective clients' investment experience and that Floyd had been suggesting investing in BCE stock to Stokes for about 3 months before the account was opened, this panel concludes that Floyd must have known Stokes' investment experience was limited, alternatively he chose to be willfully blind to that fact. If, as this panel concludes, Stokes' investment experience was limited at the time of opening the account, it is unlikely he would have known what percentages to attach to the various objectives, or if he even knew the full array of objectives to select. This panel could find no evidence of a clear agreement or understanding between Stokes and Floyd that, despite setting out the percentages for capital preservation, income and growth in the NCAF, those goals were subsequently to have been jointly disregarded.

¶ 78 Although this panel accepts that Stokes intended to open an account with Floyd when he received his inheritance and to follow Floyd's strategy to invest in BCE stock, this panel does not accept that Stokes had formed the specific intention irrespective of Floyd's advice on that subject to open the account solely for the BCE stock purchase. This panel further rejects the suggestion that Stokes already had it in his mind that he would ask Floyd to also open a margin account. As argued by IIROC counsel, if such intentions had been formed at that date and agreed to by Stokes, it would have been very simple for Floyd or McDonald to make some notation either on the NCAF or a contemporaneous memorandum of those important facts for each of Floyd and Stokes.

¶ 79 This panel finds the Respondents' argument that the absence of such notation may be equally consistent with the existence of such a common intention to be without merit, given Floyd's evidence that he typically made numerous notes but purged all such notes pertaining to the Stokes account prior to the date of these proceedings.

(f) *Whether the BCE trades were unsuitable*

(1) 7000 BCE shares April 23, 2008

¶ 80 This panel notes that in Floyd's reply to particulars dated August 17, 2012, he admitted that it was widely known in the securities industry that BCE had in June 2007 accepted a takeover bid of \$42.75 per share from a private equity group led by Ontario Teachers' Pension Plan ("Teachers") and that the deal was subject to certain conditions and approvals.

¶ 81 Stokes testified that Floyd recommended the entirety of his inheritance be applied to purchase of BCE stock because Floyd was convinced it would be a short term gain on a "done deal" with the result that Stokes stood to earn \$35,000. Stokes said Floyd told him the investment was 100% safe, a solid and sound investment, not speculative because the deal was signed, sealed and delivered with a specific closing date and as such the purchase contained no risk whatsoever. Stokes said he did not try to determine how this BCE investment would fit within the objectives stated on the NCAF or questioned that a purchase of so many shares would present a higher risk because Floyd advised him it represented zero risk, the finance was in place and there was nothing to worry about. He said it was Floyd's idea to purchase the amount of 7000 shares.

¶ 82 Floyd testified that it was Stokes who suggested the number of shares of stock be purchased because of the dividend income, the name of BCE, and the fact that Teachers was in the process of acquiring BCE. However in his compelled statement, he said it was his suggestion that Stokes purchase the BCE stock. He testified that his original intent was to provide advice and recommendations to demonstrate his opinion on the quality and stability of the investment and produced several pages of literature on BCE into evidence to show that his advice on this issue was not simply based on his own personally held opinion or research. He also said that he and Stokes agreed that the BCE purchase would be a medium risk and would meet the NCAF objectives of 70% capital preservation.

¶ 83 Floyd agreed that the purchase of 7000 BCE shares at \$37 per share for Stokes represented 98% of Stokes' inheritance. In his cross examination of Stokes, Floyd endeavored to establish that Stokes knew BCE

would be paying a dividend. Stokes in his evidence did not accept that contention.

¶ 84 Floyd also testified that when the initial BCE stock purchase was made, he did not foresee the type of market turmoil and price decline that ensued. Floyd admitted in cross examination that he told Stokes at the time that the worst case scenario was that the shares would trade at \$39.90 and \$41.75 but claimed it was not “advice”. In any case, Floyd said he had consulted knowledgeable sources. In McDonald’s compelled statement, when asked if the fact that the stock was not trading on the market at \$42.75 reflected any uncertainty about the deal closing, he said it was not a clear cut thing because of all the government approvals that were needed.

¶ 85 Floyd was evasive when initially asked in cross examination if he had provided Stokes any cautionary advice about investing such a large portion of his account in one security. His first response was that this transaction was Stokes’ wish. When pressed again he admitted he did not provide any such cautionary advice. When asked if he had advised Stokes there was even a remote possibility that the deal might not go through, Floyd initially stated that he and Stokes did discuss it, but when pressed again under cross examination, Floyd conceded that he never did so because he held a firm conviction that it was a sure thing.

¶ 86 Floyd’s evidence on this subject was clearly problematic in that his answers in cross examination were diametrically opposite to the evidence he gave in chief. At once he sought to portray himself as a qualified and experienced stock broker who gave sound advice to purchase stocks in a traditional blue chip company with a high reputation for dividend income with a decades long reputation for low risk and suitable for investors with goals of capital preservation, but at the same time to suggest he was simply taking an order from a sophisticated investor who wanted to preserve his capital in this way and reap the dividend income. Notwithstanding the obvious problem that these two versions cannot stand together in any event, Floyd contended, apparently under either version that this loss among other of Stokes’ losses under his watch was due to an unpredictable “financial Pearl Harbour” of the fall of 2008.

¶ 87 Floyd admitted he knew that the BCE takeover bid was subject to certain conditions and approvals but that he never so advised Stokes because Floyd held a firm conviction that it was a sure thing. This testimony squares entirely with Stokes’ evidence that Floyd advised him there was no risk to this share purchase. Floyd’s provision of other investment counselors’ opinions to help Stokes decide would have been more impressive had they contained opinions divergent from Floyd or containing comments about risk or uncertainty so that Stokes could make an informed decision. However it appears that Floyd provided only opinions and facts that supported his views which included only reference to positive factors. In addition, in evidence Floyd stated that some of his commentary was both recommendations and suggestions. In the result, this panel could not determine how Stokes could be expected to distinguish which of Floyd’s statements constituted advice or suggestions or ideas.

¶ 88 Moreover, Floyd’s attempt to blame Stokes’ losses on the unpredicted “financial Pearl Harbour” was unfortunately undermined by his own testimony that he himself had experienced similar market conditions in 1974 that were so far back that no one reported on it. As was said in *Rhoades*, the possibility of a market downturn, whether minor or major, would be reasonably foreseeable to the registrant and is not in the nature of an intervening act for which the registrant cannot be held responsible.

¶ 89 Most importantly, Floyd did not apprise Stokes of any negative factors associated with the purchase of 7000 BCE shares, specifically, that the takeover bid was subject to a risk, even remote, that it would not close. He did not advise Stokes, as he confessed in testimony, that there is always doubt in the market. He did not advise Stokes that as a consequence of those risks Stokes could lose money, perhaps significant amounts on this trade, and that there were other less risky alternatives he could select if he did not have the risk appetite for these consequences.

¶ 90 From the foregoing, this panel finds that Floyd failed to use due diligence to learn or alternatively, to keep front of mind the essential facts relating to Stokes which may have required him to modify his strategy as it related to Stokes’ account. As stated in *Re Lamoureux*, a registrant’s obligation is to ensure that any recommendations made by them are appropriate based on factors both negative and positive reasonably known

to a diligent registrant at the time the investment is contemplated. Floyd's own evidence mirrors that of Stokes in respect of Floyd's efforts to induce Stokes to believe that he had exceptional skill and experience to furnish valuable advice in respect of this trade. As stated in *Nesbitt Thompson, supra*, he is not permitted to allow personal interest to conflict with the interest of the principal without full consent of the principal. If the stockbroker undertakes to or does provide advice within the customer's account, the stockbroker then has imposed on him a duty "to advise fully, carefully and honestly and will be liable if he does not, ... although he will not be liable for honest errors in judgment."

¶ 91 This panel concludes, particularly in the face of Floyd's lack of candor in his answers under oath, that his failure to advise Stokes that the deal was subject to uncertainty, even a remote one, and that there is always doubt in the market and that the purchase of 7000 BCE shares could result in monetary loss to Stokes were not mere errors in judgment. Instead, this panel finds that these omissions in these circumstances constituted a failure to fulfill his suitability obligation to Stokes. In our view, in the circumstances Floyd also owed a fiduciary obligation to Stokes, which he similarly failed to meet.

(2) 1000 shares of BCE September 22, and September 23, 2008

¶ 92 Stokes testified that by the end of May, 2008 he was upset that the BCE share price had gone down significantly and said he questioned Floyd about whether the takeover deal would conclude. He said Floyd advised that it was one of those fluctuations that always occurs and that he should not worry and hold on to the stock. Stokes queried Floyd at about that time whether a news report of a court decision could be a deal breaker and noted that Floyd sent an email response dated June 3, 2008 which said "*I am more than positive the original deal is o.k.*" and that Floyd was "holding personally and had solicited more buy orders in these last few days." Although the deal did not conclude at the end of June, this panel heard no evidence that Floyd ever discussed with him the ramification that it would not close or an exit strategy regarding the BCE shares because Floyd was adamant that it would go through and that there was no risk.

¶ 93 It is important to note that in the interval of the first purchase of 7000 BCE shares in April of 2008 and the second and third purchases of 1000 BCE shares on each of September 22 and September 23, 2008, several other trades were made on Stokes' account including a purchase of 20,000 shares in Westaim on April 28, 2008 with the few thousand dollars left in Stokes' account. This purchase was admittedly speculative and thus outside the stated goals of the portfolio. In fact Floyd required Stokes to put his authority for this purchase in writing for Floyd.

¶ 94 Stokes sent an email on June 23, 2008 advising Floyd if the BCE stock funds were received in the next week, to purchase 3000 shares of Merrill Lynch, 4000 shares of Lloyds and 4000 shares of Barclays. From this email, it is evident that Stokes held the belief at that date that the takeover bid was due to close at the end of June, 2008.

¶ 95 A purchase of 3000 shares of EPCOR was made on July 16, 2008 for \$62,002, with funds from Stoke's cash savings account and a purchase of 2500 shares of Sherritt on September 11, 2008 for \$20,000 with funds he transmitted to Floyd from his earnings.

¶ 96 Despite the fact that the BCE deal did not close at the end of June, 2008, the 5000 Merrill Lynch shares were purchased on September 17, 2008 for \$94,386.32, 4000 Barclays shares on September 18 for \$96,343 and on September 22, 4000 Lloyds shares for \$84,829 on the understanding that payment for these purchases would be made from margin account that would be opened for the purpose of these and other future trades. On September 18, 2008 there was no money left in Stokes' cash account and a margin account was opened for Stokes on September 19, 2008. On September 22, 2008, when McDonald approved the margin account application, there was a cash account settlement debit of \$112,217.

¶ 97 Floyd testified that when making a recommendation, suggestion or idea to a client he did so in order that the client could relate to the stock or they would not make a commitment. He would advise the client about the company's sales history and operating income, quote the highs and lows and suggest the client read about the company on the internet. He testified that sometimes his comments to his clients were advice, sometimes recommendations or suggestions and sometimes both recommendations and suggestions.

¶ 98 Floyd said the news was so negative he could not believe it could be so bad but that this is when the experts recommend to buy stock. He concluded that it was the right time to do so and would send opinions of others to Stokes that supported his recommendations. He said he believed in what he was saying and found it refreshing that Stokes accepted his aggressive stance when others were not aggressive. He contended that Stokes had given him these various orders following their discussions about what would take place within the framework of the North American equity markets and that “they” had anticipated that September-October would be weak periods in the markets.

¶ 99 This panel found some disturbing features in the evidence on the trades ensuing between the first and subsequent BCE trades that reflect upon our evaluation of Floyd’s performance of the suitability obligation in respect of the subsequent BCE trades. These are as follows:

- (a) *Stokes testified that Floyd told him the Westaim trade would be a short term investment but it was not speculative stock because the Chair of Westaim’s board was also a board chair of Sherritt and that Chair did not engage in speculation. Nevertheless, Floyd required Stokes to send an email to him authorizing purchase of Westaim shares because it was speculative stock and outside the goals of the portfolio. If according to one of Floyd’s versions the purpose of opening the cash account was solely to purchase 7000 shares of BCE stock, why was he advising Stokes to purchase other stock? If this trade did not meet the goals of the portfolio, why was he advising Stokes to purchase it? Stokes said in cross examination that Floyd required this written confirmation otherwise Union compliance would consider the trade out of line. In addition Stokes’ email regarding Westaim confirmed that once the profile was complete they would invest in growth and dividend type stocks which contradicted Floyd’s evidence that the cash account was set up only for the one time BCE stock purchase. Finally, we note that Floyd said he requested the email for Stokes’ benefit and Floyd’s protection.*
- (b) *On the Sherritt trade, Floyd testified that he spoke of the merits of Sherritt and recommended this purchase but then said he did not solicit it.*
- (c) *Stokes said Floyd recommended the purchase of 5000 shares of Merrill Lynch on September 17 as a good opportunity for a short term investment and called him within a week to sell and take the profit.*
- (d) *Floyd claimed that Stokes approached him, wanted and recommended the orders to purchase Merrill Lynch and Barclays as a result of their anticipation of what would develop in the weak period of September and October in the North American equity markets. Later in his evidence he admitted he named these specific companies for possible investment and that he also suggested the quantity of shares which represented 23% of Stokes’ equity at the time. When asked for his rationale for those quantities of securities, his response was “round numbers” but claimed Stokes liked the figures.*
- (e) *On the rationale for the purchases and sale of Merrill Lynch stock, Stokes said that Floyd recommended this trade as a good opportunity for a short term investment. Floyd in his evidence said his long term approach was known to Stokes and they were so advanced on the low end of the cycle, this kind of company would continue to grow overtime and get back to a more realistic level. He said initially short term gains were not an objective in the account and Stokes did not express a desire for short term gains but when the opportunity presented itself and Stokes wanted to take advantage of it, Floyd could not say no. Floyd recalled an occasion when Stokes told him anytime he could book at \$20,000-25,000 profit on a transaction he was pleased to do so, whereupon Floyd said he had to explain to Stokes on several occasions that accounts were monitored and where there was too much activity in accounts, the investment advisor would be flagged for churning and Floyd did not want that. However Floyd said in a volatile market environment he could not say no when a client wanted to take advantage of a substantial increase in a particular activity. Floyd said he*

saw no need to change the investment objectives in the account at this time since it was all within the desired framework of what they wanted to accomplish.

(f) *Stokes testified that when the funds from the BCE sale did not come through, Floyd recommended that he open a margin account to purchase stocks as a good way to increase value of the account. He explained that Stokes' existing stocks could be used as collateral to borrow money from and that the returns would be greater than the interest paid on the borrowed funds. Stokes said Floyd outlined no trading strategy but said there would be no risk because Floyd would monitor the account to ensure there were no issues with it. He said Floyd did not explain what risks there were but instead pushed all the positive points about how he would make money for Stokes.*

Floyd told him the margin would never exceed 70% of Stokes' portfolio. From the evidence it appeared to this panel that Floyd never described the process of Union requiring a deposit from him or to sell stock to bring the balance above the value of that 70 percent. He said Floyd never explained what a margin call was. Floyd said Stokes' retirement goals were unchanged at the time he signed the application for the margin account completed by Floyd. He understood the goals and objectives of the margin account were the same as those listed in the NCAF and he wanted those goals and objectives to remain so he could retire. He understood that this account would allow him to borrow money to invest and the investments would pay more than the cost of interest payable on the loan.

Stokes testified that he did not understand how the risk factors would affect his account and did not know the difference between "margin long" and "margin short." He also said that Floyd convinced him that the income he would earn on the investments would pay more interest than at the bank in his interest savings account. He said he told Floyd not to let his margin account exceed 70% of the portfolio and that Floyd said not to worry because it would not but that Stokes could make money on a margin account. He said he used the margin account under the advice of Floyd and would follow his recommendations about what stocks to buy.

Floyd's evidence was that Stokes wanted to conduct more trades in good quality investments that had high dividends but did not want to add any more money on the account and told Floyd he "might like to use margin". When asked if Stokes used the term "margin", Floyd answered that Stokes wanted to borrow money, not just to cover such (further desired) trades but it was going to be a "natural process". When asked if Stokes had named any specific stocks he wanted to buy and switch to margin for that reason, Floyd replied that over the months they had discussed that traditionally there is weakness in the market in the September – October period so they had discussed and were "anticipating things". He said they had both discussed the fact that markets had deteriorated and there were excellent companies trading at their 52 week lows relative to the range with exceptional dividend deals. He said Stokes wanted to take advantage of that and the dividend income would offset the interest charges. He said that they had never discussed selling the BCE shares and investing those securities in cash. Then he said in evidence that Stokes wanted to continue to hold the BCE stock.

When first asked if he had explained to Stokes the risks and rewards of opening a margin account Floyd replied in the affirmative. However he said nothing to Stokes about limits to the margin and he felt that Stokes understood from his explanation of the margin that his debt could exceed the value of his initial investment because Stokes was a project manager, played an important role in the Sherritt plant in Madagascar and had worked for Dome Petroleum and Nortel. He was asked again what discussion he had with Stokes to show Stokes understanding of the margin concept and whether for example they did calculations together. Floyd answered that they did no calculations. Floyd said he did not normally trade in the same stock as his client. He said that he did not foresee the major decline.

Floyd agreed in cross examination that using a margin account for purchase of securities involved a greater risk than cash. He agreed that the amount of margin used increases the risks in the account. He agreed that risk of using margin increases as the amount of margin increases. This panel found no evidence that these risks were explained by Floyd to Stokes.

McDonald said that he did not look at the income objectives or risk factors to determine if the margin was appropriate for the client but concluded if the client signed the form, the client wanted the margin account. He said the margin account provided more buying power to the account. When asked how the risk factors of 50% low and 50% moderate fit with a margin use and if it was allowable with those risk factors, his response was that was Stoke's desire and decision as he signed the account. McDonald said there would be a limit on a margin account imposed by the Union credit department. McDonald could not answer whether Stokes intended the purchases occurring as the paperwork was being done were to be resolved through the margin account or if he had means to cover the debt with any other funds. When asked if he had questioned Floyd about the account before he approved it, McDonald said that Floyd advised the margin account was being set up and that was why the purchases were made and he should not worry about it, it was ok.

- (g) ***Stokes said he questioned the proposed purchase of 3500 shares of Sherritt on September 22, 2008, was worried that this was pushing the margin to a high amount and questioned it when he exceeded 70%. Floyd told him the 70% amount was the total value of the portfolio, not the percentage of the value of his stocks, at the end of a given month, but instead Floyd said the 70% related to the amount he invested in the margin account. He said Floyd told him the amount Union would lend would never exceed 75% of his equity or his investment. Floyd told him not to escalate his concern beyond Floyd because he could get into a lot of trouble for doing unauthorized trades and it would be a career limiting move for Floyd. Stokes agreed to give Floyd the benefit of the doubt but directed Floyd to fix it. He said Floyd promised to fix it but did not do so.***

¶ 100 Having regard to these intervening trades, we now turn to the further two purchases of BCE stock on September 22 and 23rd. Stokes testified that he expressed concern to Floyd on September 18 about the BCE deal but Floyd told him there was no possible way the BCE deal would not go through. At about that date Floyd recommended Stokes buy 1000 more shares in BCE respectively on September 22nd and 23rd as there was no possible way the deal would not go through.

¶ 101 Stokes recalled noting a news report indicating the court could stop the deal but Floyd said that was a non-issue, the deal would go through and it was a secure investment. Although Stokes admitted that he was aware that in that interval the share price dropped more than \$2 in one day he said he believed Floyd who told him there was a firm sale date set. Floyd admitted that he was still recommending BCE at this time and the Stokes' holding of BCE was 82% of the total equity in the account. He admitted he said that he was even more confident at this date than he was in April 2008 that the takeover deal would go through. Stokes said he withdrew money from his bank account that was earning interest because Floyd told him he would make more money if it was in the BCE stock.

¶ 102 When questioned whether Stokes made inquiries indicating doubts in June of 2008 about the BCE takeover deal concluding, Floyd's answer was that he had no notes to that effect. When asked if at this date he had advised Stokes there was even a remote possibility that the deal would not go through, Floyd responded that he and Stokes did discuss it based on news reports of the issue being taken to court. Only when asked a third time and shown the email from Stokes asking if the Court could be a deal breaker, did Floyd agree that his statement to Stokes in response to Stokes' doubts were that he was "more than positive the original deal was ok." This panel found Floyd's second response as revealed by his third response misleading and evasive. In cross examination Floyd admitted telling Stokes at worst, the BCE stocks would trade at \$39.90 and \$41.75 and when asked if the fact that the share purchases on September 22 and 23rd settled at \$34.86 and \$32.58 indicated doubt that the deal would go through, Floyd's response was "there was always doubt in the market."

¶ 103 When asked if he had recommended these purchases to Stokes, Floyd stated that Stokes told Floyd the price had dropped and Stokes suggested it would be a great opportunity to add to the holding, whereupon Floyd agreed. He admitted giving Stokes no cautionary advice at this time that there was a potential that the deal might not go through.

¶ 104 This panel again refers to the comments in *Re Lamoureux* that the registrant's obligation is to ensure any recommendations made by them are appropriate for the client based on the factors, both negative and positive reasonably known to a diligent registrant at the time the investment is contemplated. It is not disputed that the obligation rests solely with the registrant and cannot be transferred to the client. Accordingly, Floyd cannot escape his responsibility by reason that for some time in social and professional conversations prior to and after opening both accounts for Stokes he had advocated an aggressive marketing strategy that contemplating buying stocks at the low end of the cycle in weak market and persuading Stokes to copy or follow his strategy. This is particularly so when Stokes had limited prior investment experience and was not accessing alternate opinions from other experienced investment advisors but was receiving all his information from Floyd or was obtaining information on the internet that he would recount to Floyd during their discussions.

¶ 105 This panel finds that Floyd did not establish on the evidence that he advised Stokes carefully, fully, honestly and in good faith so as to carry out Stokes' intention to invest for the purpose of having a secure retirement income starting at age 65. In September of 2008 when the option to purchase another 2000 shares of BCE was put forward, Floyd did not advise Stokes that there was even a remote chance that the BCE deal might not go through, even though Stokes had followed Floyd's advice to follow the news about BCE on the internet and Stokes observed that some aspect of the BCE deal was being submitted to judicial determination. Given that reality and the fact that the deal had not concluded at the end of June as had been previously expected, this panel cannot find any objective basis for Floyd's advice to Stokes that he was even more certain that the deal would conclude than he was in April 2008. Even if he honestly held that belief, it was not careful advice to avoid his own knowledge that there is always doubt in the market.

¶ 106 This panel accepts the evidence of Stokes that these trades were made on Floyd's recommendations. Floyd's answers on this question were internally inconsistent and in this panel's assessment lacked candor. Moreover, he admitted reluctantly that he continuously failed to make Stokes aware of the negative factors associated with purchasing more BCE stock and continued to recommend trades to Stokes without apprising him of any negative factors in connection with such trades. He never apprised Stokes of a risk assessment of any such trades, objective or otherwise.

¶ 107 This panel accepts that Stokes was enamoured of Floyd's aggressive philosophy. As he himself candidly admitted, he was "caught up in the euphoria". Eventually under cross examination Floyd admitted that he now saw a problem of having so much concentration in one BCE security but claimed that the Stokes' account was never set up as a portfolio. When asked if a client is not put at greater risk if all the investment funds were put into one security as opposed to diversifying among 20 securities, Floyd conceded that was "theoretically" correct. Floyd continued to deny that he recommended or solicited the buy order but said he had merely told Stokes for some weeks that is what he had done and had no idea what Stokes would do. Floyd admitted that he liked to recommend larger purchases and aggressive stances which proved more rewarding. He allowed that if he had told Stokes he had funds in a margin account and Stokes came to the view that if such a strategy was good enough for Floyd it was good enough for Stokes, in Floyd's mind that would not amount to a solicitation.

¶ 108 In this panel's view, none of the above factors excuse Floyd for failing to advise Stokes that success in such trades could not be predicted with certainty or that opening a margin account could be done without any risk of monetary losses to Stokes. Floyd failed to determine Stokes' risk appetite and risk tolerance because he pretended to Stokes that he could protect Stokes from any such risks with his many years of skill and expertise and devotion to his craft. Choosing to remain willfully blind to the risks as Floyd did, by refusing to believe the news could be so negative, Floyd "educated" Stokes to the belief that the risks did not exist. In the view of this panel, Floyd owed Stokes the duty to advise him from the outset and thereafter that there was a risk that the deal would not go through.

¶ 109 The Respondent's position on this issue is that Stokes was a sophisticated investor who understood risk

and was motivated to copy Floyd to increase profits. In *Re Daubney* OSC found the registrant recommended excessive leveraging which was entirely unsuitable for the investors because (i) they did not have sufficient income or unencumbered liquid assets to be able to respond to any market reverses; (ii) for many investors, their homes were their main assets; (iii) they were retired, about to be unemployed or close to retirement and had few earning years left in which to make up any losses; and (iv) they told the registrant they wanted conservative investments that did not threaten their financial security.

¶ 110 Applying the principles enunciated in the case authorities cited above on the issue of suitability obligations to the facts found on the evidence, this panel concludes that Floyd did not meet his suitability obligation to ensure that the risk associated with the investment products compared with the risk profile of the investor. This panel further concludes that Floyd ignored Stokes' ability to understand the risks associated with Floyd's aggressive trading style of purchasing stocks in uncertain economic conditions when in Floyd's words, everyone else was afraid to do so. Floyd ignored Stokes' capacity to withstand losses associated with the investment, when on the facts in this case, Floyd admittedly failed to explain to Stokes that there existed negative risks to the trading strategy and to the opening of a margin account with stated written and approved objectives that were primarily intended to preserve capital. Instead, Floyd pushed only the positive features of his approach at all material times, not only to Stokes, but to McDonald. All these failures taken together renders on the facts before this panel what might well have been suitable investment products in other circumstances unsuitable in this case.

¶ 111 In this panel's view, what makes Floyd's obligations more onerous in this case is that Floyd knew that Stokes placed full reliance, trust and confidence in Floyd and gave over to Floyd the power to advise which trades to make and in what amounts and at what times. In view of the foregoing, this panel concludes that this particular relationship was fiduciary which rendered fiduciary the obligations which attached.

¶ 112 Although Floyd urged upon us there would have been no complaints by Stokes had he responded differently in later weeks or months, the case law is clear that such factors are not relevant to the suitability assessment. Floyd urged upon us that he "knew" this client very well, however in his sworn testimony he denied knowledge of information about Stokes' investment experience that he typically asked of his prospective clients.

¶ 113 Although Floyd admitted not advising Stokes of any negative factors associated with any of the trades he sought to absolve himself from the responsibility to advise his client of negative factors to investment products recommended on the basis that "he could not believe the news was so bad" and that he was "more than certain" that the deal would go through. As was stated in *Re Foresight Capital Corp.* risk assessment cannot be based on the registrant's optimism in the venture but on a realistic and objective assessment of the circumstances of the investment and the investor and that clients are entitled to an objective assessment of the risk. This panel has concluded that these features Floyd claimed he failed to see and were not foreseeable, were in fact foreseeable and that he failed to give Stokes an objective assessment of the risk of the BCE trades under consideration in this case.

(g) *Whether Floyd is shielded from discretionary trades due to Stokes' prior consent or the caveat in the Transaction statements*

¶ 114 IIROC counsel alleged three specific trades were provably discretionary, which include a purchase of 4000 shares of Barclays stock on September 29, 2008 for \$103,806 settled on October 2, 2008 (IIROC binder # 1 tab 3 page 7 lines 2 and 3). He cited emails showing that Floyd sent an email stating he was trying to buy Barclays that morning and a subsequent email stating he had purchased shares at \$24.50 followed by an email from Stokes asking how many shares were purchased. IIROC counsel disputed a document relied upon by the Respondents which purportedly contained an admission by Stokes to Lang that Stokes had authorized this trade. IIROC counsel pointed out that such document referenced a different Barclays trade for 4000 shares on September 18, 2008 which was referenced earlier in these reasons but does not substantiate advance consent for the September 29, 2008 Barclays trade.

¶ 115 IIROC counsel further alleged trades of Hartford Financial first on October 7 and two more on

November 11, 2008. The first is referenced in an email from Floyd in response to a query from Stokes advising Stokes of a trade made the day before and the latter two involve trades made without obtaining Stokes' advance consent as to the quantity. Stokes' evidence was that Floyd had recommended these trades to try to get some of the money back. Stokes said the second of the November trades was much out of line with what was discussed. Stokes' evidence was that he authorized the first trade in November of 2000 but not the second.

¶ 116 Floyd's evidence on this topic was revealing. He disputed using discretion at any time but then allowed that there was a fine line in using discretion on trades because his experience taught him he must use discretion to sell stock at the best price. When asked in cross examination if Stokes gave him discretion, Floyd answered that he would have to look it up. When then shown the email chain by IIROC counsel beginning with one from Stokes asking for a prognosis for, (*inter alia*), Barclays stock, Floyd admitted he received the email but could only offer that Stokes did not always confirm a purchase by email beforehand. As to the trades in Hartford Financial, Floyd admitted saying in direct testimony that the Hartford Financial trade in November 2008 was one order. He said he tried to locate phone records to verify he had permission for all the trades alleged to have occurred due to his discretion. When shown the Stokes' email of November 9, 2008, Floyd agreed he had used his discretion to make the two purchases.

¶ 117 As stated in *Wenzel, supra*, a person is exercising discretion when he effects a securities transaction for a client without obtaining in advance from the client the specifics as to four elements of the transaction- quantity, security, price and timing. Applying this definition to the case at hand, this panel finds the email in question clearly implied that Floyd placed an order for Barclays' shares without advance permission as to the quantity and Floyd made no convincing refutation of that implication. Indeed, Floyd's responses taken as a whole convinced this panel on a balance of probabilities that he likely did exercise discretion in this instance. In light of the evidence on the three trades in Hartford Financial, this panel concludes that the evidence establishes on a on a balance of probabilities that Floyd used his discretion in the trade of October 7 and the second trade of November 11, 2008.

¶ 118 The Respondents have sought to argue that Stokes would have been aware of all such trades upon review of his transaction statements and made no complaints within the 10 day time frame for giving notice of objection. IIROC counsel noted that in *Re Phillips (supra)* the client did not immediately complain about the trades that were discovered after the fact but that did not absolve the registrant from a finding of discretionary trading. This panel agrees that the authority in *Re Phillips (supra)* is applicable on these facts and finds that Stokes' late complaints cannot by themselves be sufficient grounds to validate trades that were discretionary in the first instance.

(h) *Whether the extensive use of margin was unsuitable in all the circumstances*

¶ 119 Floyd admitted he failed to make Stokes aware of the negative factors associated with opening a margin account and continued to recommend trades to Stokes without apprising him of any negative factors in connection with such trades. Further, according to McDonald's statement with respect to the opening of the margin account, Floyd advised that purchases were made while he was setting up and putting the margin account in the works, so McDonald "should not worry, it was ok."

¶ 120 In this panel's view, Floyd's failure to fully apprise Stokes of the negative risks attendant on trading on margin perpetuated Stokes' belief that Floyd would protect him from financial losses on his account by virtue of his special expertise and skill in trading in weak markets and during financial turmoil. Further it appeared that Floyd had arranged for trades on margin to take place in advance of the establishment of the margin account, which would appear to undermine the purpose of the NCAF to be completed so that the registered representative *and supervisory staff* are able to "conduct the necessary review to ensure that the recommendations made for any account are appropriate for the client and in keeping with his investment objectives" and to ensure that "all recommendations made for any account are and continue to be appropriate for a client's investment objective"...

¶ 121 McDonald seemingly realized from Floyd's statement that he was arranging trades prior to establishing and allowing McDonald to review and approve the opening of the margin account. As indicated above, the

Policy also obligates branch managers to review ongoing activities in branch accounts. ...The daily review must “attempt to detect, among other things,” lack of suitability, undue concentration of securities, excessive trading activity, inappropriate/high risk trading strategies and quality downgrading of client holdings. In addition, branch managers must inform themselves on other client related matters, such as complaints, undisclosed short sales and trading under margin.

¶ 122 This panel concludes that both Floyd and McDonald were aware that the arranging of trades was occurring before the margin account client objectives were properly established. They both knew or should have known that such conduct would obviate or make it more difficult to establish that one or both of the registrant or branch manager ensured the client was properly apprised of the risks of trading on margin. Moreover, neither Floyd nor McDonald produced sufficient evidence to convince this panel on a balance of probabilities that Floyd had brought home to Stokes the risks and potential negative consequences of trading on margin. In this panel’s view the responses by Floyd should have put McDonald on notice to inquire into a lack of suitability and both failed to meet the suitability obligation in the circumstances.

(i) *Whether McDonald failed to conduct adequate supervision*

¶ 123 As indicated, Gauthier gave evidence on behalf of IIROC. He was an investment dealer investigator with no less than 20 years on staff in addition to work experience with the Alberta Securities Commission and stock exchanges. Gauthier testified the opening of a margin account on September 19-22, 2008 was a time of extreme market volatility, with a credit crisis causing bankruptcy requiring bailouts of large financial institutions and market turmoil with persons within the Union Edmonton branch showing concern about market volatility.

¶ 124 Gauthier testified that Stokes received no dividend into his account during the time he held BCE shares. Gauthier noted the point in Stokes’ account when there was a debit of \$181,012.47. He noted that commissions exceeded \$1500 and at this threshold, the supervisor is to review transactions to ensure trades are suitable for a client. He noted that there were daily reviews to be conducted by the branch manager looking for any unusual concentration of securities in trading for the day.

¶ 125 Gauthier noted that McDonald had initialed the branch daily review of April 23, 2008 which showed the trade for 7000 shares of BCE for \$265,000 on April 18, 2008 but had provided no comment evidencing that he considered whether such trade was consistent with the Stokes’ objectives listed on the client account form, which Gauthier expected to see. In the Stokes’ account where the objective was listed at 70% capital preservation, Gauthier observed that the high concentration in the BCE position resulted in greater risk to the account as well as considerable debit particularly in October which indicated that the capital was put at risk. He expected to see some query (from the supervisor) about the nature of risk and holdings.

¶ 126 Gauthier said having over 90% of the balance of the account in one stock in the early months created a greater risk to the balance of the account. Gauthier said there was little trading in the first 5-6 months but then many trades in September and October, all concentrated in the financial sector and suggested investigation was warranted into the sudden and increased trading in that period.

¶ 127 While McDonald signed Branch manager monthly supervision account on October 18, 2008 Gauthier found no notes of any investigation of the Stokes’ account for inconsistencies with client objectives or unusual trades requiring client follow up. Gauthier noted that on November 16, 2008 McDonald had selected 3 accounts randomly to ensure they were in accord with regulatory standards, however if he reviewed the daily and monthly reviews, Gauthier expected to see comments to show McDonald had investigated the Stokes’ account.

¶ 128 Gauthier noted the Branch daily reviews completed by McDonald showed no notes on Floyd trades reviewed on September 10 or September 16 although McDonald had noted in this month it was a very bad market and to ensure margin accounts were watched closely. Despite several trades made on September 18, 24, 29, no notes were made by McDonald.

¶ 129 The Branch daily review on October 6, 2008 contained a note from McDonald “to be careful about margin and ensure clients know exactly where they stand.” Gauthier explained that a margin call is required

when the value of securities holdings fall below the firms' accepted level and requires the firm to sell securities in the account to pay down the margin debt. Despite trades by Floyd for Hartford, Mavrix, Sherritt, CBS, and Merrill Lynch in October, McDonald made no notes to show consideration of suitability of trades, concentration and amount of risk taken on by client despite mention of margin calls.

¶ 130 Gauthier also noted that in the commission report for November 5, 2008, commissions totaled \$6532.44 and the opening balance showed a debit of \$221,016.83 which then ended at debit of \$484,388.47. He said the supervisor is to review the trades in light of the client's objectives. In this circumstance, Gauthier expected to see notes or comments from McDonald evidencing a query or investigation into the nature of trading and holdings in the Stokes' account at month end.

¶ 131 Gauthier noted that Floyd stated to him that the sales of stock on November 19 including sales of stock in Merrill Lynch, EPCOR, Barclays, CBS, Lloyds, Nortel and Westaim and the sale of BCE shares on October 29 were margin calls (sales ordered by Union) to reduce the amount of the debt in the account. Floyd told Gauthier he did not advise Stokes nor did Stokes instruct Floyd to sell the BCE stock.

¶ 132 Gauthier pointed out to McDonald during his compelled statement that settlements due on September 18, 19, 22 and 23, did not show any of the Stokes' trades. From his compelled statement his evidence was that these reports were a safety valve and what was important was the last number on the last page which showed the exposure for the firm, so the firm could make a business decision to contribute its own capital if the client does not have it. McDonald said that he would see a cash account debit settlement in the account on the commission sheet on the trade date, the day after the trade and 3 days before the settlement date.

¶ 133 McDonald noted that the September statement top right stated it was a margin account but when it was pointed out by Gauthier that it was a cash account at the beginning of the month and during the period of the trades and was converted to margin later in the month, whereas the daily review was processed on September 18, McDonald answered that the trade would not show up until the settlement date, 3 days after the trade. McDonald was then informed by Gauthier that September 17 was the settlement date as the trades occurred on September 12th. McDonald then said he thought that where there is a cash account debit settlement in the account, it would show up only if there was a capital requirement for the firm.

¶ 134 When asked during his statement what he looked for in the monthly supervision report, McDonald said it was common sense, but he would look for unusual things, aberrations, things he had not seen before, concentration and quality of household names (i.e. large cap companies) or non-household names, something with little liquidity, excessive trading, or potential churning. On a random basis, he would run the list of clients who paid more than \$1500 in the year and pull two such files to make sure they were complete. As to the other accounts over \$1500 he would look at the account statement. He said that over the course of a year, it was likely that all such files would be reviewed.

¶ 135 McDonald was sure he reviewed this report, but when asked if he made any inquiries of Stokes or Floyd, he did not think he spoke to Stokes and saw no need to do so. He made no specific inquiries of Floyd. He noted it was all uncharted turbulent territory and unsettled times. Also, up until the major downturn in September 2008 to the end of 2008, financial securities were quite volatile. When asked how he qualified the risk or objectives of major companies in general, McDonald answered that from an investment perspective, he could not say if they were more or less or as risky as in the past.

¶ 136 McDonald's statement demonstrated that his own view of his supervisory responsibilities as they related to settlements were to protect the possibility of exposure of Union to a capital requirement that the client could not meet. There was nothing in his evidence to suggest he considered his responsibility extended to examining any undue exposure to an individual client.

¶ 137 McDonald's statement on the Monthly Supervision Report did not reveal that he had a specific recollection of actually reviewing this report or took into account any potential undue exposure to Stokes despite his recollection that the market conditions were turbulent, unsettled and resulted in a major downturn beginning that very month.

¶ 138 McDonald was also sure he reviewed the Commission over \$1500 report for Stokes for October 2008 and when asked if he made any inquiries of Stokes or Floyd, he said he talked to Floyd and others the whole day. McDonald did not agree that paying \$6970 in commission for several trades and \$6532 in October was fairly active trading but also noted that the market was in the “emergency room” and things had to be done quickly. When asked if he ever suggested to Floyd that the application form or objectives (in Stokes’ account) should be updated in response to this trading, McDonald said that Stokes signed the margin account in mid-September and did not ask that it be updated in the 30 days subsequent to the last updating. When asked if the sell out in the account was initiated by Stokes, Floyd or the Union branch, McDonald said Floyd told him Stokes asked them to get him out. McDonald said that Stokes never called him.

¶ 139 McDonald did not recall raising any other questions about the Stokes’ account. McDonald contended that the events in Stokes’ account were beyond everyone’s control. He also noted that as a result of the financial crisis, the investment practice has changed.

¶ 140 Under cross examination by McDonald, Gauthier agreed that nothing prevents a brokerage from allowing clients access to the firm’s capital through the use of margin accounts and that Stokes had signed the account to evidence his agreement to the terms and conditions. Gauthier agreed that where a call is made on a margin account, a client has the option to add more funds or sell securities. When asked if it was true that commissions reported for a month would not reflect the entire account, Gauthier instead responded that an account that paid \$6000 in commissions seemed skewed on the high side.

¶ 141 IIROC counsel in argument cited a number of problems with the level of supervision of McDonald in the face of activities that arguably should have raised questions and given rise to investigation and comment by McDonald. McDonald knew Stokes had come into an inheritance which was the purpose of opening the account. He knew or should have known that Stokes’ investment knowledge was limited because that fact was recorded by Floyd in the NCAF. His own compelled statement indicated he knew the BCE takeover bid was not certain. He also knew that the initial trade of 7000 shares in BCE for \$265,000 was made before the funds were in the account and must have known that as a result Stokes was charged interest between April 23 and April 28.

¶ 142 McDonald endeavored to explain that the delay entailed in transmitting the funds was due to the fact that the wire came from Britain and the Union office was not familiar with use of SWIFT account, but this does not explain why McDonald and Floyd chose to allow Stokes to be charged interest. When the fact that the trade had been made before the funds were in the account was brought to Stokes’ attention at the hearing, Stokes stated that he had never noticed that detail before. This evidence suggests no one at Union brought the charge to Stokes’ attention or explained why he, rather than Union was liable for it. McDonald made no notation of any inquiries or answers received when he signed the cover page of the Capital Requirement Report dated April 24, 2008 for overdue cash accounts when the initial BCE trade left a cash debit account balance of \$264,968 leaving a capital requirement for Union of \$1488.

¶ 143 All of the foregoing indicates that McDonald’s primary concern was protecting the position of Union, rather than ensuring that an inexperienced investor aged 60 was aware that he had put virtually his entire inheritance into a trade involving a security that was subject to known uncertainty. IIROC contended a similar lack of due diligence on the part of McDonald at the time the margin account was opened for Stokes. The evidence shows a similar pattern of trades being effected by Floyd before the margin account was opened and McDonald, as he had done in April 2008, evidently condoning the practice and making no notes to evidence what supervisory measures had been effected to prevent recurrence.

¶ 144 Moreover, the margin account when opened contained the same investment objectives, including 70% capital preservation, when McDonald was aware of market turmoil and aware that Stokes’ investment knowledge was recorded as limited. Given that McDonald was told by Floyd that Stokes purportedly was copying Floyd’s aggressive trading philosophy, but that verbal indication contradicted the objectives recorded in the margin account application, due diligence steps of contacting Stokes directly to verify if Stokes understood the risks of opening a margin account and of following Floyd’s aggressive trading philosophy would be expected. McDonald’s evidence in his compelled statement however was that Stokes signed the application form for the margin account. Implied in McDonald’s evidence was the fact of the client’s signature on the

account was all that McDonald required to satisfy his supervisory obligations. This panel concluded that McDonald's concern was to protect the interest of the Union firm and if there was any risk to Stokes, he was content to ignore the existence of such risk.

¶ 145 IIROC counsel contended that McDonald also failed to question the concentration and large dollar amounts of various trades made by Floyd including the BCE trades and financial stocks and sales and repurchases of Hartford Financial, Barclays and Merrill Lynch shares when short term trading was not a stated account objective. In this regard this panel notes that according to Stokes, he had not discussed with Floyd in the year prior to opening his account in April 2008 any desire to take advantage of short term profits. Stokes said Floyd told him the initial BCE trade would be a short term gain on a "done deal" such that Stokes stood to earn \$35,000. Stokes said Floyd told him the Westaim trade would be a short term investment. Stokes said Floyd told him the purchase of 5000 Merrill Lynch shares on September 17 was a good opportunity for a short term investment and called him within a week to sell and take the profit.

¶ 146 With the above evidence in mind this panel must determine if McDonald fulfilled his obligation with respect to the daily account to "attempt to detect, among other things," lack of suitability, undue concentration of securities, excessive trading activity, inappropriate/high risk trading strategies and quality downgrading of client holdings. In addition, branch managers must inform themselves on other client related matters, such as complaints, undisclosed short sales and trading under margin.

¶ 147 This panel accepts the testimony of Gauthier without reservation. He is amply qualified as an investment dealer investigator with no less than 20 years on staff in addition to work experience with the Alberta Securities commission and stock exchanges. He was not effectively challenged on cross examination and this panel accepts that in the circumstances, the trading activity by Floyd on Stokes' account, including the large position of BCE stock initially and the numerous trades in September and October 2008 warranted some active supervisory investigation at the time to verify whether the trades were aligned with the account objectives.

¶ 148 It is evident that McDonald accepted Floyd's representation that Stokes asked to get him out of the market. However given the large position taken with BCE, the fact that Floyd had evidently told McDonald that it was refreshing to him to have a client that was prepared to be extremely aggressive, the fact that the market conditions were unsettled and that McDonald was aware there was some uncertainty in the BCE deal closing suggests to this panel that more supervision of the Stokes' account was warranted. McDonald's failure to determine if the margin was appropriate for the client because the client signed the form neither meets the suitability obligation or the supervisory obligation. His evidence persuaded this panel that McDonald viewed his supervisory responsibility primarily, if not exclusively, to protect Union rather than Stokes from the exposure to capital loss. The fact that McDonald could not answer whether Stokes intended the purchases occurring as the paperwork was being done were to be resolved through the margin account or if he had means to cover the debt with any other funds also further supports the conclusion this panel has arrived at.

¶ 149 IIROC counsel contended that the facts in *Re Mills* case are similar to the case involving McDonald. There the branch manager testified that he conducted the required daily and monthly reviews; that the trading and account profiles were inconsistent with the investment objectives of the NAAFs throughout this period, suggesting a lack of suitability and inappropriate, high risk trading strategies...; the accounts reflected undue concentration, which would have been apparent from the monthly concentration reports. Mills knew the registrant was an aggressive "momentum trader who ...took only active accounts that suited his trading style. Mills, when he approved the client's accounts, believed that the client was also aware of the registrant's trading style and sought that kind of trading activity that the registrant would provide. Because the client was a business man, Mills saw him as an entrepreneur and gave little weight to his age of 63 years, because in his view entrepreneurs do not retire. He thought the client's net worth was \$3 million and concluded he must be an experienced investor with excellent understanding and a significant net worth.

¶ 150 Mills trusted the registrant who was a senior registrant ("RR") and assistant branch manager. He concluded that the client wanted to be "a player". Mills believed there was no need to investigate the accounts further than he did in view of the discussions with the RR which indicated the client was happy with the profit he was making but this panel noted that his monitoring activities were limited to discussions with the RR. He

did not obtain the NAAFs for the client's accounts, did not review update forms or consider contacting the client. This panel held that there were too many indications of a need for further investigation for him to have relied solely on discussions with the RR. In effect this amounted to a delegation of responsibility to the RR with respect to monitoring of his own accounts. (at pages 20-21) The following comments in the finding against the branch manager were included in the decision:

“His errors were errors of judgment. He...placed too much trust in an aggressive RR; he failed to respond to a number of indications, identified in these reasons that should have led him to take further steps. Such errors, particularly because of the legitimate tendency of managers to trust RRs with whom they work closely must be carefully guarded against. A branch manager should be alert to facts that even with honest and trustworthy RRs, may indicate a need for further investigation. It is sometimes necessary that a manager go beyond discussions with an RR and address an issue directly with the client. In the District Council's view, this case represents one such instance. “

¶ 151 McDonald contended that the case at hand is distinguishable from *Re Mills* because in that case there was evidence of churning, the registrant was characterized as an “aggressive ‘momentum trader’ who...only took active accounts that suited his trading style, there was “unusual trading activity” and in *Re Mills*, it was suggested that the branch manager ought to have investigated further once he reviewed the daily reports and not relied solely on the registrant. McDonald contended that in the present case there is no suggestion of churning and even if Floyd was at times aggressive, he was not recommending highly speculative investments. As to his own conduct, McDonald says he met the test in *Re Mills*, by taking the extra step of talking to Floyd in the office and determining that BCE was a “specific idea”. He then contended that further supervisory steps would not have altered the outcome because in McDonald's opinion the investments were sound, the head office compliance department had no problem with the situation, and McDonald who had met Stokes on at least two occasions, considered further contact with Stokes unnecessary.

¶ 152 This panel concludes that the trading and account profiles in the Stokes account were *prima facie* inconsistent with the investment objectives of the NCAFs throughout this period, suggesting a lack of suitability and warranted further inquiry. McDonald admits that Floyd engaged at times in aggressive trading strategies which are a fact pattern similar to the RR in Mills. McDonald, like Mills, when he approved the client's accounts, believed that Stokes was also aware of Floyd's trading style and sought that kind of trading activity that Stokes would provide. Mills considered the client was an entrepreneur who would not retire, and concluded he must be an experienced investor with excellent understanding and a significant net worth. McDonald, despite having met Stokes at least twice according to his evidence seemingly knew only that Stokes had come into an inheritance and became a friend of Floyd's in a social context, also thought Stokes was an experienced investor with an excellent understanding .

¶ 153 McDonald, trusted Floyd and, like Mills, believed there was no need to investigate the accounts further than he did in view of the discussions with the RR which indicated the client was happy with the profit he was making. In *Re Mills*, this panel noted that his monitoring activities were limited to discussions with the registrant and he did not among other things, consider contacting the client.

¶ 154 In the case at hand, it would have not been difficult or onerous for McDonald to make direct contact with Stokes to satisfy himself whether Floyd had given proper cautionary advice to Stokes and that Stokes had proper understanding of the same. Had he done so, he might have learned that Stokes thought the initial purchase in BCE was presented as a short term investment. Had he asked more pointed questions of Floyd, as occurred in this hearing, Floyd may have admitted that he had not performed all the requirements of his suitability obligations at the time the cash account was initially opened and at later points within the period between April and October, 2008. Floyd may have admitted he failed to provide Stokes with warning of any negative risks to the aggressive trading philosophy.

¶ 155 As in *Re Mills*, this panel concludes that McDonald failed in his supervisory obligation by placing too much trust in an aggressive registrant, by failing to respond to a number of indications identified in these reasons that should have led him to take further steps, which because of the legitimate tendency of managers to trust registrants with whom they work closely, must be carefully guarded against.

¶ 156 In this panel's view, McDonald should have gone beyond discussions with Floyd and confirmed directly with Stokes what Floyd had told McDonald. However, in this panel's view McDonald's conduct went beyond a mere delegation of authority to the registrant. His lack of documentation of any objective monitoring of the Stokes' account combined with his evidence that seeing the signature of the client on the NCAF was sufficient to satisfy him that the suitability obligation had been met demonstrated a failure to understand his own supervisory responsibility to monitor suitability and thus not merely a delegation but an abdication of his responsibility to exercise supervision over Stokes' account.

¶ 157 As a result, this panel concludes that Counts 1, 2 and 3 are proven to the required standard and directs that a penalty hearing be scheduled.

Dated at Edmonton this 22 day of January, 2013.

Shelley L. Miller, Q.C. (Chair)

Martin Davies

William Welton

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