Re Scotia Capital

IN THE MATTER OF:

The Rules of the Investment Industry Regulatory Organization of Canada ("IIROC")

and

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

and

Scotia Capital Inc.

2015 IIROC 27

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

Heard: August 5, 2015
Decision: August 11, 2015

Hearing Panel:
Martin L. Friedland, C.C., Q.C. (Chair), Peter J. Gribbin and Guenther W. K. Kleberg
Appearances:
Charles Corlett, Senior Enforcement Counsel, IIROC
James Douglas and David Di Paolo, for the Respondent

REASONS FOR DECISION

INTRODUCTION

¶ 1 Staff of the Investment Industry Regulatory Organization of Canada ("IIROC") and the Respondent, Scotia Capital Inc. ("Scotia Capital" or "the Respondent"), entered into the attached Settlement Agreement, signed July 22, 2015.

¶ 2 The Settlement Agreement was presented to the Hearing Panel for acceptance on August 5, 2015.

¶ 3 After hearing counsel for IIROC and the Respondent and considering the material filed, the Hearing Panel issued an order accepting the Settlement Agreement. These are our reasons for making that order.

SETTLEMENT AGREEMENT

¶ 4 Scotia Capital is a Member of IIROC and was formerly a member of the IDA. One of its divisions, HollisWealth, formerly Dundee Wealth, a division of DWM Securities Inc. ("DWM"), was the subject of an IIROC investigation.

¶ 5 DWM had been acquired by the Bank of Nova Scotia, the parent company of Scotia Capital, on February 1, 2011. DWM subsequently amalgamated with Scotia Capital on November 1, 2013, at which time it became a division of the Respondent under the name HollisWealth.

¶ 6 In the Settlement Agreement, Scotia Capital admits to the following contravention of IIROC Dealer Member Rules, Guidelines, Regulations or Policies:

"Between September 14, 2005 and June 2013, DWM Securities Inc. ("DWM"), which subsequently

amalgamated with the Respondent, failed to establish and maintain a system of controls and supervision that was adequate to ensure that certain clients were qualified to purchase investment funds offered pursuant to prospectus exemptions, contrary to IIROC Dealer Member Rules 38.1, 1300.1(a) and 2500 (II) (formerly IDA By-Law 29.27(a)(i), Regulation 1300.1(a) and Policy 2)."

¶ 7 Exempt Funds (funds that do not require a prospectus) are only permitted to be distributed pursuant to prospectus exemptions: see National Instrument 45-106 *Prospectus and Registration Exemptions*. DWM's advisors sold a large number of Exempt Funds to many clients over the course of approximately eight years without noting in the client files that those clients were qualified to purchase Exempt Funds.

¶ 8 IIROC Rule 2500 II outlines as follows the importance of entering such information:

> "To comply with the 'Know-Your-Client' rule each Dealer Member must establish procedures to maintain accurate and complete information on each client...Accurate completion of the documentation when opening a new account allows both the Registered Representative and the supervisory staff to conduct the necessary review to ensure that recommendations made for any account are appropriate for the client and in keeping with his investment objectives."

¶ 9 The failure to enter such information was identified in 2012 by Scotia Capital, which subsequently conducted an internal Review of all Exempt Funds sold by HollisWealth and its predecessors to clients during the eight year period, September 14, 2005 to December 31, 2013, to determine the scope of the issue. Scotia Capital reported the matter to, and shared the results of the internal Review with, IIROC Staff.

¶ 10 Due to its comprehensive scope and complexity, the Review took over a year to complete. The Review analysed each purchase of the Exempt Funds together with the available client account documentation to determine whether those documents were sufficient to show that the client qualified for a prospectus exemption at the time of the transaction.

¶ 11 The result of the Review by Scotia Capital is set out in some detail in paragraph 21 of the Settlement Agreement. About 1700 "separately identified clients" – out of a total of about 10,000 such clients – purchased exempt funds where the account information did not support the clients' qualifications for an exemption. (The issue is somewhat complex because a client may have more than one account.)

¶ 12 Although DWM had policies, procedures and advisor training programs relating to the sale of Exempt Funds during the Review Period, the Respondent admits in paragraph 24 of the Settlement Agreement that

> "DWM failed to establish and maintain a system of controls and supervision that was adequate:
>
> (a) to reasonably ensure that its advisors were following the policies and procedures and discharging their responsibilities under the policies and procedures;
>
> (b) to reasonably ensure that its Branch Managers were adequately implementing and enforcing the policies and procedures; and
>
> (c) to detect in a timely manner that the Identified Funds were being sold to clients where the account information in client files did not support the clients' qualifications for a prospectus exemption."

¶ 13 IIROC Staff and Respondent agreed to the following terms of settlement:

> "(a) A fine of $500,000;
>
> (b) the Respondent will report on the execution of the Remediation Plan (as defined below in paragraph 28 [of the Settlement Agreement]) to IIROC's Vice-President of Enforcement by no later than October 30, 2015, and as thereafter required by the Vice-President of Enforcement to ensure the Remediation Plan is completed satisfactorily; and
>
> (c) the internal fines imposed, as set out in paragraph 31 [of the Settlement Agreement], will be donated by the Respondent to charity."

Staff and the Respondent also agreed that "no costs be paid by the Respondent to IIROC in connection with this

Settlement Agreement".

STANDARD FOR REVIEWING A SETTLEMENT AGREEMENT

¶ 14 The standard for reviewing a Settlement Agreement was well-stated in a Pacific District hearing, *Re Johnson* (2012 IIROC 19), where the panel stated:

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

¶ 15 There are many similar statements. See, for example, *Re Taggart* (2013 IIROC 24); *Re Scotia Capital* (2013 IIROC 38); *Re Jiwa and Hoffar* (2012 IIROC 9); *Re Rotstein and Zackheim* (2012 IIROC 27); *Re Portfolio Strategies Securities Inc.* (2012 IIROC 36), and *Re Ast* (2012 IIROC 38), all stemming from *Re Milewski* ([1999] I.D.A.C.D. no. 17), where the panel stated:

> "A District Council considering a settlement agreement will tend not to alter a penalty that it considers to be within a reasonable range, taking into account the settlement process and the fact that the parties have agreed. It will not reject a settlement unless it views the penalty as clearly falling outside a reasonable range of appropriateness. Put another way, the District Council will reflect the public interest benefits of the settlement process in its consideration of specific settlements."

WHY THE PANEL ACCEPTED THE SETTLEMENT AGREEMENT

¶ 16 We did not view the penalty as "clearly falling outside a reasonable range of appropriateness." Indeed, we concluded that the penalty is very appropriate in the circumstances of this case.

¶ 17 Scotia Capital inherited the problem. It did not create it. Moreover, it dealt with it effectively. It reported the issue to IIROC in December 2013 and kept IIROC informed of its Review, promptly sharing the detailed findings of the Review with IIROC and otherwise fully cooperating with the regulatory investigation. The Review included all Exempt Funds sold during the Review Period. The Respondent expended considerable amounts of time, money and personnel in understanding and dealing with the issue. IIROC staff took into account (paragraph 25 of the Settlement Agreement) "this proactive and exceptional cooperation as a factor in agreeing to the sanction." (See IIROC Sanction Guidelines, February 2, 2015, part I, section 8.)

¶ 18 The IIROC Staff Policy Statements (which are companion documents to the Sanction Guidelines) of February 2, 2015 states: "In light of the general requirement to cooperate with IIROC investigations, only a record of cooperation that is proactive and exceptional will be considered as a mitigating factor for the sanctions sought against a respondent." One of the examples given in the Policy Statements fits the present case: "early self-identification of contraventions followed by thorough internal review, the results of which are promptly shared with IIROC Staff." The Policy Statements go on to state: "Proactive and exceptional cooperation allows investigations to be commenced, conducted and completed more quickly using fewer resources, thereby allowing IIROC to deploy its resources more efficiently and effectively to other matters."

¶ 19 In addition, as set out in paragraph 27 of the Settlement Agreement, remedial steps were taken by the Respondent. A number of enhanced compliance procedures and policies and training modules have been implemented, and continue to be implemented, by HollisWealth, relative to the documentation and sale of exempt market products. A new mandatory Prospectus Exemption Certificate was introduced to be completed and signed by clients, advisors and branch managers and forwarded to Head Office Compliance in connection with each purchase of a product sold pursuant to a prospectus exemption.

¶ 20 Further, as set out in paragraphs 28 to 31 of the Settlement Agreement, a remediation plan has been introduced by Scotia Capital to compensate persons affected by any losses suffered. We were told that letters recently went out informing affected persons of what remediation steps are being taken by Scotia Capital. The plan is to complete the remediation process in the fall.

¶ 21 Significant internal discipline steps (see paragraphs 31 and 32 of the Settlement Agreement) have been taken by the Respondent in connection with the sale of Exempt Funds. Advisors who sold Exempt Funds where the account information did not support the clients' qualification for a prospectus exemption are required to re-

write the Conduct and Practices Handbook Examination. And these advisors are required to pay internal fines ranging from $2,500 to $30,000, totalling approximately $440,000, which will be donated to charity. In cases where there has been a loss, the advisors have to contribute a percentage to the remediation payments described above. Branch Managers who supervised the advisors will also be required to re-write the Conduct and Practices Handbook Examination and all current Branch Managers have to write or re-write a relevant industry course on exempt market products.

¶ 22 IIROC Staff Policy Statements, dated February 2, 2015 encourages such internal discipline steps, stating: "This practice is to be encouraged as it is appropriate for Dealer Members to effectively address the conduct of its employees and to encourage and foster a culture of compliance."

¶ 23 The one similar IIROC case cited by counsel is *Re TD Waterhouse Canada Inc.* (2008 IIROC 7). In that case, the fine was $2 million, but the conduct was more serious, resulting in a bankruptcy and significant losses, and the important mitigating factor of self-reporting in the present case was not found in that case. In the present case, the gains by the investors far exceeded the losses (see paragraph 21 of the Settlement Agreement). Moreover, the exempt products sold in the present case were all legitimate funds, for which the Respondent received ordinary fees.

¶ 24 Self reporting, compensation, and upgrading compliance systems, as in the present case, was stressed by a recent Ontario Securities Commission panel in *Re TD Waterhouse Private Investment Counsel Inc.* (2014 LNONOSC 2192). The Panel stated in paragraph 7 in accepting a settlement:

> "These factors respecting compensation, improvement of compliance processes to protect investors, and self-reporting by registrants, in the Panel's view, are crucial to the acceptability of this no-contest settlement since they achieve the objectives of being protective of investors and of being forward-looking. They also signal to other market participants the importance placed by the Commission on self-reporting, remediation of harm to investors and on internal compliance systems that operate appropriately."

¶ 25 The Commission Panel underscored the importance of self-reporting, stating at paragraph 10:

> "the Panel wishes to underscore the importance of timely and fulsome self-reporting of potential regulatory infractions by market participants. Not only is this an on-going responsibility of registrants, but it is an important component of accountability to the Commission for potential regulatory inadequacies."

¶ 26 The Penalty in the present case is sufficient to achieve both general and specific deterrence. We agree with the concluding statements of IIROC Counsel in the present case, concurred in by counsel for the Respondent:

> "The settlement recommended for your acceptance today is consistent with the objectives of the IIROC disciplinary process – to protect the integrity of Canada's capital markets and maintain high standards of conduct. The sanctions and remedies are preventative in nature, protect the investing public, address and remediate the client harm and improve the overall business standards and practices at Scotia Capital. The facts of this case will it is hoped encourage other industry participants to take similar steps when becoming aware of breaches of regulatory requirements and when faced with similar circumstances make similar choices including self-reporting and thorough internal reviews which are shared with IIROC Staff.'

CONCLUSION

¶ 27 For the above reasons we accepted the Settlement Agreement.

Dated at Toronto this 11 day of August 2015

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

Peter J. Gribbin

Guenther W.K. Kleberg

SETTLEMENT AGREEMENT

I. INTRODUCTION

1. IIROC Enforcement Staff ("Staff") and Scotia Capital Inc. (the "Respondent") consent and agree to the settlement of this matter by way of this agreement (the "Settlement Agreement").

2. The Enforcement Department of IIROC has conducted an investigation ("Investigation") into the conduct of HollisWealth, a division of the Respondent, which was formerly DundeeWealth, a division of DWM Securities Inc.

3. The Investigation discloses matters for which the Respondent may be disciplined by a hearing panel appointed pursuant to IIROC Transitional Rule No.1, Schedule C.1, Part C (the "Hearing Panel").

II. JOINT SETTLEMENT RECOMMENDATION

4. Staff and the Respondent jointly recommend that the Hearing Panel accept this Settlement Agreement.

5. The Respondent admits to the following contravention of IIROC Dealer Member Rules, Guidelines, Regulations or Policies:

> Between September 14, 2005 and June 2013, DWM Securities Inc. ("DWM"), which subsequently amalgamated with the Respondent, failed to establish and maintain a system of controls and supervision that was adequate to ensure that certain clients were qualified to purchase investment funds offered pursuant to prospectus exemptions, contrary to IIROC Dealer Member Rules 38.1, 1300.1(a) and 2500(II) (formerly IDA By-Law 29.27(a)(i), Regulation 1300.1(a) and Policy 2).

6. Staff and the Respondent agree to the following terms of settlement:

   a) A fine of $500,000;

   b) the Respondent will report on the execution of the Remediation Plan (as defined below in paragraph 28) to IIROC's Vice-President of Enforcement by no later than October 30, 2015, and as thereafter required by the Vice-President of Enforcement to ensure the Remediation Plan is completed satisfactorily; and

   c) the internal fines imposed, as set out in paragraph 31, will be donated by the Respondent to charity.

7. Staff and the Respondent agree that no costs be paid by the Respondent to IIROC in connection with this Settlement Agreement.

III. STATEMENT OF FACTS

(i) Acknowledgement

8. For the purposes of this Settlement Agreement only, Staff and the Respondent agree with and rely upon the admitted facts and conclusions set out in this Section III.

(ii) Factual Background

Overview

9. DWM's advisors sold certain investment funds offered pursuant to prospectus exemptions ("Exempt Funds") to clients over the course of approximately eight years without ensuring that certain clients were qualified to purchase the Exempt Funds.

10. During much of that time DWM failed to identify that Exempt Funds were being sold by advisors to certain clients where the account information contained in client files did not evidence the clients' qualifications to purchase Exempt Funds.

11. The Respondent self-identified the documentation deficiencies and conducted an internal review of all Exempt Funds sold to clients during the period September 14, 2005 to December 31, 2013 (the "Review

Period") to determine the scope of the issue. The Respondent reported the issue to, and shared the results of the internal review with, IIROC Staff.

The Respondent

12. DWM was acquired by the parent company of the Respondent on February 1, 2011. DWM subsequently amalgamated with the Respondent on November 1, 2013 at which time it became a division of the Respondent under the name HollisWealth. References to the Respondent in this Settlement Agreement refer to DWM prior to November 1, 2013 and to HollisWealth on and after November 1, 2013.

13. At all material times, the Respondent was a Member of the IDA, and then IIROC, with its head office located in Toronto, Ontario.

Sale of the Exempt Funds by the Respondent

14. The Exempt Funds consist of (a) investment funds previously managed by GCIC Ltd. and now managed by an affiliate of the Respondent (the "Dynamic Exempt Market Funds") and (b) investment funds managed by unaffiliated third party fund managers ("Third Party Funds").

15. During the Review Period, none of the Exempt Funds were qualified by a prospectus and, therefore, the Exempt Funds were only permitted to be distributed pursuant to prospectus exemptions.

16. During the Review Period, Exempt Funds were sold to approximately 9,983 separately identified clients[1] of the Respondent.

17. During the Review Period, the Respondent sold the Exempt Funds to clients primarily pursuant to the following prospectus exemptions in National Instrument 45-106 *Prospectus and Registration Exemptions*:

    (a) Section 2.3 (Accredited Investor);

    (b) Section 2.9 (Offering Memorandum) (except Ontario);

    (c) Section 2.10 (Minimum Amount Investment);

    (d) Section 2.19 (Additional Investment in Investment Fund); and

    (e) Section 2.24 (Employee, Executive Officer, Director and Consultant).

Internal Review of Client Documentation Deficiencies

18. In mid to late 2012, instances of lack of documentation to support clients' qualifications to purchase certain Dynamic Exempt Market Funds were identified. That led to a comprehensive internal review for the Review Period of the sale of both the Dynamic Exempt Market Funds and Third Party Funds (the "Review").

19. Due to its comprehensive scope and complexity, the Review took over a year to complete. During that time and thereafter, the Respondent has devoted substantial internal resources to completing the Review and to implementing changes to its policies, procedures and internal controls as outlined below. In addition, the Respondent retained at significant expense the services of external legal and forensic accounting advisors to assist in conducting the Review and designing and implementing the Remediation Plan.

20. The Review analysed each purchase of the Exempt Funds together with the available client account documentation to determine whether those documents were sufficient to support that the client qualified for a prospectus exemption at the time of the transaction.

21. The Review found that:

[1] Individual clients are assigned identification markers. A single client may have one or more such markers, each of which may be associated with one or more accounts. The term "separately identified clients" is synonymous with client identification markers.

(a) certain Exempt Funds (the "Identified Funds") were sold by advisors to approximately 1,710 separately identified clients with the Respondent where (i) the account information did not support the clients' qualifications for a prospectus exemption; and (ii) such clients have already sold the Identified Fund(s) and the clients have experienced a realized loss/gain or such clients continue to hold the Identified Fund(s) in their accounts with the Respondent (the "Affected Clients");

(b) Affected Clients experienced approximately $16.7 million in net gains (including unrealized gains) in respect of purchases of the Identified Funds and approximately $4.5 million in net losses (including unrealized losses) in respect of purchases of the Identified Funds;

(c) approximately 594 of the Affected Clients were in a net loss position;

(d) 72 advisors across Canada sold Identified Funds to Affected Clients that resulted in net losses;

(e) approximately 84% of the net losses experienced by Affected Clients were less than $25,000 and only one Affected Client lost more than a $100,000; and

(f) approximately 91% of the purchases of the Identified Funds that led to the net losses in question took place prior to the aforesaid purchase of DWM and all took place prior to the amalgamation referred to in paragraph 12 above.

Failure to Supervise

22. DWM's advisors had frontline responsibility for ensuring that clients qualified to purchase Exempt Funds.

23. DWM had policies, procedures and advisor training programs relating to the sale of Exempt Funds during the Review Period.

24. DWM failed to establish and maintain a system of controls and supervision that was adequate:

(a) to reasonably ensure that its advisors were following the policies and procedures and discharging their responsibilities under the policies and procedures;

(b) to reasonably ensure that its Branch Managers were adequately implementing and enforcing the policies and procedures; and

(c) to detect in a timely manner that the Identified Funds were being sold to clients where the account information in client files did not support the clients' qualifications for a prospectus exemption.

Mitigating Factors

(i) Proactive and Exceptional Cooperation

25. The Respondent self-identified the lack of adequate documentation to support that certain clients qualified to purchase the Exempt Funds pursuant to prospectus exemptions. Furthermore, the Respondent self-reported the issue to IIROC in December 2013 and conducted the Review while providing IIROC with regular progress updates. The Respondent promptly shared the detailed findings of the Review with IIROC and otherwise fully cooperated with the regulatory investigation. Staff has considered this proactive and exceptional cooperation as a factor in agreeing to the sanction set out above.

(ii) Remedial Steps

26. The Respondent's own compliance program identified instances of lack of adequate documentation relating to the purchase of certain Dynamic Exempt Market Funds. The Respondent thereafter initiated the Review and, in order to ensure its comprehensiveness, expanded its scope to include all Exempt Funds sold during the Review Period.

27. A number of enhanced compliance procedures and policies and training modules have been

implemented, and continue to be implemented, by HollisWealth relative to the documentation and sale of exempt market products. HollisWealth introduced a new mandatory Prospectus Exemption Certificate ("PEC") in June 2013 to be completed and signed by clients, advisors and branch managers and forwarded to Head Office Compliance in connection with each purchase of a product sold pursuant to a prospectus exemption; enhanced its automated compliance system to flag all purchases of Exempt Funds which Compliance matched to PECs on file; and more recently further enhanced its automated compliance system to automatically permit the qualification of clients for prospectus exempt transactions based on account information in client files and produce exceptions for review.

(iii) Remediation Plan

28. The Respondent has voluntarily developed and is implementing a remediation plan that is based on client transaction information contained in its books and records. The Respondent intends to pay Affected Clients who have suffered a net realized loss, an amount equal to that realized loss, plus interest from the date of realization of the loss, and to encourage Affected Clients who continue to hold the Identified Funds in accounts with the Respondent to redeem their holdings and receive payment for any net realized losses (the "Remediation Plan").

29. The Respondent will forthwith begin to communicate to Affected Clients the details of the compensation to be provided under the Remediation Plan.

30. The Respondent will ensure that the account documentation for any Affected Client who wants to retain an Identified Fund is up-to-date and that a client suitability assessment is conducted.

(iv) Internal Discipline

31. The Respondent will require all advisors who sold the Exempt Funds to clients where the account information did not support the clients' qualifications for a prospectus exemption (the "Affected Advisors") to re-write the Conduct and Practices Handbook Examination (the "CPH"). The Respondent will also be imposing internal fines on Affected Advisors ranging from $2,500 to $30,000, totalling approximately $440,000 (which will be donated by the Respondent to charity) and will require those with Affected Clients who experienced a loss in connection with the purchase of an Identified Fund to reimburse it, in percentage amounts ranging from 20% to 50%, for remediation payments made to clients. The fine and client remediation ranges for Affected Advisors will be determined according to the number of sales of Exempt Funds to clients where the account information did not support the clients' qualifications for a prospectus exemption and by the total losses of Affected Clients, respectively.

32. Moreover, all current Branch Managers who supervised the advisors in question at the relevant time will be required to re-write the CPH. Lastly, all current Branch Managers will be required to write or re-write a relevant industry course on exempt market products and have been or will be trained on new system alerts and accredited investor supervision processes and requirements.

IV. TERMS OF SETTLEMENT

33. This settlement is agreed upon in accordance with IIROC Dealer Member Rules 20.35 to 20.40, inclusive and Rule 15 of the Dealer Member Rules of Practice and Procedure.

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

35. The Settlement Agreement shall become effective and binding upon the Respondent and Staff as of the date of its acceptance by the Hearing Panel.

36. The Settlement Agreement will be presented to the Hearing Panel at a hearing ("the Settlement Hearing") for approval. Following the conclusion of the Settlement Hearing, the Hearing Panel may either accept or reject the Settlement Agreement.

37. If the Hearing Panel accepts the Settlement Agreement, the Respondent waives its right under IIROC rules and any applicable legislation to a disciplinary hearing, review or appeal.

38. If the Hearing Panel rejects the Settlement Agreement, Staff and the Respondent may enter into another settlement agreement; or Staff may proceed to a disciplinary hearing in relation to the matters disclosed in the Investigation.

39. The Settlement Agreement will become available to the public upon its acceptance by the Hearing Panel.

40. Staff and the Respondent agree that if the Hearing Panel accepts the Settlement Agreement, they, or anyone on their behalf, will not make any public statements inconsistent with the Settlement Agreement.

41. Unless otherwise stated, any monetary penalties and costs imposed upon the Respondent are payable immediately upon the effective date of the Settlement Agreement.

42. Unless otherwise stated, any suspensions, bars, expulsions, restrictions or other terms of the Settlement Agreement shall commence on the effective date of the Settlement Agreement

AGREED TO by the Respondent at the City of Toronto in the Province of Ontario, this 21st day of July, 2015.

"Witness"	"Respondent"
WITNESS	RESPONDENT

AGREED TO by Staff at the City of Toronto in the Province of Ontario, this 22nd day of July, 2015.

"Andrew Werbowski"	"Charles Corlett"
WITNESS	CHARLES CORLETT Enforcement Counsel on behalf of Staff of the Investment Industry Regulatory Organization of Canada

ACCEPTED at the City of Toronto in the Province of Ontario, this 5th day of August, 2015, by the following Hearing Panel:

Per: "Martin Friedland"

Martin Friedland – Panel Chair

Per: "Peter Gribbin"

Peter Gribbin – Panel Member

Per: "Guenther Kleberg"

Guenther Kleberg – Panel Member