Re Bodnarchuk

IN THE MATTER OF:

The Rules of the Investment Industry Regulatory Organization of Canada

and

Edward Peter Bodnarchuk

2018 IIROC 22

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

Heard May 07-11, 2018 in Winnipeg, Manitoba
Decision: June 22, 2018

Hearing Panel:
Michael F. C. Radcliffe Q.C., Chair, Debbie Archer and Guenther Kleberg
Appearance:
Tayen Godfrey, Enforcement Counsel for IIROC
Edward Peter Bodnarchuk, Respondent, Appearing in person

DECISION AND REASONS

Introduction

¶ 1 This hearing proceeded in accordance with an Amended Notice of Hearing, issued July 26, 2017, pursuant to Part 10 Dealer Member Rule 20 of the Investment Industry Regulatory Organization of Canada (hereinafter referred to as IIROC), and pursuant to Rule 6.2 of IIROC's Dealer Member Rules of Practice and Procedure (Rules of Practice and Procedure) by way of "The Standard Track".

¶ 2 A prior hearing on this matter was held in Winnipeg, November 20-24, 2017, but the Hearing Panel recused themselves and the matter was put over to May 7-11, 2018 as aforesaid.

¶ 3 The hearings initially arose from complaints to IIROC from Client G.S. (dated 21/3/2013) and Client T.B. (dated 18/5/2016), which resulted in investigation of same by Michael Smith, an investigator employed by IIROC.

¶ 4 The following contraventions are alleged by IIROC staff, namely:

CLIENT G.S.

Count 1:

Between July of 2008 and November of 2012, the Respondent failed to use due diligence to learn and remain informed of the essential facts relative to G.S., contrary to Dealer Member Rule 1300.1(a)

Count 2:

Between July of 2008 and November of 2012, the Respondent made unsuitable recommendations for the account of G.S., contrary to Dealer Member Rule 1300.1(q)

Count 3:

Between July of 2008 and November of 2012, the Respondent made discretionary trades in the account of G.S., contrary to Dealer Member Rule 1300.4

CLIENT T.B.

Count 4:

Between August of 2010 and April of 2016, the Respondent failed to use due diligence to learn and remain informed of the essential facts relative to T.B., contrary to Dealer Member Rule 1300.1(a)

Count 5:

Between August of 2010 and April of 2016, the Respondent made unsuitable recommendations for the account of T.B., contrary to the Dealer Member Rule 1300.1(q)

Count 6:

Between August of 2010 and April of 2016, the Respondent made discretionary trades in the accounts of T.B., contrary to the Dealer Member Rule 1300.4

Count 7:

Between October of 2010 and December of 2012, the Respondent failed to disclose to his firm activities that fell outside the scope of his duties as a Registrant that created a real or potential conflict of interest between the Respondent and his clients contrary to the Dealer Member Rule 29.1

¶ 5 IIROC staff filed a motion on April 25, 2018 requesting timelines for:

a. filing and serving a Notice of Hearing
b. providing the Respondent Disclosure
c. providing the Respondent a Reliance List of documents,

all of which documents alleged an additional violation regarding personal financial dealings by the Respondent. The Hearing Panel rejected the motion by way of a decision dated May 3, 2018, and the matter proceeded based on the Notice of Hearing dated July 26 2017.

¶ 6 At the outset of the hearing, this Panel received IIROC's binders of documents, including various email communications, transaction account statements and recorded statements of the Respondent.

¶ 7 The Respondent submitted a binder containing accounts for the subject clients, correspondence from National Bank and from MLT Aikins LLP, the Respondent's former solicitor, some of which documentation was admitted by consent of counsel for IIROC. Transcripts of prior proceedings between the parties were not accepted as not relevant. The ombudsman had, at the behest of the clients, conducted an inquiry, as had National Bank. The Panel did not consider this evidence nor the conclusions they reached, because the author of these reports was not called to properly present same in evidence as the maker of the documents. The Panel was also not informed as to the test upon which these inquiries was based. The Panel was only concerned with the standards of behaviour imposed on financial consultants by the IIROC Rules, Regulations & Codes.

¶ 8 At the hearing, IIROC staff presented *viva voce* evidence of an IIROC investigator, Michael Smith, and two witnesses identified for the purposes of this decision and reasons as "G.S." and "T.B." A summary of the evidence of these witnesses is set out below.

Decision

¶ 9 Taking into account all the evidence of both parties, the witnesses who testified, the documents submitted, the case law presented, as to the issue of exercising due diligence to learn and remain informed of the essential facts relative to G.S., the Panel finds, on a balance of probabilities, the Respondent guilty on Counts 1, 2, and 3. Further, the Panel finds the Respondent guilty on Counts 4, 5, 6, and 7 as they relate to T.B.

on a balance of probabilities.

Testimony of Michael Smith

¶ 10 Michael Smith outlined his previous experience as a senior investigator of some eleven years' standing, and also his academic qualifications including a Canadian Securities course. Smith also advised he had reviewed and relied on the investigative notes of a previous IIROC investigator in these matters, Ms. Chan, who was no longer involved in the inquiry.

¶ 11 Smith advised that the Respondent had been employed with a member of brokerage houses, namely Dundee Security Corp., Union Securities, National Bank and P.I. Financial Holdings.

¶ 12 Counsel submitted NCAF (New Client Application Form) statements from G.S., one from Union Securities dated March 28, 2008 and a second from National Bank dated October 15, 2010, both prepared by the Respondent, and both signed by the client. Each form indicated G.S. had good investment knowledge, wanted long-term growth, and was prepared for speculative investment and had a high-risk factor in the portfolio.

¶ 13 Michael Smith submitted a transcript of an examination of G.S., indicating the Respondent had known G.S. for a long time and had moved the client's investments from mutual funds to "junior metals". The client's entire RRSP was invested in the junior metals.

¶ 14 G.S. indicated she was advised by the Respondent as to the meaning of risk in junior metals. Her understanding was that there could be fluctuations in value. She did not appreciate that her investment could be wiped out. This information is contained in a transcript of her examination by an IIROC investigator (Book (1) C (1)).

¶ 15 The Respondent indicated in a transcript of an examination by a previous investigation officer from IIROC that he had known G.S. for a long time, visited with her socially and did move her RRSP from mutual funds to junior metals in order to realize significant growth in her account. The Respondent confirmed that he had completed the NCAF forms set out above after discussion with G.S. and based on his lengthy relationship with her.

¶ 16 The Respondent confirmed in the transcript that "All junior exploration are specifically highest risk there is."

¶ 17 The parties both confirmed in the examination and in testimony before the Panel that G.S. had invested in a "Rainy River Resources" stock which experienced very significant capital gain and created a large profit for the client. A number of the stocks the Respondent placed G.S. in fell in value subsequently and while concerned about the loss, the Respondent counselled G.S. not to sell or diversify and wait for the market to recover.

¶ 18 The Respondent was quite clear in his testimony that he relied on the decision expressed by G.S. to invest in the junior metals, place 100% of her portfolio in the investment, and when the market fell, to remain invested in Bison Gold and RPT and wait for the cycle to change. Both IIROC, the Respondent and the client seem to agree with the facts in this matter.

¶ 19 The Respondent acknowledged he was aware of the earning capacity of the client G.S., the fact that this portfolio represented her entire retirement investment, that she had no workplace pension and wanted her capital to grow on a time horizon of 15 years, so as to satisfy her needs in retirement.

¶ 20 The Respondent testified he had a close and long-standing relationship with G.S., had visited her at her place of employment in Steinbach Manitoba, at her home and established a relationship with her husband. The Respondent reflected that G.S. was a strong-willed person, who was not shy giving him direction on her investments. The Respondent communicated regularly with G.S. by email and helped her complete several NCAF new client admission forms. He already knew a lot of the details of her life, her occupation and her needs for financial returns. The Respondent sent G.S. regular financial reports on the status of her investments which

she stated she neglected to open or review. G.S. appeared to be willfully blind as to the nature of her investments and failed to take personal responsibility for her portfolio.

¶ 21 The Respondent further testified he focused his interest in the stock market and focused his research and knowledge in junior metals and speculative stocks. We find he explained to G.S. the nature of these investments, their volatility, and long-term potential. Taking into account the specialization of the Respondent, the apparent lack of sophistication, the concentration of a small amount of assets which represented her entire net worth, we feel the Respondent failed to appreciate the vulnerability of this investor.

Rule 1300.1 (a) states:

> Each member shall use due diligence to learn the essential facts relative to every customer and to every order or account accepted.

¶ 22 This rule has been interpreted in the case law. The case Re Yaskiw (2016 IIROC 53) found at tab 4D of the Book of Authorities reviews in detail the standard or test imposed by a financial advisor.

¶ 23 Para 141 Re Lamoureux (supra) 2001 ASCD no 613, (2001 LNARASC 433) notes that the suitability obligation of the registrant cannot be passed to the client and is particularly important for clients who are not sufficiently sophisticated to enable them to fully recognize or assess the risks inherent in an investment (at pp 19-20).

¶ 24 Para 144 Re Yaskiw, the Panel notes in part:

> '144' The Panel in Re Gareau supra at paragraph 143 (2011 LN IIROC 53) also noted that the Respondent was relied upon and trusted, and in his financial capacity as a financial advisor had the responsibility of a fiduciary or near fiduciary to his client. It noted that such duty was so high that even if the clients had restricted the Respondent to create a totally inappropriate and unsuitable portfolio, he had a responsibility to warn them and to even protect them against themselves.

¶ 25 The Panel in para 145 states that the Respondent must take into account the totality of their personal circumstances including age, risk tolerance, investment knowledge and general sophistication with respect to investments and the market.

¶ 26 The Panel in para 147 in Re Yaskiw (supra) further states that the profitability of the investment, or the lack thereof, is irrelevant in determining the suitability of the investment.

DECISION

¶ 27 In conclusion with regard to the issue of using due diligence to learn and remain informed of the essential facts relative to G.S., the Panel finds the Respondent failed in his duty to invest and protect the client G.S., pursuant to Count 1.

¶ 28 Likewise, with regard to Count 2, for the reasons set out above, the facts presented, and the authorities referenced, the Panel finds the recommendations for the account of G.S. were unsuitable contrary to Dealer Member Rule 1300.1(q).

¶ 29 IIROC has charged that the Respondent between July 2008 and November 2012 made discretionary trades in the account of G.S. contrary to Dealer Member Rule 1300.4, as set out in Count 3.

Evidence of Respondent

¶ 30 The Respondent testified that he made long distance phone calls to G.S. prior to making investments. These calls may have been in the evening, to result in next day trades. No phone records were produced to substantiate these claims and no file notes or electronic record-keeping was presented to the Panel to substantiate this response by the Respondent. In fact, he testified that a disgruntled assistant may have wiped out the records.

¶ 31 G.S. testified that these calls did not occur in advance of the trades. She was advised of the transactions

after the fact. There is conflicting evidence on this count, but in the absence of any documentary proof which it would be incumbent on the Respondent to preserve, we find in favour of the client. The Respondent did not have any documentation which he could have produced to the Panel, permitting him to have the ability to trade the clients' accounts at will.

Charges relating to T.B.

¶ 32 The Respondent has been charged with similar charges with regard to T.B: Count 4, failing to use due diligence to learn and remain informed of the essential facts relative to T.B., Count 5, making unsuitable recommendations for the account of T.B. between August 2010 and April 2016, and Count 6, making discretionary trading in the accounts of T.B.

Evidence of IIROC

¶ 33 Again, IIROC relied upon the testimony of Michael Smith their investigator, who relied on a transcript of conversations between T.B. and a previous investigator, conversations with the Respondent, emails between T.B. and the Respondent and records and correspondence from the brokerage houses where the Respondent worked.

¶ 34 The client T.B. testified in person and the Respondent also testified as to his relationship and management of the accounts of T.B.

¶ 35 T.B. was a 53-year old commercial insurance agent, involved solely in the risk management side of this insurance business. He had approximately $300,000 from a sale of his business and inheritance from his father. He had no experience with investing in stocks himself and his assets were invested in mutual funds when he first started doing business with the Respondent. The first 'NCAF' form completed by T.B. and signed by him was Dundee Securities in 2007, next with National Bank in 2010, and finally with PI Financial in 2013.

¶ 36 In each form, T.B. indicated his investment objective was 100% aggressive growth and his risk tolerance was 100% high-risk. The transcripts indicate the client considered the risk to be highly volatile but he indicated the Respondent did not ever advise him he could lose his entire investments in the junior resources market.

¶ 37 T.B. invested through the Respondent in Rainy River Resources, a junior resources stock and made some significant profits. When the Respondent moved T.B. out of that investment, T.B. indicated (p.8 of the transcript of an interview with an IIROC investigator, filed as tab I(1) Book 2 in the proceedings ll:25-27):

> "… like I'm 53, 54 years old, if I can double my money over the next 10 years, I can do fine, or six percent, I'm happy with that. I said I don't want to ever go through these things again and he just, no, we got to keep on doing what we're doing."
>
> Line 27: "And he convinced you to do that?"
>
> Line 28: "yeah".

¶ 38 It's common ground between the parties that T.B. continued to invest in the junior resource stocks, and the Respondent was his financial advisor throughout the period 2010-2016. The point of contention in the evidence is whether T.B. wanted to remain invested, or take his losses, and whether the Respondent advised him to do that or stay the course. We certainly saw emails between the parties talking about the investment cycles and staying the course. The uncontroverted facts are that T.B. did remain invested in the junior resources.

¶ 39 The Respondent presented a scenario that T.B. was a sophisticated investor because he had owned an insurance business and was accustomed to reading profit and loss statements and balance sheets.

¶ 40 The Respondent indicated T.B. had a viable and prosperous insurance agency and thus a stable source of income separate from this investment portfolio.

¶ 41 The Respondent further contended that the investments in the junior resource market were made at the direction and insistence of T.B. in order to reap large and quick profits. The three NCAF forms completed and signed by T.B. clearly state he was prepared to be an aggressive investor in a high-risk market.

¶ 42 The Panel heard the representations by T.B. in person and we choose to accept his evidence that he was not experienced or particularly knowledgeable in the stock market let alone the junior resource market. The sum of money invested formed a very large part of the financial worth held by T.B. He did not appreciate that it could very likely be wiped out by these investments.

¶ 43 The Panel would consequently adopt the rationale, the tests of professional behaviour set out in the counts set out above with G.S. and find that the Respondent did not discharge his professional nor fiduciary duty in discerning that the risk tolerance for T.B. nor the suitability of the investments.

¶ 44 Sadly, we would comment that the Respondent felt badly that his clients lost the monies they did, which were significant sums to them. Further, the Respondent likely honestly believed he was acting in the best interests of both these investors. The fundamental error committed by the Respondent was that given the modest and unsophisticated background of both investors, and despite their clear instructions to invest in the market, the Respondent had a clear and unequivocal duty to place their investments in conservative "blue ribbon" shares to preserve their capital and provide modest but steady growth. The Respondent failed to employ this strategy with T.B. and consequently we find IIROC has proven the charges expressed in Counts 4 and 5.

¶ 45 The sixth Count made against the Respondent is between August 2010 and April 2016, the Respondent was involved in discretionary trading in T.B.'s accounts without proper and documented permission. We do not for a moment think that the Respondent did not inform T.B. of which stocks were purchased, but the Respondent failed to obtain permission from T.B. prior to effecting the trade. Page 16, transcript I (1) book 2 ll:20-21:

> Question: "Did he speak to you each time he bought or sold stock for you?"
>
> Answer T.B. "No"

¶ 46 T.B. expressed a similar position in his oral testimony. He was credible, and his evidence was reliable. We accept his evidence.

¶ 47 The Respondent alleged he talked frequently to T.B. about his trades, and the status of his accounts. The Respondent failed to produce a log or written notes confirming any such conversations. Consequently, we accept the position of T.B. and find there was unauthorized trading by the Respondent.

¶ 48 The last Count brought by IIROC (Count 7) against the Respondent is that between October 2010 and December 2012, the Respondent acted outside his duties as a registrant, creating a real or potential conflict of interest with his clients.

Evidence pertaining to Count 7

¶ 49 This Count 7 refers to a proxy battle in which the Respondent acted to displace the then-acting Board of Directors in RPT Uranium Resources Ltd, and Bison Gold respectively. The trail of emails in the material submitted shows that the Respondent was actively soliciting his clients to vote their share proxies to replace the directors in the said corporations. There is no evidence that the Respondent told his employer National Bank of his involvement in the proxy dispute.

¶ 50 The Respondent had personal holdings in the shares of RPT at the time he was involved in a takeover of the company. His position as a shareholder in his own right and as a financial advisor for his clients (which was his primary obligation) could be considered at odds. He was not a wholly disinterested objective advisor and hence the issue of conflict of interest arose.

¶ 51 The Respondent again likely believed that he was acting in the best interests of the corporations and his clients, but by personally interposing his personal position, his activity in the companies is tainted.

Conclusion

¶ 52 Therefore, the Panel finds IIROC has made out the case on Count 7 on a balance of probabilities, and finds the Respondent breached Rule 29.1 of the Dealer Member Rules. His conduct was clearly outside what is

required of a financial advisor.

¶ 53 The Panel finds that IIROC has made out its case against the Respondent on a balance of probabilities on all seven Counts herein and directs that a penalty hearing be scheduled.

Dated at Winnipeg, Manitoba, this 22nd day of June, 2018.

Michael F. C. Radcliffe

Debbie Archer

Guenther W. K. Kleberg