

Re Portfolio Strategies Securities

IN THE MATTER OF:

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

and

Portfolio Strategies Securities Inc

2012 IIROC 36

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

Heard: June 18, 2012 in Toronto, ON

Decision: June 26, 2012

Hearing Panel:

Hon. Patrick T. Galligan, Q.C. (Chair), Guenther W.K. Kleberg, Robert J. Guilday

Appearance:

Natalija Popovic, Enforcement Counsel

Thomas Manson, Q.C., Counsel for the Respondent (Appeared by telephone conference call)

Reasons for Decision

¶ 1 The Staff of Investment Industry Regulatory Organization of Canada (“IIROC”) and the Respondents entered into a Settlement Agreement which they had negotiated pursuant to Rule 20.36 of IIROC Dealer Member Rules. They submitted the Settlement Agreement to this Hearing Panel pursuant to Rule 15 of the Rules of Practice for approval or rejection. After considering the material filed and the submissions made by counsel, we issued an order accepting the Settlement Agreement. These are our reasons for making that order.

THE CONTRAVENTIONS

¶ 2 The Respondent has admitted to the following contraventions of IIROC Rules, Guidelines, IDA By-Laws, Regulations or Policies:

1. From approximately December 2009 to November 2010 the Respondent failed to designate a supervisor qualified to supervise options trading at the firm, contrary to IIROC Rule 1900.2(a).

and

2. From approximately March to December 2010 the Respondent failed to supervise the activities of an individual who was a consultant and agent, of the firm, contrary to IIROC Rule 38.1.

TERMS OF SETTLEMENT

¶ 3 Staff and the Respondent have agreed to the following terms of settlement:

- The Respondent to pay a global fine of \$40,000;
- The Respondent to pay costs to IIROC in the sum of \$3,500.

THE CIRCUMSTANCES

¶ 4 The circumstances are set out, in detail, in paragraphs 16-36 of the Settlement Agreement. It is attached as Appendix “A” to these reasons for decision. The following is a brief summary of them.

¶ 5 Lack of Qualified Options Supervisor. From December 15, 2009 to November 12, 2010, the Respondent did not have a qualified Options Supervisor on its staff. During that period, however, there were approximately 100 opening options trades entered into. There were also approximately 90 closing options trades which were made to offset existing options positions.

¶ 6 Failure to Supervise Staff. In March 2010 the Respondent retained a Consultant to provide services to its financial department. It failed to supervise the account activity and the email account of the Consultant. The lack of supervision of the Consultant continued until January 2011.

SERIOUSNESS OF THE CONTRAVENTIONS

¶ 7 The responsibility of Dealer Members to comply with their obligations to supervise their activities and their employees is a very important one. Supervision is necessary to ensure ethical conduct, fair trading and the integrity of the investment industry. The contraventions in this case must, therefore, be treated as serious ones.

CIRCUMSTANCES OF MITIGATION

¶ 8 In the determination of an appropriate penalty, it is always necessary to consider circumstances of mitigation. The circumstances of mitigation which we take into account in this case are:

- (1) The Respondent has no disciplinary history;
- (2) The Respondent cooperated fully with Staff during its investigation which demonstrates that the Respondent has acknowledged its contraventions, accepted its responsibilities and has shown remorse;
- (3) There were no complaints from clients from which we infer that no losses were suffered.

DUTY OF A HEARING PANEL UPON A SETTLEMENT HEARING

¶ 9 It is clear from jurisprudence emanating from the courts and from Hearing Panels of IIROC, Investment Dealers Association and the Mutual Fund Dealers Association, that our task is not to decide whether, in this case, we would have arrived at the same decision as that reached by the parties. Rather, our duty is to determine whether the penalty is a reasonable one and that it meets the objectives of the disciplinary process which are to maintain the integrity of the investment industry. We cite from the recent decision of the Hearing Panel in *Re CIBC World Markets Inc.*, [2011] IIROC No. 38:

13 Finally, hearing panels will not lightly interfere with a negotiated settlement. As was said in *Re Milewski*, [1999] IDACD No. 17,

... 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.

14 Or, as put by Winkler J. (albeit in another context) in *Gilbert v. CIBC*, [2004] O.J. 4260:

There is a presumption of fairness when a proposed class settlement negotiated at arms length ... is presented to the court for approval. A court will only reject a proposed settlement when it finds that the settlement does not fall within a range of reasonableness.

The test to be applied is whether the settlement is fair and reasonable ... This allows for a range of possible results and there is no perfect settlement. Settlement is a product of compromise, which by definition, necessitates give and take.

15 In our view, the settlement, negotiated as it was by the parties assisted by capable counsel, does not clearly fall “outside a range of appropriateness” and it should therefore be, and was, accepted by the panel.

¶ 10 We share the opinion expressed by the hearing panel in *Re Vorstadt*, [2012] IIROC that the settlement process is an important one which should be “encouraged and supported”.

GUIDELINES AND OTHER DECISIONS

¶ 11 In determining whether a settlement is a reasonable one, a hearing panel is entitled to look at regulatory guidelines and other decisions. Guidelines are not binding upon a hearing panel and cannot derogate from its responsibility to decide what may be an appropriate penalty in a given case. However, they are useful in that they show what penalties members of the industry think are generally appropriate. In this case there are no specific guidelines for the contraventions which are admitted by the Respondent.

¶ 12 Decisions in other cases can often be of some assistance by helping to indicate what might be a reasonable range of monetary penalties. This case is somewhat unique in that there is no jurisprudence which deals with the particular circumstances. Counsel referred us to the decisions in *Re First Capital Partners*, [2009] IIROC No. 19, *Re National Bank Direct*, [2011] IIROC No. 2; and *Re Gareau*, [2005] IDACD No. 25. Those cases have been helpful in that they tend to suggest that the penalties agreed to in this case fall within a reasonable range. The recent decision of a hearing panel in *Re BMO Nesbitt Burns Inc.*, [2012] IIROC was a case involving the failure of adequate supervision by a Member. That case also supports our view that the penalties in this case fall within an appropriate range.

IMPACT OF THE PENALTY

¶ 13 Monetary penalties are necessary to act as specific and general deterrence. The Respondent is not a large organization. The penalty, composed of a fine of \$40,000 and costs of \$3,500, is a significant penalty to it. The penalty is sufficient to act as a specific deterrent to this Respondent and should be sufficient to alert all Members that failure of supervision will attract significant consequences.

DECISION

¶ 14 After the hearing, we considered the circumstances of this case and reached the conclusion that the settlement was a reasonable one. Therefore, we accepted it.

DATED this 26th day of June 2012.

The Hon. P. T. Galligan, Q.C., Chair

Guenther W.K. Kleberg, Industry Representative

Robert J. Guilday, Industry Representative

SETTLEMENT AGREEMENT

I. INTRODUCTION

1. IIROC Enforcement Staff and the Respondent, Portfolio Strategies Securities Inc. (PSSI) consent and agree to the settlement of this matter by way of this settlement agreement (the Settlement Agreement).
2. The Enforcement Department of IIROC has conducted an investigation (the Investigation) into the conduct of PSSI.
3. On June 1, 2008, IIROC consolidated the regulatory and enforcement functions of the Investment Dealers Association of Canada and Market Regulation Services Inc. Pursuant to the Administrative and Regulatory Services Agreement between IDA and IIROC, effective June 1, 2008, the IDA has retained IIROC to provide services for IDA to carry out its regulatory functions.
4. The Respondent consents to be subject to the jurisdiction of IIROC.

5. 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

6. Staff and the Respondent jointly recommend that the Hearing Panel accept this Settlement Agreement.
7. The Respondent admits to the following contraventions of IIROC Rules, Guidelines, IDA By-Laws, Regulations or Policies:

1. From approximately December 2009 to November 2010 the Respondent failed to designate a supervisor qualified to supervise options trading at the firm, contrary to IIROC Rule 1900.2 (a).

And

2. From approximately March to December 2010 the Respondent failed to supervise the activities of an individual who was a consultant and agent, of the firm, contrary to IIROC Rule 38.1.

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

- Global fine of \$40,000

9. The Respondent agrees to pay costs to IIROC in the sum of \$3,500.

III. STATEMENT OF FACTS

(i) Acknowledgment

10. Staff and the Respondent agree with the facts set out in this Section III and acknowledge that the terms of the settlement contained in this Settlement Agreement are based upon those specific facts.

(ii) Factual Background

A. Overview

11. PSSI failed to designate a supervisor qualified to supervise options trading at the firm for a period of approximately 11 months during which time approximately 100 options trades were entered into. In addition, it failed to supervise the activities of an individual working in the corporate finance department, who was a consultant and agent of PSSI, for a period of approximately nine months.

B. Registration Background

12. PSSI became a Dealer Member of IIROC in April 2008 and continues currently to be registered as such. PSSI's head office is located in Toronto, Ontario.

13. The trading activities of PSSI include securities, options, and managed accounts.

C. Regulatory Requirements

14. IIROC Rule 1900.2 requires, in part, that a Dealer Member that trades in options on behalf of customers designate a supervisor qualified to supervise options trading and to be responsible for approving customer accounts to trade in options; and for establishing and maintaining procedures for the supervision of account activity involving options.

15. IIROC Rule 38.1 requires, in part, that a Dealer Member establish and maintain a system to supervise the activities of each partner, Director, Officer, Registered Representative, Investment Representative, employee and agent of the Dealer Member.

D. Failure to Designate a Qualified Supervisor for Options Trading

16. In October 2010 IIROC's Business Conduct Compliance (BCC) Staff conducted an examination of PSSI. The examination included a follow up on the status of a previous examination and report by BCC

in 2009.

17. In March 2011 BCC Staff delivered its 2010 Business Conduct Examination Report (Report) to PSSI. Among other findings, the Report noted that PSSI did not have a qualified options supervisor at the firm for approximately 11 months from or about December 15, 2009 to November 12, 2010.
18. During this 11 month period approximately 100 opening option trades were entered into and approximately 90 closing option trades were made to off-set existing option positions.
19. On or about November 15, 2010 IIROC was advised that PSSI's carrying broker would commence to temporarily act as the options supervisor at PSSI. The terms of the temporary supervision included that going forward there would be no new option accounts opened or any opening option positions executed. The termination date of the carrying brokers' temporary supervision was to be March 18, 2011, the last expiry date of the existing option positions.
20. No opening or closing option trades occurred between March 18, 2011 and October 20, 2011; the latter being the date when a qualified options supervisor was designated and commenced options supervision at PSSI.

E. Failure to Supervise Staff

The Consultant

21. In or about February 2010 PSSI commenced providing corporate finance services to an Ontario company (the CPC); including in relation to the TSX Venture Exchange's Capital Pool Company program.
22. In or about March 2010 PSSI retained a consultant (the Consultant) to provide translation and other services to its corporate finance department, among other things, in relation to the CPC. However there was no formal written retainer detailing the consulting services.
23. The services provided by the Consultant included joint meetings with potential investors in the CPC to provide information about the investment. In addition, the Consultant on occasion collected information from the investors for the PSSI new client application forms. At all relevant times, the Consultant acted as a consultant and agent of PSSI.
24. There is no evidence that the Consultant offered investment advice to any of the clients.
25. The Consultant subsequently worked full time at PSSI as of September 2010. In or about July 2011 this individual became a registrant of IIROC in the category of a registered representative.

Potential Conflict of Interest

26. The lawyer who introduced the CPC to PSSI also introduced the Consultant to PSSI. In or about August 2010 PSSI was made aware that the Consultant was in a potential conflict of interest as between the CPC and PSSI clients investing in the CPC.
27. In addition to formally noting the existence of the potential conflict of interest, PSSI sought and obtained legal advice regarding whether to disclose the conflict of interest. The advice was that disclosure should be addressed if and when the Consultant became registered. However, PSSI was not advised to and did not consider any other supervisory steps to address and/or manage the potential conflict of interest.

Failure to Supervise Account Activity

28. In or about March 2010 the Consultant opened a personal trading account (the Account) at PSSI. The Account was not marked "pro" or "non-client" at this time. In the capacity as a consultant to the corporate finance department, the Consultant had access to confidential information related to PSSI including client information. Accordingly, to ensure that the Account was properly supervised PSSI had an obligation to impose a heightened level of supervision that could have been achieved by marking the

account as a “pro” or “non-client. It was not until January 2011, that the Account was so identified.

29. The Consultant held shares of the CPC in the Account. On three separate occasions in June, July and August 2010, trading of shares having been halted on July 6, 2010, the Consultant instructed the transfer agent for the CPC to register in excess of 60,000 shares, via three share certificates, in the names of three other PSSI clients.
30. The Consultant subsequently delivered the three share certificates to PSSI and they were subsequently deposited into the accounts of the three clients.
31. PSSI became aware of the circumstances surrounding the deposit of the share certificates in the client accounts and on the advice of a third-party securities consultant, simply documented the matter. PSSI took no other supervisory steps in relation to this issue.

Failure to Supervise Email Account

32. Upon commencing work as a consultant for PSSI in March 2010 the Consultant was assigned a PSSI email account. However, in addition to this email account, the Consultant also used an external personal email account to conduct PSSI business during the relevant time.
33. PSSI knew, or ought to have known, about the use of this external email account as in some cases PSSI staff communicated with the Consultant in this manner or were copied on email sent from this external account. The external email account was used as the first language of the Consultant was not English and the email account had a translation function which enabled translation to English. However, there is no evidence that PSSI supervised the Consultant’s use of this external account.
34. In some cases, the external email account was also used for communications between the Consultant and PSSI clients which were not sent to PSSI. While PSSI became aware of some of these communications after the fact, there is no evidence that PSSI took any supervisory steps as a result.
35. In addition, both the Consultant’s PSSI and external email signature lines contained a reference to the PSSI office in Toronto and an office (where the Consultant worked) in Markham, Ontario, including: a street address, telephone and fax numbers. PSSI did not have a Markham office at the relevant, or any other, point in time. In fact the Markham address, telephone and fax numbers were those of the offices of the CPC and the Consultant worked there on Tuesdays and Fridays.
36. The use of this signature and reference to a Markham office were known, or ought to have been known, to PSSI; however there is no evidence that it took any supervisory steps as a result thereof.

Mitigating Factors

37. The Respondent co-operated with Staff in the investigation of this matter.
38. The Respondent has no discipline history with IIROC or the IDA and there is no evidence of any client complaints.

IV. TERMS OF SETTLEMENT

39. 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.
40. The Settlement Agreement is subject to acceptance by the Hearing Panel.
41. The Settlement Agreement shall become effective and binding upon the Respondent and Staff as of the date of its acceptance by the Hearing Panel.
42. 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.

43. 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.
44. 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.
45. The Settlement Agreement will become available to the public upon its acceptance by the Hearing Panel.
46. 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.
47. Unless otherwise stated, any monetary penalties and costs imposed upon the Respondent are payable immediately upon the effective date of the Settlement Agreement.
48. 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 Calgary, in the Province of Alberta, this 1st day of June, 2012.

“Witness signature”

Witness

“Respondent’s signature”

Respondent

AGREED TO by Staff at the City of Toronto, in the Province of Ontario this 4th day of June, 2012.

“Witness signature”

Witness

“Natalija Popovic”

Natalija Popovic

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 18th day of June, 2012, by the following Hearing Panel:

Per: “Patrick Galligan”

Panel Chair

Per: “Robert Guilday”

Panel Member

Per: “Guenther Kleberg”

Panel Member

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