

Re Hampton Securities

IN THE MATTER OF:

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

and

Hampton Securities Ltd.

2017 IIROC 37

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

Heard: July 6, 2017 in Toronto, Ontario

Decision: July 6, 2017

Reasons for Decision: July 24, 2017

Hearing Panel:

Edward T. McDermott, Chair, Lou D'Souza, Charles Macfarlane

Appearances:

Stacy Robertson, IIROC Counsel

Joe Pavao, President of Hampton Securities Ltd., the Respondent

REASONS FOR DECISION

PURPOSE OF HEARING

¶ 1 This Hearing Panel was constituted pursuant to the provisions of the Consolidated Enforcement, Examination and Approval Rules of IIROC (the "Rules") including in particular sections 8203, 8205, 8215 and 8428 thereof.

¶ 2 The Notice of Application which initiated this matter is dated May 2, 2017 and states that a hearing will be held on July 6, 2017 at the IIROC premises located at 121 King Street West, Suite 2000, Toronto, Ontario for the purpose of determining whether a Settlement Agreement entered into between the staff of IIROC and the Respondent Hampton Securities Ltd. ("Hampton") pursuant to a written agreement dated April 4, 2017 (a copy of which is attached as a schedule to these Reasons for Decision) will be accepted or rejected by the Hearing Panel in accordance with the provisions of the Rules.

¶ 3 This Hearing Panel accordingly convened at 10:00 a.m. on July 6, 2017 at the place set forth in the Notice of Application. At that time, both parties were in attendance.

SERVICE AND ADEQUACY OF NOTICE OF APPLICATION

¶ 4 Before proceeding with the hearing, the Hearing Panel reviewed the contents of the Notice of Application filed with the National Hearing Coordinator and was advised by the parties that service of this Notice had been effected in accordance with the Rules. We were accordingly satisfied that the requirements of sections 8406(4), 8428(3) and (4) of the Rules had been satisfied.

¶ 5 The Hearing Panel then proceeded to review the terms of the Settlement Agreement and receive the submissions and representations of counsel for IIROC and the representative of Hampton, both of whom

requested this Hearing Panel to accept the Settlement Agreement and impose the sanctions provided for therein.

SETTLEMENT AGREEMENT

¶ 6 The Hearing Panel also reviewed the form of the Settlement Agreement and was satisfied that it contained the requirements of a Settlement Agreement as set forth in Rule 8215(2).

¶ 7 The Hearing Panel accordingly received and gave careful consideration to the Settlement Agreement and the submissions of the parties in support of such agreement. At the conclusion of these presentations, the Panel recessed the hearing in order that it could deliberate on the information and submissions that had been presented to it with respect to its decision as to whether it should accept or reject the Settlement Agreement. Following such recess, the Hearing Panel advised the parties that it was prepared to accept the Settlement Agreement on the terms proposed and proceeded to execute and record acceptance of such agreement with the reasons for this decision to follow.

¶ 8 The following constitutes the reasons for the decision of this Hearing Panel which led it to conclude that the Settlement Agreement should be accepted.

THE ROLE OF THE HEARING PANEL

¶ 9 The Hearing Panel considered the decisions of previous Hearing Panels placed before us by counsel for IIROC relating to the role of this Hearing Panel in deciding whether it should accept or reject the Settlement Agreement to which the parties to this proceeding have agreed.

¶ 10 The Hearing Panel noted that in previous cases each of us has endorsed the standard and scope of review of the Settlement Agreement as set forth in the following excerpt from the decision in *Re Faber* 2014 IIROC 14 (see also *Re Melville* 2014 IIROC 51 and *Re Sole* (2016 IIROC 30):

9. Under the provisions of IIROC's Rule 20.36, it is open to this Hearing Panel to either accept or reject the Settlement Agreement tendered upon us by the parties. It is not a question of whether the agreed-upon penalties are ones which this Panel would have imposed had the matter come before us for determination at a hearing. It is also not open to us to amend, re-write or alter the terms of the agreement reached between the parties.

10. It is however our fundamental responsibility to be satisfied that the penalties set forth in the agreement are within a reasonable range of appropriateness in the circumstances set forth in the agreed-upon statement of facts.

11. The following excerpts from previously decided cases as recorded in the decision of *Re Ast* (2012 IIROC 38) set forth the parameters of the Hearing Panel's decision making processes when reviewing a Settlement Agreement presented to us by the parties to the dispute:

Standard for Reviewing a Settlement Agreement

13. The standard for reviewing a Settlement Agreement was well-stated in a recent 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.’

14. There are many similar statements. See, for example, *Re Jiwa and Hoffar* (2012 IIROC 9), which adopted an earlier IDA decision, stating: ‘It will not reject a settlement unless it views the penalty as clearly falling outside a reasonable range of appropriateness.’ Another recent example is *Re Trapeze Capital* (2012 IIROC 25), where the panel states:

‘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.’

15. And, finally, see the statement in *Re Rotstein and Zachheim* (2012 IIROC 27):

‘Based upon this material it is our responsibility to review the agreement in order to satisfy ourselves that it falls within a reasonable range of appropriateness to the offence and circumstances recorded in the agreement and that there is nothing in the agreement which would be contrary to the public interest or bring the administration of the Rules of IIROC into public disrepute. If we are satisfied that the Settlement Agreement does not offend these principles then it should be accepted.’

(See also *Re Johnson* (2012 IIROC 19); *Re Portfolio Strategies Securities* (2012 IIROC 36); *Re Malewski* [1999] I.B.A.C.D. No. 17).

¶ 11 In accordance with this well-known standard of review, this Hearing Panel then undertook a review of the Settlement Agreement placed before us on July 6, 2017 and concluded that the agreement should be accepted.

CONTRAVENTIONS

¶ 12 By engaging in the conduct described below, the Respondent agreed that it committed the following contravention of IIROC’s Rules:

Between May and November 2012 and between January and June 2013, Hampton Securities Ltd. (the “Respondent”) failed to comply with the provisions of Universal Market Integrity Rules (“UMIR”) Rule 10.1 by allowing direct market access to a client without fully complying with the applicable marketplace rules.

AGREED FACTS

¶ 13 It is agreed that Hampton is a Dealer Member of IIROC and is also a member of several exchanges including the TSX and the TSX Venture Exchange (“TSXV”) as well as being a Participant as defined in UMIR Rule 1.1. As such, the Respondent is subject to the Rules and Policies set forth in the Universal Market Integrity Rules (“UMIR”).

¶ 14 The applicable provision of UMIR which it is agreed the Respondent has contravened is Rule 10.1, which provides as follows:

10.1 Compliance Requirement

- (1) Each Participant and Access Person shall comply with applicable Requirements.
- (2) For the purposes of subsection (1), a Participant or Access Person shall, with respect to a particular order, comply with the Marketplace Rules of:
 - (a) the marketplace on which the particular order is entered; and
 - (b) the marketplace on which the particular order is executed.

¶ 15 Both the TSX and TSXV had similar requirements for members who provide direct market access (“DMA”) for clients which included the following:

- i. To provide the TSX with a Standard Form of Agreement between the client and

Hampton;

- ii. To provide the TSX with a copy of all training materials provided to the DMA client;
- iii. To submit a unique trader ID request for the DMA client to the TSX; and
- iv. To provide a schematic (or written description) outlining how the client's orders will be routed to the TSX.

¶ 16 The purpose of such a requirement is to attempt to ensure that both the member and the client know precisely what the extent of the client's authority is in order to use the DMA and that the client has been provided with training materials on how to use the system and the limits on its authority to do so. All of this material is to be filed with the Exchange in question so that it can verify that the limitations, restrictions and authorizations to use the DMA through a member's systems and processes are known to the client and recorded in writing which is then kept on file with the Exchanges.

¶ 17 Most importantly, a client who is extended the ability to have direct market access must have a unique trader ID issued by the Exchange to be used when the client uses DMA. Without such information, the Exchange (as well as IIROC) is unable to quickly isolate, monitor and identify the trading transactions undertaken by the client in order to ensure there are no improprieties (including trading manipulation) in the client's trading activities which might affect the market.

¶ 18 If the Exchange loses or has its ability impaired to monitor and regulate trading activity in its marketplace, it presents a serious impediment to the proper operation (as well as the integrity) of the Exchange and the capital markets in general. The marketplace regulations and rules of the Exchanges are established for good and sufficient reason and it is of considerable importance that they be followed by all who are authorized to access the market through the facilities of the Exchanges.

¶ 19 The agreed upon facts disclosed that Hampton contravened these exchange requirements in the following manner:

A. May to November 2012

- (i) During this period of time, Mr. Gary Koverko ("Koverko"), a trader with Hampton, extended direct market access through Hampton's systems and terminal to the TSX and TSXV to Client A while using Koverko's trader identification without any order management by Koverko. While Koverko knew about and facilitated this arrangement (which was restricted to orders under 250,000 shares and under \$750,000 in value), Hampton had no knowledge of it until November 2012.
- (ii) Once Hampton became aware of this improper activity, Hampton took immediate steps to terminate such access and to require Koverko to manage all orders from Client A. Hampton also contacted the TSX which reiterated its requirements (*supra*) relating to DMA for clients.
- (iii) During the period between April and November 2012, 178 of Client A's orders were created in this manner using Koverko's trader ID.

B. January 2013 to June 2013

- (i) In January 2013, Mr. Lister (who was Hampton's Chief Compliance Officer ("CCO") at the time) obtained a signed agreement between Client A and Hampton as required by the Exchange regulations. He then proceeded to authorize Hampton's trading system service provider to extend DMA to Client A through Koverko's terminal at Hampton. Mr. Lister was then advised of the reactivation of the DMA for Client A.
- (ii) This arrangement allowed Client A to access the marketplace without any pre-order management from Koverko or anyone else at Hampton so long as the order size was

under 100,000 shares and under \$1,000,000 in value. Hampton never submitted a request for a unique trader ID for Client A as required by the TSX rules. Client A continued to use Koverko's trader ID when the orders were sent to the marketplace.

- (iii) Subsequently in May 2013, Mr. Lister requested that Client A's DMA be terminated although it could still enter orders which would be sent electronically to Koverko's terminal for active order management. On June 6, 2013, the DMA for Client A was disconnected.
- (iv) Between January and June 2013, 105 of Client A's orders were processed by Client A through Koverko's terminal using the DMA and Koverko's trader ID.
- (v) Following the discontinuance of the extension of DMA to Client A in June 2013, there is no evidence before the Hearing Panel that there were any further contraventions of these rules by Hampton.

¶ 20 The above-noted facts disclosed a clear violation of the requirements of the TSX and TSXV relative to the extension of DMA to one of Hampton's clients. It was Hampton's initial position during the IIROC investigation that it had not had any DMA clients since April 2011. The person who made that representation (the then CCO) left Hampton in September 2012.

THE PENALTY

¶ 21 Both Enforcement Staff and the Respondent urge this Hearing Panel to accept their joint recommendation that the following sanctions and costs set forth in the Settlement Agreement be accepted:

- A. A fine in the amount of \$20,000;
- B. Costs of \$1,500.

¶ 22 In considering the appropriateness of this penalty, the Hearing Panel has taken into account the importance of requiring members of the industry who are regulated by IIROC and subject to the Universal Market Integrity Rules, to be ever vigilant to ensure that they and their organizations are in compliance with the trading rules and requirements of IIROC and UMIR as well as the marketplace rules adopted by the Exchanges and other marketplaces where the Participant or Access Person undertakes trading in the markets. The integrity of the markets can only be protected if all who are involved know the rules and take every reasonable step to ensure that they are complied with.

¶ 23 On the facts of this case, Hampton failed in its oversight and gatekeeper responsibility to ensure that the trading rules and requirements of the TSX and TSXV were complied with when it permitted Client A to have direct access to the marketplace without following the conditions proscribed by those Exchanges. It also failed to ensure that the trader ID issued to Mr. Koverko was not used (or misused) as a means to circumvent the requirements of the Exchanges rules.

¶ 24 Fortunately, in the particular circumstances of this case, no actual harm appears to have been done by reason of these contraventions as there was no evidence placed before this Hearing Panel that any of the trades made on behalf of Client A resulted in market manipulation or otherwise gave an improper advantage to Client A. The fact remains, however, that the potential for such improprieties was very real as a result of Hampton and the trader failing to take the necessary steps to ensure that the regulated conditions of direct market access for Client A were complied with.

¶ 25 In our view it is important that such contraventions should be regarded as serious matters since the failure to implement and follow the regulated procedures of the Exchanges by the registrants who are responsible for maintaining them, could negatively impact upon the integrity of the capital markets. Penalties fashioned to respond to contraventions of this nature should accordingly reflect the important elements of specific and general deterrence with the objective of communicating to members of the industry and the public that systems are in place and eyes are watching in order to ensure that all trading on the Exchanges is carried out in a professional manner and without any improper distortion of the marketplace itself.

¶ 26 In considering the sanctions imposed in this case, the Hearing Panel has considered the previous cases to which we were referred by Enforcement Counsel. While such cases are often of assistance in considering whether the sanctions sought in the instant case are within a reasonable range of appropriateness, they also generally turn on their own individual facts and accordingly cannot be dispositive of the appropriateness of the sanctions which were the subject matter of the Settlement Agreement in this particular case.

¶ 27 We do, however, find that the decision in *Re Lakeshore Securities Inc.* (2014 IIROC 59) is reasonably related to the facts of this case. In the *Lakeshore* case, it was found that the Member failed to comply with its trading supervision obligation under Rule 10.1 of UMIR and the rules of the TSX by failing to take adequate steps to carry out its trading supervision, testing and reporting responsibilities as well as to ensure that clients who were offered DMA met the financial eligibility requirement under the rules of the TSX.

¶ 28 The Hearing Panel noted that there was no evidence of market manipulation and accordingly after considering various other cases submitted to that Hearing Panel, a determination was made that a fine in the amount of \$20,000 as well as an order for costs in the amount of \$5,000 was within a reasonable range.

¶ 29 While we are not required to do so, this Hearing Panel also reviewed IIROC's Disciplinary Sanction Guidelines and noted the submissions of Enforcement Counsel that the Respondent accepted that its conduct was in breach of the UMIR and Exchange rules and accordingly negotiated and entered into a Settlement Agreement with IIROC. Once again, there was no evidence of manipulative trading or unfair advantage with respect to the trades made by Client A.

DECISION

¶ 30 Accordingly, after reviewing all of the relevant factors set forth in this Decision and bearing in mind the standard and scope of review that a Hearing Panel should adhere to when considering the sanctions agreed to in a Settlement Agreement, we are of the view that the penalties agreed to by the parties in this particular matter do not clearly fall outside a reasonable range of appropriateness in all of the circumstances and accordingly the Settlement Agreement and sanctions referred to therein are hereby accepted by this Hearing Panel.

DATED this 21st day of July, 2017.

Edward T. McDermott

Lou D'Souza

Charles Macfarlane

SETTLEMENT AGREEMENT

PART I – INTRODUCTION

1. The Investment Industry Regulatory Organization of Canada ("IIROC") will issue a Notice of Application to announce that it will hold a settlement hearing to consider whether, pursuant to Section 8215 of the Consolidated Enforcement, Examination and Approval Rules of IIROC, a hearing panel ("Hearing Panel") should accept the settlement agreement ("Settlement Agreement") entered into between the staff of IIROC ("Staff") and Hampton Securities Ltd. ("Respondent").

PART II – JOINT SETTLEMENT RECOMMENDATION

2. Staff and the Respondent jointly recommend that the Hearing Panel accept this Settlement Agreement in accordance with the terms and conditions set out below.

PART III – AGREED FACTS

3. For the purposes of this Settlement Agreement, the Respondent agrees with the facts as set out in Part III of this Settlement Agreement.

Overview

4. An institutional client of the Respondent (“Client A”), and the only client of Hampton’s trader, Gary Koverko (“Koverko”), was provided with direct market access (“DMA”) through Hampton using a trader’s trade identifier without complying with the marketplace rules of the TSX and TSXV which require, among other things, that any client that has DMA must have a unique identifier for trading purposes.
5. Throughout IROC Staff’s investigation into this matter, the Respondent stated that it did not have any clients with DMA. The Respondent was unable to identify orders placed directly to the marketplace by any of its clients. The Respondent was unable to distinguish direct client orders from orders that Koverko actively placed to the marketplace as all orders used Koverko’s trader ID.

Respondent

6. Hampton Securities Limited (“Hampton”) is a Dealer Member of IROC with its head office in Toronto, Ontario. Hampton is a member of several exchanges including the TSX and the TSX Venture Exchange and is a Participant as defined in UMIR Rule 1.1.

The Regulatory Requirements for Direct Market Access

7. UMIR Rule 10.1 requires that each Participant and Access Person must comply with the applicable requirements of the marketplace on which an order is entered or executed.
8. The TSX requirements for DMA clients are found in TSX rule 2-501 and 2-502. The TSXV has similar requirements for DMA clients. The TSX requirements for each DMA client included the following:
 - i. To provide the TSX with a Standard Form of Agreement between the client and Hampton;
 - ii. To provide the TSX with a copy of all training materials provided to the DMA client;
 - iii. To submit a unique trader ID request for the DMA client to the TSX; and
 - iv. To provide a schematic (or written description) outlining how the client’s orders will be routed to the TSX.

Client’s Direct Market Access

9. In August 2011, IROC Staff reviewed Hampton’s supervision of clients’ DMA orders and issued a letter to Hampton dated July 8, 2013. The letter reminded Hampton of its obligations to supervise clients’ DMA activity. During that review, Cheryl de Montigny, the then-CCO of Hampton, advised IROC that Hampton had not had any DMA clients since April 2011. Cheryl de Montigny left Hampton in September 2012.
10. In April 2012, Koverko authorized DMA for Client A whereby all of its orders that were under 250,000 shares and under \$750,000 in value would go directly to the marketplace using Koverko’s identification but without any order management by Koverko.
11. Between April and November 2012, 178 of Client A’s orders traded through Koverko’s terminal to the marketplace, including the TSX and TSXV. These orders used Koverko’s trader ID.
12. In or around November 2012, Hampton became aware that Client A had DMA through Koverko. Management of Hampton took immediate steps to terminate such access and to require Koverko to manage all orders from Client A.
13. In November 2012, after discovering the improper DMA granted to Client A by Koverko, Lister contacted the TSX who reminded him of their requirements relating to DMA for clients.
14. Lister kept senior management of Hampton apprised of both IROC’s and the TSX’s DMA requirements.
15. In January 2013, Lister obtained a signed agreement between Client A and Hampton as required by the

TSX. Lister then proceeded to authorize its trading system service provider to provide Client A with DMA through Koverko's terminal at Hampton. Lister was advised of the reactivation of DMA for Client A.

16. The DMA allowed Client A to access the marketplace, including the TSX and TSXV, without any pre-order management from Koverko, or anyone else at Hampton, provided that the order size was under 100,000 shares and under \$1,000,000 in value.
17. The DMA for Client A was routed through Koverko's terminal at Hampton and used Koverko's ID when the order was being sent to the marketplace. Hampton did not submit a unique trader ID for Client A as required by the TSX rules.
18. The failure to request and obtain a unique trader ID for Client A from the TSX is a violation of TSX's rules and is therefore a breach of UMIR Rule 10.1.
19. In May 2013, Lister requested that Client A's DMA be terminated. Client A could still enter orders and they would be sent electronically to Koverko's terminal for active order management. On June 6, 2013 the DMA for Client A was disconnected.
20. Between January and June 2013, 105 of Client A's orders traded through Koverko's terminal using the DMA. These orders used Koverko's trader ID.

PART IV – CONTRAVENTIONS

21. By engaging in the conduct described above, the Respondent committed the following contravention of IIROC's Rules:

Between May and November 2012 and between January and June 2013, Hampton Securities Ltd. (the "Respondent") failed to comply with the provisions of Universal Market Integrity Rules ("UMIR") Rule 10.1 by allowing direct market access to a client without fully complying with the applicable marketplace rules.

PART V – TERMS OF SETTLEMENT

22. The Respondent agrees to the following sanctions and costs:
 - a. Fine in the amount of \$20,000; and
 - b. \$1,500 in costs.
23. If this Settlement Agreement is accepted by the Hearing Panel, the Respondent agrees to pay the amounts referred to above within 30 days of such acceptance unless otherwise agreed between Staff and the Respondent.

PART VI – STAFF COMMITMENT

24. If the Hearing Panel accepts this Settlement Agreement, Staff will not initiate any further action against the Respondent in relation to the facts set out in Part III and the contraventions in Part IV of this Settlement Agreement, subject to the provisions of the paragraph below.
25. If the Hearing Panel accepts this Settlement Agreement and the Respondent fails to comply with any of the terms of the Settlement Agreement, Staff may bring proceedings under Rule 8200 against the Respondent. These proceedings may be based on, but are not limited to, the facts set out Part III of this Settlement Agreement.

PART VII – PROCEDURE FOR ACCEPTANCE OF SETTLEMENT

26. This Settlement Agreement is conditional on acceptance by the Hearing Panel.
27. This Settlement Agreement shall be presented to a Hearing Panel at a settlement hearing in accordance with the procedures described in Sections 8215 and 8428, in addition to any other procedures that may be agreed upon between the parties.

28. Staff and the Respondent agree that this Settlement Agreement will form all of the agreed facts that will be submitted at the settlement hearing, unless the parties agree that additional facts should be submitted at the settlement hearing. If the Respondent does not appear at the settlement hearing, Staff may disclose additional relevant facts, if requested by the Hearing Panel.
29. If the Hearing Panel accepts the Settlement Agreement, the Respondent agrees to waive all rights under the IROC Rules and any applicable legislation to any further hearing, appeal and review.
30. 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 based on the same or related allegations.
31. The terms of this Settlement Agreement are confidential unless and until this Settlement Agreement has been accepted by the Hearing Panel.
32. If this Settlement Agreement is accepted, the Respondent agrees that neither he nor anyone on his behalf, will make a public statement inconsistent with this Settlement Agreement.
33. The Settlement Agreement is effective and binding upon the Respondent and Staff as of the date of its acceptance by the Hearing Panel.

PART VIII – EXECUTION OF SETTLEMENT AGREEMENT

34. This Settlement Agreement may be signed in one or more counterparts which together will constitute a binding agreement.
35. A fax or electronic copy of any signature will be treated as an original signature.

DATED this “4th” day of April, 2017.

“Witness” _____

Witness

“Joe Pavao” _____

Hampton Securities Ltd.

Respondent

“Paul Smith” _____

Witness

“Stacy Robertson” _____

Stacy Robertson

Enforcement Counsel on behalf of Enforcement
Staff of IROC

The Settlement Agreement is hereby accepted this “6th” day of July, 2017 by the following Hearing Panel:

Per: “Edward McDermott”

Panel Chair

Per: “Charles Mcfarlane”

Panel Member

Per: “Lou D’Souza”

Panel Member